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## Articles

Copyright Exhaustion Rationales and Used Software  
by **Antoni Rubí Puig**

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A Recent Lithuanian BitTorrent Case and What It Means  
for the Construction of the E-commerce Directive  
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Not for Designers  
On the Inadequacies of EU Design Law and How to Fix It  
by **Thomas Margoni**

## Book Review

Jacques de Werra (ed.), Research Handbook on Intellectual Property Licensing  
Edward Elgar 2013, 499 pages, ISBN 978-1-84980-440-0  
by **Lucie Guibault**

Editors:  
Thomas Dreier  
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# Copyright Exhaustion Rationales and Used Software

## A Law and Economics Approach to Oracle v. UsedSoft

by **Antoni Rubí Puig**, Senior Lecturer of Civil Law at Universitat Pompeu Fabra (Barcelona, Spain)

**Abstract:** This article aims to provide courts and policymakers with an analytical framework that, building upon the traditional rationales of IP exhaustion doctrine, identifies factors which advocate for a modulation or flexibilization of the role of exhaustion in copyright law. Factors include (i) the personal features of acquirers of copies of copyrighted works, distinguishing between consumers and commercial users; (ii) whether post-sale restrictions have been adequately communicated to acquirers and have been agreed in the contract or license; (iii) the degree

of complexity of the acquired goods and their prospects of productive uses and interoperability; (iv) the role of other exclusive rights in providing rightholders with indirect control over uses of the copies in the aftermarket; (v) the impact of post-sale restraints in preventing opportunism in long-term contracts and in reducing deadweight losses created by IP pricing; and (vi) the temporal scope of post-sale restraints. After setting out this analytical framework, the ECJ Judgement in *Oracle v. UsedSoft* is discussed.

**Keywords:** Exhaustion, Law and Economics, Ownership Rationale, Information Costs

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### A. Exhaustion as a structural limitation to aftermarket control

1 The right of distribution plays a substantial role in the exploitation of intellectual property assets and in the commercialization of works protected by copyright law. The right of distribution basically allows rightholders to control the introduction of tangible embodiments of a work into the market and, in this regard, supplements the right of reproduction in cases where the act of reproduction has occurred outside the EU or where the origin of the infringing copies is unknown.<sup>1</sup> Obvious as it may be, this right is not unrestricted: among other limitations, once the rightholder authorizes the transfer or transfers ownership of a copy of the work or the medium in which the work was fixed, she will not be able to prevent

the acquirer from reselling the copy in the aftermarket. Exhaustion of copyright (first-sale doctrine, *Erschöpfung*, *épuisement du droit de mise en circulation*, *agotamiento del derecho de distribución*) and of other intellectual property rights limits rightholders' ability to monitor and control purchasers' conduct in relation to copies of a protected work or products in which the copies have been installed.

2 Article 4(2) of the Directive 2001/29/EC of 22 May 2001 on the harmonization of certain aspects of copyright and related rights in the information society<sup>2</sup> establishes the general rule providing for the regional exhaustion of the right of distribution in the European Economic Area (EEA).<sup>3</sup> In the case of software copies, which are the focus of this article, Article 4(2) of the Directive 2009/24/EC of the European Parliament and the Council of 23 April 2009

on the legal protection of computer programs<sup>4</sup> codifies exhaustion doctrine in the EU. According to the last provision, the first sale of a copy of a computer program by the copyright owner or with her consent shall exhaust the distribution right of that copy within the European Community (EC), i.e. the EEA.<sup>5</sup> According to these provisions, transferring ownership of a copy exhausts the distribution right in relation to a specific copy or item of an original work. Yet from a broader analytical standpoint, exhaustion reduces rightholders' control over aftermarket activity by acquirers or third parties in relation to that specific copy or item.

- 3 Both traditional and law and economics scholarship has advocated the limitation of monitoring and controlling powers over further distribution of a copyrighted work, its copies and the products into which the work is incorporated, and has endorsed exhaustion as a sound and socially desirable policy for copyright markets. First, without exhaustion of the distribution right, ordinary dealings in the market would frequently give rise to copyright infringement unless the rightholder had authorized them in advance.<sup>6</sup> Traditional foundations of exhaustion highlight that markets for copyrighted works would be seriously affected if their participants lacked the minimum security that common events such as a consumer sale implied a potential liability risk for copyright infringement, or if the distribution rightholder had the opportunity, at any time, to seek an injunction and paralyze any business by a third party that consisted in introducing copyrighted copies into circulation.<sup>7</sup> In this scenario, exhaustion of the distribution right stands as the legal solution to the transaction costs and risks of hold-up that the need for the rightholders' consent would involve for such normal mass behaviours in the market. Second, exhaustion of copyright involves several positive externalities that have been identified in the law and economics literature.<sup>8</sup>
- 4 However, application of the exhaustion doctrine is not without social costs. To put it simply, exhaustion prevents parties from including some covenants and conditions in sales and other transfer agreements, and freedom of contract is thus restricted. In this vein, the doctrine has been heavily criticized from the standpoint of economic analysis of competition law, which in recent years has shown the benefits and pro-competitive effects of vertical restraints and the ability of IP rightholders to engage in efficient price discrimination. Extensive literature on the theory of the firm has shown how post-sale restrictions – or, in general terms, the ability to control post-commercial activities – reduce the need for the vertical integration of firms commercializing IP assets.
- 5 The goals of this article are threefold: 1) to present a critical assessment of the traditional foundations

of exhaustion, which balances the benefits that are ordinarily associated to the doctrine with costs that arise in particular distribution or marketing contexts; 2) to provide an analytical framework for examining issues related to the exhaustion of the right of distribution, which identifies factors that sustain a lower scope for exhaustion in some settings; and 3) to apply this analytical framework to ECJ Judgment of 3 July 2012 in *Oracle v. UsedSoft*. In pursuing these goals, the article is organized as follows: Section B surveys the positive external effects that the doctrine of exhaustion may have in markets for copyrighted works; Section C further describes the rationales identified in traditional legal scholarship to support the exhaustion of the distribution right; Section D critically assesses these traditional rationales against findings from law and economics literature and builds an analytical framework that may help decision-makers in matters concerning copyright exhaustion; Section E applies this framework to the ECJ Judgment in *Oracle v. UsedSoft*; and finally, Section F provides a summary of the article's main conclusions.

## B. Spillovers of exhaustion

- 6 Copyright exhaustion entails substantial positive externalities or spillovers which may serve as a justification for the enactment or keeping in force of rules that purport to reduce or eliminate rightholders' control of aftermarkets.<sup>9</sup>

### I. Creation of secondary markets

- 7 The doctrine of exhaustion of copyright allows the creation of secondary markets for legal copies and the development of alternative distribution models outside rightholders' control.<sup>10</sup> Thrift stores, bookstores, public libraries and websites like eBay depend to some extent on the previous exhaustion of the distribution right on the products or works that they offer in the market. The immediate social consequence of these alternative distribution systems, outside rightholders' control, is greater public access to works. Moreover, the existence of these alternative systems increases competition in the primary market and encourages rightholders to improve or update their products.<sup>11</sup> In this regard it is common for sellers of a copyrighted work in the primary market to put new versions of the same product into circulation – such as remastered CDs, DVDs with new content or new versions of computer programs – in order to compete with those in the secondary market offering lower quality copies or copies with less content.

## II. Cultural preservation and access to controversial works

- 8 Exhaustion of the distribution right contributes to cultural preservation: the doctrine facilitates conservation and public access to works that are no longer offered by their producers (works discontinued for financial reasons,<sup>12</sup> works withdrawn for political or ideological motivations, orphan works,<sup>13</sup> and so on). Again, the existence of multiple copies, beyond the rightholder's scope of control, and their geographical distribution, facilitate greater public access to the work.
- 9 It has also been argued that exhaustion contributes to the protection of privacy and anonymity in cultural consumption: lack of rightholder control allows consumers to transfer copies of works anonymously, which may be particularly important for works with controversial or stigmatizing content.<sup>14</sup> Anonymity in cultural consumption reduces the chances of detection by agents enforcing restrictive social norms and allows greater dissemination of ideas. The dissemination of minority views and new ideas which are opposed to those prevailing in a society at a given time furthers the search for truth in the classical sense promoted by John Milton or John Stuart Mill.<sup>15</sup> Positive externalities or spillovers in the form of education, public debate and the search for truth have a positive effect on social welfare.<sup>16</sup>

## III. Reduction of transaction costs in IP markets

- 10 The exhaustion of IP rights reduces the transaction costs associated with the need to examine the idiosyncratic properties of products which incorporate copyrighted works – for instance, whether a particular copy can be resold in the aftermarket or not. Consumers or purchasers of copies of copyrighted works would not need to invest more effort, time and money to learn about the particular characteristics of the goods or product concerned and might instead resort to the legal system – i.e. a domestic copyright act – to find out what they can and cannot do with their copies. If producers of copyright-protected goods were provided with greater flexibility in the commercialization of works and could therefore establish certain restrictions or limitations for some copies while distributing others without limitations, an economic burden in the form of information costs and constraints on trading would be created for the public.<sup>17</sup>
- 11 Also, other sources of transaction costs are lessened and legal and economic exchanges are consequently protected. Without exhaustion, the prospects of selling a copy in the secondary market would face new

transaction costs that would arise if the copy owner needed to negotiate a license or authorization with the holder of the exploitation rights. First-sale doctrine decreases these transaction costs, including the associated risks generated by hold-up problems.

## IV. Decentralized innovation

- 12 The doctrine of exhaustion of rights allows users to modify products, adapting them to their own preferences and interests. This results in an increase in the value that users and consumers ascribe to their purchased goods. As a consequence, decentralized innovation and the development of new products and markets are enhanced.<sup>18</sup>
- 13 The doctrine contributes to innovation at least in two ways.<sup>19</sup> First, it allows the modification and processing of a specific copy or product. For example, the purchaser of a piece of furniture may certainly make some alterations and adjustments to it that deviate from the original design, or the purchaser of a book may remove the binding and transform it into a lamp or a backpack. An absolute control by rightholders over aftermarket activities by copy owners would make those innovative modifications impossible. Needless to say, not all modifications would be permitted under the exhaustion doctrine: alterations that affected the copyrighted work and not only specific copies may infringe on the transformation and reproduction rights; or, especially in relation to unique and original works, modifications are obviously subjected to limitations imposed by the moral right of integrity in countries within the '*Droit d'auteur*' tradition and by preservation of cultural heritage rules. Second, the exhaustion doctrine alleviates what is called 'the problem of the future': it prevents restrictions or limitations imposed by the rightholder which were grounded in short-term objectives or reasons from being enforced at a later time at which they are no longer sound, or even prove counterproductive in solving an unanticipated problem.<sup>20</sup> Remoteness between a sound post-sale restriction today and an unforeseen problem in the future may involve substantial transaction costs due to the renegotiation of an obsolete limitation for the copy user.

## V. Competition between technological platforms

- 14 The doctrine of exhaustion increases competition between technological platforms, and as a consequence it reduces the possibilities of technological lock-in. It allows a user who wants to shift from one technological platform to that of a competitor to transfer ownership of the product (for instance, video games for a particular platform or the video

game console itself) and to recoup some of her investment. Limiting the possibilities of reselling the product would make shifting platforms more burdensome and less likely. Besides, the availability of secondary markets promoted by the exhaustion doctrine makes shifting to new platforms cheaper.

- 15 In spite of all this, the scope of these externalities would need to be contrasted empirically. As the article shows, in some circumstances – depending on the model or type or distribution, such as the kind of work put into circulation or the features of agents in the market – spillovers may prove to be extremely scarce or off-set by the costs of exhaustion on freedom of contract. Exhaustion of the distribution right may indeed have a negative effect on social welfare.

### C. Three traditional foundations of exhaustion: reward, market protection and full ownership

#### I. Origins of the exhaustion doctrine

- 16 The origins of the doctrine of exhaustion of intellectual property rights in Europe can be traced back to the work of the German jurist Josef Kohler (1849-1919), who elaborated on the principle of the connection between the different acts of exploitation (*Zusammenhang der Benutzungsarten*).<sup>21</sup> According to this principle, legally recognized acts which would involve the economic exploitation of a patent are connected from the moment the invention is produced and end up determining the extent of all the profits a rightholder may obtain from it. Other acts fall outside the scope of the legal entitlement and the patent is deemed exhausted (*Erschöpfung*): the rightholder is not then entitled to any further profits.<sup>22</sup> In fact, at the time that the product is made available to the public, the rightholder can anticipate further distribution acts by potential acquirers and internalize this fact in the product prices.<sup>23</sup>

#### II. Reward theory

- 17 The doctrine was soon recognized by German courts in the field of trademark law<sup>24</sup> and copyright.<sup>25</sup> The principle of the connection between different exploitation acts is fundamentally linked to the basic notions of the theory of reward (*Belohnungstheorie*), which the rightholder may obtain by distributing copies of a copyrighted work or products distinguished by a trademark.

### III. Full ownership theory

- 18 Another basis for the doctrine of exhaustion of the distribution right lies in the idea of full or unconditioned ownership (*Eigentumstheorie*). According to this rationale, the function of exhaustion is to provide the purchaser with a copy of a work which encompasses the bundle of rights that are ordinarily assigned to property: once ownership of a copy is acquired, the owner is presumed to be entitled to exercise all rights attached to the legal status of property. This argument, embraced by the first *Reichsgericht* case, was later abandoned:<sup>26</sup> during the last century the expanding notion of property was eroded and has been progressively replaced by a paradigm in which limitations to property rights are observed and are deemed part of its definition. In the case of copyrighted works, the existence of other exclusive rights and related rights over the work contained in the copy involves a restrictive interpretation of the *usus* or the set of behaviours that the owner of a copy may engage in. The bundle of rights provided by copyright is understood as an allocation of different property rights among different individuals. Even individuals other than the contracting parties may have some property rights over the copyrighted work, such as the right to create a parody, for instance, or other fair uses. In other terms, full or unconditioned property is merely an illusion.

### IV. Market and legal certainty protection theory

- 19 A third rationale for the exhaustion of intellectual property rights is based on the idea of protecting the market and legal certainty (*Verkehrssicherungstheorie*). As mentioned earlier, restricting rightholders' control over distributed copies of a work serves to protect legal and economic exchanges and to prevent transaction costs that would arise if acquirers of a copy had to negotiate a new license or authorization every time they envisioned a new form of use for the copy. Moreover, legal certainty is also promoted if the idiosyncratic features of goods are confined and the law is used as the focal point to determine what users can do with their own copies of the goods. Besides the transaction costs associated with checking goods' particular characteristics and negotiating a new license or agreement, costs related to hold-up situations have to be considered as well: rightholders may abuse their bargaining position and try to extract the whole surplus created by the new allocation of rights – i.e. the results of specific investments made by users in gathering information about new uses of the copies or work.
- 20 Protection of markets and legal certainty, together with the reward rationale, are currently the main foundations of the exhaustion doctrine.<sup>27</sup> However,

the very idea of providing legal certainty in economic exchanges may be used to attack some of the doctrine's traditional features, as this article will show: protection of legal certainty may sometimes be achieved by less costly remedies and institutions, which may serve to adequately inform the acquirers of goods that incorporate copyrighted works and perform this function without hindering potentially efficient marketing strategies such as price discrimination or socially beneficial vertical restraints.

## D. The erosion of traditional exhaustion foundations

### I. Limits to the full ownership rationale: productivity, interoperability and the modulation of exhaustion rules

#### 1. Property as a bundle of rights and the right of use

- 21 As previously mentioned, the idea of full ownership has mainly disappeared from modern discussions about the concept of property in private law theory. Although it has been subjected to many critiques, the notion of property understood as a bundle of rights seems to have gained acceptance and even esteem among private law scholars.<sup>28</sup> Within this framework the conjunction of law, contract and technology yields the final allocation of the rights comprised in the bundle at a given time among right-holders, copy owners and third parties.
- 22 The use of a good – *usus* in the Roman law tradition – is one of the main rights that is ordinarily presumed of proprietors. Copyright law does not explicitly recognize a generic exclusive right of use. Therefore, and at least in principle, authors or copyright holders do not have the right to control how owners actually use their copies of the copyrighted work, and the copies' proprietors are allowed to use them at their will. Moreover, there is no legal provision in EU law to establish that a right of use shall be deemed exhausted if some circumstances or requisites concur. Within this normative setting, the copyright holder who owns the exclusive rights over a literary work and sells copies of the book with the restriction that it can only be read on weekends, or the rightholder that gives promotional CDs to radio stations with a notice establishing that they cannot be resold, will lack any opportunity to bring an action for copyright infringement against the direct purchaser who reads the book on a Monday or against the radio station which resells the CD on eBay. If a contractual relationship or other enforceable promise were established, the copyright holder could then only bring an action for breach of contract or promise against the purchasers.<sup>29</sup> However, these actions would not be available against subsequent or remote purchasers since the latter would not be in a contractual or obligatory relation with the rightholder.<sup>30</sup> Privity of contract eliminates the availability of remedies for breach.

#### 2. Productive and non-productive uses

- 23 It makes sense that in non-complex products – that is, copies of goods that are not really susceptible to productive uses, or that, in fact, do not interoperate or interoperate minimally with other products or services – the control that the rightholder may exercise over purchasers' activity is to be understood as non-existent, and a strong rule of exhaustion of distribution rights is promoted.
- 24 When mentioning the prospect of productive uses, I am not implying that the work embedded in a copy cannot be successfully transformed or adapted – for instance, through the cinematographic adaptation of a book. I am referring instead to the functional characteristics of the copyrighted work and the frequent interrelated use of the copy with other goods and services, namely computers.
- 25 In this respect, if a company buys a batch of copies of a printed book, its goal is likely to be to resell them to other companies or consumers. It makes sense that the rightholder should not be entitled to restrict the resale of copies of this kind of product and that the right of distribution should be deemed exhausted with the rightholder's first sale of the products or with her consent. In this context, there are sound arguments against the possibility of introducing restrictions on the use of copies in aftermarkets for consumers or final users.<sup>31</sup>
- 26 On the other hand, putting acts of reproduction aside, if a company buys a batch of software copies, it may be interested in reselling them to end consumers, but its aim may also be to install them into other products (e.g. computers, home appliances or cars) and to sell the latter goods in the market. Software acquirers can also commercialize the software copies purchased together with other computer programs that they have developed.<sup>32</sup> In this context, a computer program's interoperability with hardware or other software may advocate a greater degree of rightholder control over these prospective uses. The prospects of productive interaction with other products or services suggest that it may be reasonable and socially desirable to extend the scope of the control that rightholders may continue exercising once the product has left their commercial sphere. More scope for modulating the effects of exhaus-

tion or for opting out of its legal regime should perhaps be provided.

### 3. Uses linked with other IP exclusive rights

#### a.) Right of reproduction: Ram copies

27 Indeed, in the latter category of products, their use either in isolation or in interaction with other products would frequently require acts of the exploitation of exclusive rights other than the right of distribution. Despite prior distribution, the ordinary use of copies in this category of products remains to some extent under the rightholder's control. This is particularly true of computer programs whose functional definition raises problems related to the limits of exhaustion.

28 For technical reasons, the use of computer programs requires acts of reproduction: running a software application on a computer necessarily involves having one or more Random Access Memory copies (RAM copies) in the machine it is installed or run on.<sup>33</sup> Because of the exclusive right of reproduction, copyright owners have some control over software users' activities. In other terms, the right of reproduction entails an indirect form of control over use in this category of functional goods or products.

29 Article 4.1(a) of the Software Directive establishes that

[...]the exclusive rights of the rightholder [...] shall include the right to do or to authorise: (a) the permanent or temporary reproduction of a computer program by any means and in any form, in part or in whole; in so far as loading, displaying, running, transmission or storage of the computer program necessitate such reproduction, such acts shall be subject to authorisation by the rightholder.

30 Hence RAM copies require copyright owner authorization or some other specific authorization established in the law.<sup>34</sup> With the aim of preventing hold-up situations, Article 5 of the Software Directive provides for some legal authorizations limiting the exclusive right of reproduction:

1. In the absence of specific contractual provisions, the acts referred to in points (a) and (b) of Article 4(1) shall not require authorisation by the rightholder where they are necessary for the use of the computer program by the lawful acquirer in accordance with its intended purpose, including for error correction. 2. The making of a back-up copy by a person having a right to use the computer program may not be prevented by contract in so far as it is necessary for that use. 3. The person having a right to use a copy of a computer program shall be entitled, without the authorisation of the rightholder, to observe, study or test the functioning of the program in order to determine the ideas and principles which underlie any element of the program if he does so while performing any of the acts of loading, displaying, running, transmitting or storing the program which he is entitled to do.

#### b.) Right to prepare derivative works

31 Authorization to prepare derivative works may also be required, depending on the type of actions necessary to carry out specialized or productive uses of the software program. For example, the developer of a new software program may generate a composite or derivative work as a result of incorporating library calls to an external source and will therefore need authorization to market the new software program from the holder of the right of transformation.<sup>35</sup>

### 4. Flexibility of exhaustion in complex products

32 This article advocates distinguishing between copies of works that have a high degree of interaction and non-productive copies. The greater the degree of interaction and productivity, the greater the flexibility of exhaustion: the existence of other exclusive rights that serve as indirect control over users' activities calls for more room to control distribution and for the scope of copyright exhaustion to be more limited.

## II. Limits to market protection and legal certainty rationale: Information costs, idiosyncratic goods and agent identity

### 1. Information costs caused by idiosyncrasy in goods

33 Exhaustion of IP rights reduces the transaction costs associated with the need to check the idiosyncratic properties of products which incorporate copyrighted works. Exhaustion thus protects certainty in legal and economic exchanges and prevents new transaction costs arising from the burden on copy owners of negotiating a new license with the copyright holder or the risks generated by hold-up problems associated with rightholders' interest in demanding a greater share of the profits or extracting them all.

34 This rationale highlights the information problems that lack of copyright exhaustion and greater control of subsequent distribution may bring about in the market. As previously established, exhaustion can be understood as the legal solution designed to reduce transaction costs, since it removes the need for potential acquirers to examine the idiosyncratic features of non-technologically complex copyrighted goods. Consumers or purchasers can use the law as the focal point for learning what they can and can-

not do with the copy they use or own. If greater flexibility were available to producers of those goods, they could decide to establish restrictions or limits on certain kinds of use for some copies while offering other copies without these restrictions at the same time. This possibility would create a burden for market participants, who would have to invest more effort and money to learn about the characteristics of goods. In a highly influential law review article, Thomas W. Merrill and Henry E. Smith argued that the legal solution consisting of defining an optimal set of standardized property rights and the prohibition on creating new idiosyncratic rights in rem serve to prevent or reduce such costs for third parties in the market.<sup>36</sup> Although the article focuses on the analytical explanation of the *numerus clausus* doctrine, its findings prove useful to understand exhaustion's role in copyright law.<sup>37</sup>

- 35 The *numerus clausus* doctrine serves to reduce information costs for third parties, including both potential acquirers of property rights and individuals interested in not infringing others' property rights. To that end, the law establishes an optimal standardization of legal property rights. Standardization affects both the number of rights and their content and scope, and therefore contracting parties are prevented from creating new rights in rem and from altering the content of rights defined by the law. Optimal standardization is determined by the trade-off between the utility of having a larger catalogue of rights in rem and the confusion that the configuration of new rights would bring about.

## 2. Trade-off between measurement costs and frustration costs

- 36 Merrill and Smith identify two kinds of costs involved in the trade-off: measurement costs, which affect third parties outside the contract that creates a new property right; and frustration costs, affecting the contracting parties themselves who are deprived of creating a right in rem according to their own wishes and interests and observe the curtailment of their freedom of contract.

### a.) Measurement costs

- 37 Measurement costs are borne by the parties outside the contract – future successors of the contracting parties as well as other market participants – and are not internalized by the parties when self-regulating the uses of specific goods; that is, when allocating the different property rights over the goods. Permitting a contractual design of an idiosyncratic system and the consequent modification of the contours of a legal right (e.g. the creation of a right consisting of only performing a particular musical work

in public in spring and summer) also affects remote purchasers: knowing that some market participants have introduced idiosyncratic restrictions on their goods, remote purchasers will need to inform themselves about the legal characteristics of the goods they are interested in acquiring, even though they are not contracting with the parties that designed the particular idiosyncratic allocation. In order to prevent this negative externality, Merrill and Smith advocate the mandatory standardization of property rights: first, the number of basic forms of property rights ought to be limited to provide market participants with incentives aimed at reducing the efforts and costs involved in finding out whether the property right they are interested in acquiring fits with those established in the legal catalogue; and second, rights in rem with idiosyncratic features that are not established in the legal catalogue will not be enforceable by courts and other adjudicators.

### b.) Frustration costs

- 38 Frustration costs, on the other hand, comprise the consequences that limiting freedom of contract has on the parties' interests. Mandatory standardization – or, in our case, the inability to mitigate or modulate the legal effects of exhaustion by validating aftermarket restrictions – does not come without costs. The parties will sometimes be unable to achieve their desired legal outcome, or on other occasions doing so will be more expensive. Indeed, the inability to opt out of the exhaustion of the distribution right would mean that the rightholder will not be able to avoid arbitrage – i.e. limiting the opportunities for potential acquirers to obtain the goods or service from sellers other than the rightholder and who acquired them at an inferior price. They will thus have fewer opportunities to engage in efficient price discrimination.<sup>38</sup> Moreover, the impossibility of enforcing certain vertical restraints will result in a reduction in the incentives to enter into long-term contracts for manufacturing and distributing copies of copyrighted works. Finally, taking into account the inherent uncertainty of technological innovation, an over-rigid exhaustion right may increase frustration costs due to the unfeasibility of the right's accommodating unanticipated innovation or new state-of-the-art developments.<sup>39</sup>

## 3. Reduction of information costs

- 39 Henry E. Smith developed this analytical approach in the field of intellectual property rights in a later article.<sup>40</sup> In his opinion, an optimal legal regulation of intellectual property rights cannot be guaranteed, but it may serve as a point of reference that parties may resort to when allocating different property rights over a protected work or a copy thereof.<sup>41</sup> This le-

gal regulation's ex-ante availability provides a basic framework that may be used to identify rights in the market and as a cost reduction device, since it contributes to the understanding of their scope.

- 40 However, one must consider that there are some alternative mechanisms that may also entail transaction cost reduction for potential purchasers. Digital licenses may provide the necessary information about the terms of use of digital copies.<sup>42</sup> In this regard, providing information about the terms of use – the allocation of property rights – may be easier and cheaper for digital copies than for tangible goods.<sup>43</sup> As a consequence, the availability of these informative tools may serve as grounds for advocating broader freedom of contract or private ordering in the field of digital works and a more flexible exhaustion regime.<sup>44</sup>
- 41 Another transaction cost reduction device has its origins in the sophistication and specialization of some agents in the market. In general terms, legal systems establish uniform rules on IP rights exhaustion which do not contemplate the different personal features of potential acquirers of copies of works and provide for the same legal effects for both companies and consumers. This uniformity contrasts with the legal solution provided for other issues (among others, legal warranties for lack of conformity, contract formation, liability limitations and exclusions, or the right of withdrawal) which would usually depend on purchasers' personal characteristics.
- 42 Specific knowledge, comparative advantages, and repeated interactions will usually entail fewer information costs and efforts and therefore may serve as a basis for a more flexible exhaustion regime.<sup>45</sup> The effects of exhaustion may be linked to the specific characteristics of agents in the market, and distinguishing between different groups of potential acquirers – namely, commercial producers and consumers – may prove socially desirable.<sup>46</sup> Modifying exhaustion's legal effects will thus be admissible when sufficient information has been conveyed to potential acquirers, when there is consent as to its inclusion into the contract, and when the acquirer is a specialized agent in the market.

#### 4. Exhaustion as an obstacle for pro-competitive post-sale restrictions

- 43 Despite the information externalities created by the exhaustion of the distribution right and its impact on social welfare, the application of its legal effects may have other costs that should be balanced in the trade-off. Following the terminology coined by Merrill and Smith, a mandatory exhaustion rule and the correlative reduction in post-sale control involve frustration costs for parties interested in allocat-

ing property rights over copyrighted works. In this regard, the doctrine of exhaustion has been heavily criticized from law and economics perspectives, which have highlighted the pro-competitive effects of vertical restraints in contracts and the efficiency-enhancing nature of price discrimination in some settings.<sup>47</sup> A strong mandatory exhaustion rule may frustrate the availability of these strategies.

#### a.) Vertical restraints: Concept and classification

- 44 For the purposes of this article, the vertical restraints will be examined. Unlike horizontal restraints, vertical restraints appear in situations in which the contracting parties are not competing in the same market. Post-sale restrictions are a form of vertical restraint imposing some restrictions or conditions upon how goods may be used or commercialized after a first sale.<sup>48</sup>
- 45 Vertical restraints are usually classified as 'intra-brand' or 'inter-brand' restraints. The former refer to limits on how the seller's product may be distributed or used afterwards. Common examples of intra-brand restraints include the establishment of resale prices (RPM), sales area segmentation, client group segmentation, commercial guarantees, post-sale maintenance or repair services and field-of-use restrictions. Inter-brand restraints, however, deny acquirers the possibility of using the goods together with products or services offered by third parties or limit acquirers' commercializing of products or services offered by third parties. The two main examples of inter-brand restraints are tying agreements and exclusive distribution.

#### b.) Positive externalities of vertical restraints

- 46 Although vertical restraints may sometimes be used with anti-competitive purposes, they frequently enhance social welfare and reduce opportunism in long-term contracts. Because of these positive externalities, competition law has viewed their legal validity in a more positive light in recent decades.<sup>49</sup>
- 47 In contrast with horizontal restraints, parties in a vertical agreement share an interest in an increased level of market competition. For instance, sellers and producers profit when there is a high level of competition among different providers, and also when no single distributor has sufficient market power.
- 48 Vertical restraints also allow firms to profit from the advantages associated with the vertical integration of the firm but without having to face the costs arising from property rules on the firm's organization.<sup>50</sup>

- 49 Moreover, vertical restraints provide distributors with the incentives to make specific investments, in the context of a long-term contract, in order to expand a local market and to offer pre-sale and post-sale services without incurring the risk that the principal may opportunistically profit from those investments afterwards. In this vein, the development of an efficient distribution system, which proves beneficial to all parties to the contract and also to consumers, requires that some specific investments are made to identify needs in the local market; to abide by all domestic regulations; to engage in promotional and advertising campaigns aimed at local consumers; to provide pre-sale services such as free samples; to participate in fairs and exhibitions; and to provide post-sale services such as maintenance services, technical assistance, repair services and management of legal and commercial guarantees.
- 50 If the holder of exclusive rights over the work is vertically integrated and assumes all distribution and sale services for third parties, she will make the appropriate investment decisions to commercialize the product in the local market. However, on many occasions it would be cheaper to avoid such vertical integration and to enter into contracts with specialized agents in the local market who will be in charge of distributing the products. If these agents cannot be certain that a third party is not able to extract a profit from the specific investments they have previously made, they will lack the necessary incentive to enter into a contract with the rightholder in the first place. If agents who have developed the necessary infrastructure for commercializing the products and informed the local public about the goods cannot prevent a new distributor entering the local market and offering the same products at a lower price, the positive externalities associated with distribution systems will not exist.

### c.) Vertical restraints in the Technology Transfer Block Exemption Regulation

- 51 This pro-competitive understanding of vertical restraints has been accepted by European institutions, in particular the European Commission. In the field of software contracts, the Commission passed Regulation (EC) No 772/2004 of 27 April 2004 on the application of Article 81(3) of the Treaty to categories of technology transfer agreements (hereinafter 'TTBER').<sup>51</sup> The TTBER and accompanying Guidelines<sup>52</sup> explain the new approach to vertical restraints in software agreements and other technological dealings, how the regulation should be interpreted, and how Article 81 EC Treaty – now Article 101 of the Treaty on the Functioning of the European Union (hereinafter 'TFEU') – applies to licensing agreements not covered by the regulation. The function of the TTBER is to apply Article 101(3) of the TFEU to

technology transfer agreements. Article 101(1) prohibits undertakings from entering into agreements which have as their object or effect the prevention, restriction or distortion of competition within the common market, whereas Article 101(3) exempts such agreements if they improve the production or distribution of goods or if they promote technical or economic progress, provided they do not impose unnecessary restrictions on the undertakings involved nor enable the undertakings to eliminate competition in the relevant product market. According to the Commission, licensing agreements, though capable of having anticompetitive effects, often also have pro-competitive effects. They promote innovation because they allow innovators to earn the returns of their research and labour; and they promote dissemination of technical knowledge and information, which leads to the production of new or more sophisticated goods.<sup>53</sup>

- 52 Pro-competitive effects of vertical restraints, as reflected in the TTBER and the accompanying Guidelines, mainly occur in situations of shared production of goods between undertakings that are not vertically integrated. As expressed in the Guidelines,

*efficiencies at the level of the licensee often stem from a combination of the licensor's technology with the assets and technologies of the licensee. Such integration of complementary assets and technologies may lead to a cost/output configuration that would not otherwise be possible. For instance, the combination of licensors having improved technology with licensees having more efficient production or distribution assets may reduce production costs or lead to the production of a higher quality product.*<sup>54</sup>

- 53 Pro-competitive effects occur immediately after the first sale of the product has taken place or shortly after the first transfer of ownership.<sup>55</sup>
- 54 The aforementioned pro-competitive effects of vertical restraints obviously do not occur in all distribution and commercialization scenarios. Hence it is possible to advocate a strict mandatory rule of exhaustion in situations in which these effects are non-existent or insignificant. This can be the case with contracts which do not aim at shared production of goods (mainly contracts with consumers) and with restraints which include limitations for an excessive period of time, and this can aggravate the problem of the future.

### III. Limits to the reward rationale: Internalization of price discrimination strategies

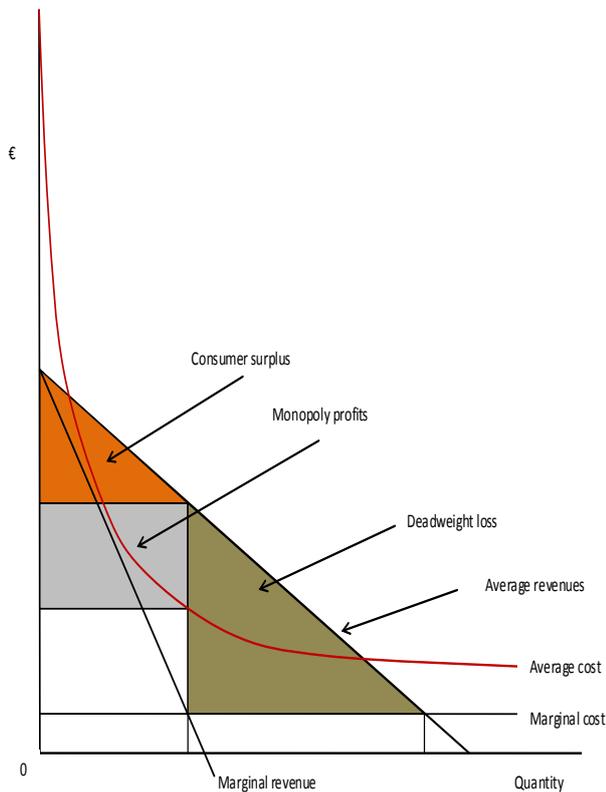
- 55 According to the reward rationale, the producers of copyrighted works would be entitled to the prof-

its dictated by market conditions at the time they put them into circulation but are not entitled to reap other earnings when purchasers or users try to transfer the products to third parties. In fact, the producers may anticipate that some of the copies will be transferred to third parties in the second-hand market and can reflect this eventuality in the price of their products. The fact that some potential purchasers may prefer to obtain a used copy instead of paying the producer for a new one may lead the producer to demand a higher price for the copy should market conditions concur.

- 56 The reward rationale for exhaustion seems to forget that the product's features will have an impact on its price and consequently on the profits that the producer may earn. The product's features include not only quality or performance attributes but also the allocation of property rights over the copy among the parties. The more the purchaser can do with the product, the higher the price; the more restricted the purchaser's use of the goods, the lower the price. In other terms, the license is also the product, and the price internalizes the terms of use.
- 57 Including the license as a product feature mainly requires that the producers are able to enforce it and to avoid arbitrage. If the license cannot be enforced and, in particular, if a resale prohibition is deemed unenforceable, the producer will probably be encouraged to increase the price of her products; as a result, some purchasers may be deprived of the goods because they cannot meet the new price. Producers who anticipate that exhaustion will make these reselling restrictions unenforceable will have fewer incentives to produce the goods in the first place. Moreover, they might also be encouraged to develop additional technical measures or other arrangements to avoid the copies being resold on the market. These measures, of which planned obsolescence is one, are costly both privately and for society.
- 58 A strict mandatory exhaustion rule may frustrate welfare-enhancing price discrimination strategies. The right of distribution allows the rightholder to choose how the copyrighted copies of works will be put into circulation, the distribution channels, whether ownership is transferred, the products' price and the limitations on their use according to the market structure at a given time.
- 59 By using the right of distribution, agents in charge of commercializing a copyright-protected work may implement price discrimination strategies that may increase social welfare.<sup>56</sup>
- 60 In the field of software agreements, producers normally offer different versions of the same computer program to different groups of individuals. For instance, students and academics are offered lower-priced versions, while higher-priced versions are sold to commercial users such as professionals and companies. Legal databases are also priced differently for university libraries and law firms. In general terms, price discrimination involves charging different consumers different prices for access to the same goods or service when the variation cannot be explained by differences in the cost of producing the respective versions.<sup>57</sup> Firms that resort to price discrimination usually make more profits. However, price discrimination is not always available, and certain circumstances may have to concur to be able to engage in it:
- a The seller must have market power. Substitute goods or services must not be accessible in the market.
  - b The seller must be able to prevent arbitrage – that is, restrict the possibility that potential acquirers may obtain the goods or service from another client (not the seller) who obtained it at an inferior price.<sup>58</sup>
  - c The seller must be able to discriminate among potential clients and identify to some extent the different valuations that they assign to the goods or service.
- 61 As mentioned earlier, charging different prices will also involve different allocations of property rights – that is, the different versions of the products will be conditioned to different terms of use. For instance, the market may be chronologically segregated and a higher price charged to consumers who are interested in accessing the work in the first place. Different formats of the work may also be put into circulation at different prices (hardcover versions, paperback, pocketbooks and e-books). Price may depend on the volume or amount of use that is intended by the consumer: in the field of software licenses the price or a part thereof is usually set according to the number of concurrent sessions of the computer program or the number of machines on which the program is installed or accessible. Using different terms of use is also a price discrimination strategy. In this regard, the allocation of property rights included in a software license may impact the price of the product, and consumers who are provided with a broader scope of use will probably be charged a higher price. For instance, consumers who are deprived of the right to resell the product will probably pay less than those who are afforded this possibility.
- 62 The conventional law and economics literature on intellectual property law is generally optimistic about price discrimination for copyrighted works and other products protected by IP rights.<sup>59</sup> Price discrimination is perceived as Pareto-efficient since it may help to reduce the deadweight losses that in-

lectual property law involves for establishing prices.<sup>60</sup>

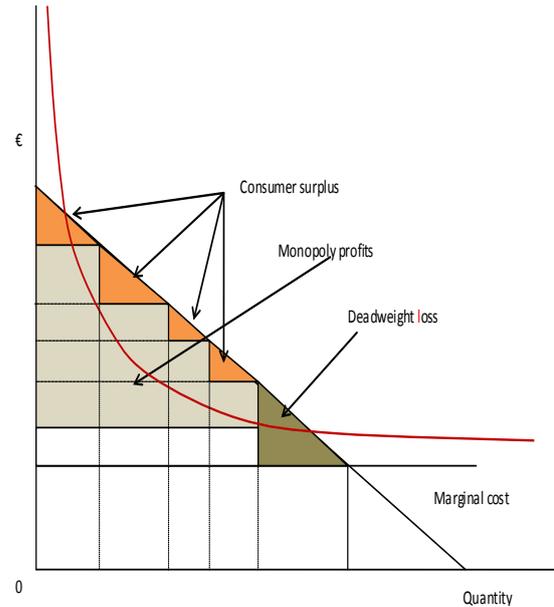
63 According to neoclassical economics, producers in a competitive market are expected to price their goods at the marginal cost of distribution, i.e. the cost of supplying the next additional unit to consumers. It is assumed that competition in the market will lead producers to price at marginal cost. Intellectual property rights are presumed to be public goods since they are non-rivalrous and non-exclusive goods. The marginal cost of distributing public goods is zero, i.e. it costs nothing for the next consumer to enjoy the goods. Anticipating this, producers will rationally not invest in producing the work or invention in the first place. Intellectual property law allows producers to charge prices above marginal cost and, in doing so, provides incentives for the creation and development of new inventions that would otherwise be under-produced. Producers of goods protected by intellectual property law may to some extent charge prices as if they were a monopoly:



64 Intellectual property law provides an opportunity to charge prices above marginal cost and to reap profits greater than zero. However, this is not without social costs: artificially raising prices and restricting output may price certain consumers out of the market. Consumers who would have enjoyed the product for free, who valued it above the marginal price but below the monopoly price, will be unwilling or unable to meet the higher monopoly price. This wasting of consumer surplus is a social cost known among

economists as the deadweight loss of gains that go unrealized either to the producer or the consumer.<sup>61</sup>

65 If producers are allowed to charge different client groups different prices, the deadweight loss is reduced. Obviously, some of the gains made will go to the producer, but consumers who value the product above the marginal cost of production but below the profit-maximizing price will gain access to the work. As a consequence, price discrimination, besides being efficient, is also frequently said to be fair because it redistributes welfare:



66 However, it is impossible to conclude as a matter of principle that price discrimination increases social welfare. It may sometimes increase the deadweight loss if some market characteristics concur. The effects of price discrimination on social welfare basically depend on the conditions of the market in which the strategy is implemented.<sup>62</sup> Michael Meurer has suggested that in cases in which a bigger deadweight loss and output restriction occur, the prospect of higher profits for firms may encourage innovation and therefore price discrimination should be allowed: the increase in the deadweight loss may be compensated by the dynamic efficiencies arising from innovation.<sup>63</sup> Moreover, price discrimination does not always involve output restriction; in many instances, it will generate a larger quantity of goods on the market, which promotes economies of scale.<sup>64</sup>

67 In any case, uncertainty about the impact of price discrimination on social welfare ought not to mean that these strategies should be banned and post-sale restrictions should be unenforceable. Price discrimination externalities would actually depend on the market traits of a specific industry and their effects should be empirically contrasted.<sup>65</sup>

#### IV. Summary of critiques of the traditional rationales of exhaustion

- 68 The legal and judicial delimitation of exhaustion and of the powers of control established by right-holders over the use of copies in the aftermarket through post-sale restrictions would impact the viability of vertical integration and price discrimination strategies.
- 69 This article advocates a more flexible approach to the exhaustion of the right of distribution, especially in the field of software agreements and licenses. As has been shown, if certain circumstances concur, relaxing the legal effects of exhaustion or permitting the parties to contract to opt out of its legal consequences may prove welfare-enhancing.
- 70 There are several elements that can be factored into the decision to allow producers a greater degree of control over the aftermarket, basically aiming to provide incentives to innovation and the creation of new works in the first place. The concurrence of these elements advocates the possibility of applying exhaustion rules more flexibly, as some courts have done when deciding software licensing cases. Among these elements, adjudicators should take into consideration (i) the personal characteristics of acquirers of the copyrighted copies of works – basically whether they are acting as consumers and whether they will use the products for commercial or non-commercial purposes; (ii) whether adequate and sufficient information about post-sale restrictions has been conveyed to the purchaser who accepted them in the contract; (iii) the degree of productivity and interoperability of the purchased goods – basically whether the copies in question embody complex or non-complex products; (iv) the degree of indirect control that rightholders may have over the uses of copies through other exclusive rights – namely, the right of reproduction and the right to prepare derivative works; (v) the impact of post-sale restraints in preventing opportunism in long-term contracts and in reducing deadweight losses created by IP pricing; and (vi) the temporal scope of post-sale restrictions. If these circumstances – or at least some of them – concur, and as a result the producer can prove that the post-sale restrictions have pro-competitive effects, exhaustion should be displaced and the restriction enforced.<sup>66</sup>
- 71 What follows is a critical discussion of a recent case decided by the European Court of Justice concerning exhaustion of the distribution right in the field of used software. In this case, the Court adopts a mandatory and strict regime for the exhaustion of copyrights, which if applied indiscriminately may curtail efficient strategies in the distribution and commercialization of computer programs in the European Union.

#### E. Digital exhaustion: The special regime for computer programs and the ECJ Judgment in *Oracle International Corp. v. Usedsoft GmbH*

##### I. Facts of the case

- 72 The increase in the digital transmission of software copies through the Internet and the development of new software commercialization and distribution models have actually required a new legal interpretation of the contours of the exhaustion doctrine both at the EU level and in domestic jurisdictions. The ECJ has recently resolved a reference for a preliminary ruling from the German Supreme Court<sup>67</sup> concerning the exhaustion of the right of distribution in computer programs offered on the Internet: *Oracle International Corp. v. Usedsoft GmbH*.<sup>68</sup>
- 73 Oracle International Corp., the plaintiff in the case, develops and markets computer programs. Oracle basically distributes its software (mainly client-server software) via Internet downloading; in fact, direct downloads from the Internet represent 85% of the company's distribution activity. Clients do not receive a CD or DVD with the computer program unless they specifically ask for one. When commercializing its client-server software, Oracle uses a mixed second- and third-degree price-discrimination strategy:<sup>69</sup> companies are offered the client-server software with fewer restrictions on group licenses for a minimum of 25 users per group, so if a customer requires that 30 of its employees be able to use the software issued, it will have to acquire two licenses. However, it offers more restrictive licenses and products to other sorts of clients.
- 74 The right to use the program, governed by the license agreement, included the right to store a copy of the program permanently on a server that could be accessed by a certain number of users who would make temporary copies on their own computers. Updates and patches for correcting errors could be downloaded from Oracle's website.
- 75 In the case in question, Oracle's license agreement contained the following term, under the heading, 'grant of rights': 'With the payment for services you receive, exclusively for your internal business purposes, for an unlimited period a non-exclusive non-transferable user right free of charge for everything that Oracle develops and makes available to you on the basis of this agreement.'
- 76 The defendant, UsedSoft GmbH, was a German company that offered 'second-hand' or 'already used' licenses for computer programs on the market. In October 2005 UsedSoft promoted an 'Oracle Special Offer' in which it offered 'already used' licenses

for the Oracle programs and informed prospective customers that the licenses were valid and updated and that the lawfulness of the original sale was confirmed by a notarial certificate.

- 77 UsedSoft had acquired the licenses from Oracle clients who had requested group licenses for a larger number of users than they actually needed as a consequence of the licensing policies.
- 78 After acquiring a license, UsedSoft's clients either downloaded a copy of the Oracle software directly from Oracle's website or, if they were already in possession of the computer program in question, were induced to copy the program onto the additional user's work station.
- 79 Oracle filed a lawsuit against UsedSoft for copyright infringement, trademark infringement and unfair competition practices. In relation to the copyright infringement claims, according to Oracle, the actions of UsedSoft and its customers infringed the company's exclusive rights of reproduction and distribution. The District Court in Munich granted Oracle's application in a Decision issued on 15 May 2007.<sup>70</sup> This Decision was upheld by the Court of Appeal in a Judgment rendered on 3 July 2008 in which UsedSoft's appeal was dismissed.<sup>71</sup>
- 80 UsedSoft then appealed against the Judgment to the Federal Supreme Court, which decided to stay the proceedings and refer to the ECJ for a preliminary ruling. The following questions were referred to the ECJ:<sup>72</sup>
1. Is the person who can rely on exhaustion of the right to distribute a copy of a computer program a 'lawful acquirer' within the meaning of Article 5(1) of Directive 2009/24?
  2. If the reply to the first question is in the affirmative: is the right to distribute a copy of a computer program exhausted in accordance with Article 4(2) of Directive 2009/24 when the acquirer has made the copy with the rightholder's consent by downloading the program from the Internet onto a data carrier?
  3. If the reply to the second question is also in the affirmative: can a person who has acquired a 'used' software license for generating a program copy as a 'lawful acquirer' under Article 5(1) and Article 4(2) of Directive 2009/24 also rely on exhaustion of the right to distribute the copy of the computer program made by the first acquirer with the rightholder's consent by downloading the program from the Internet onto a data carrier if the first acquirer has erased his program copy or no longer uses it?
- 81 The Court addresses the second question first and discusses whether and under what conditions the downloading from the Internet of a copy of a computer program, authorized by the rightholder, involves the exhaustion of the right of distribution. In this regard, it has to be decided whether a software download in the context of a license agreement may be regarded as a 'first sale' within the meaning of Article 4(2) of Directive 2009/24. The ECJ answers the question in the positive.

## II. The concept of sale: Downloads as first sales for exhaustion purposes

82 After stating the need for a uniform application of European Union Law,<sup>73</sup> the ECJ declares that, since Directive 2009/24 does not make any reference to domestic laws as regards the meaning of sale, an autonomous concept shall be adopted.<sup>74</sup>

83 In adopting this autonomous concept, the ECJ refers to a pragmatic definition of 'sale', which is understood as 'an agreement by which a person, in return for payment, transfers to another person his rights of ownership in an item of tangible or intangible property belonging to him' (Para. 42). In assessing whether Oracle's commercialization system fits with this definition, the Court examines its underlying economic function and states that the downloading of a copy of a computer program and the conclusion of a user license agreement 'form an indivisible whole' (Para. 44), together with the installation of patches and updates (Para. 68). When downloading the copy from the Internet and concluding the license agreement, Oracle's customers receive a right to use the copy for an unlimited period in return for payment. The Court uses the reward rationale to affirm that the copyright holder is able to 'obtain a remuneration corresponding to the economic value of the copy of the work of which it is the proprietor' (Para.45) and should not therefore be able 'to control the resale of copies downloaded from the Internet and to demand further remuneration on the occasion of each new sale, even though the first sale of the copy had already enabled the rightholder to obtain an appropriate remuneration' (Para. 63).

84 Examined as a whole, the economic substance of Oracle's commercialization system shows that ownership of the copy has been transferred to the customer (Para. 46) and it makes no difference to the Court whether the copy of the computer program was made available to the customer by the rightholder by means of a download from the rightholder's website or by means of a tangible medium such as a CD-ROM or a DVD (Para. 47).<sup>75</sup> In both cases, the right to use the downloaded copy or the tangible copy depends on the conclusion of the license agreement.

85 The Court follows the opinion of the Advocate General,<sup>76</sup> who had supported a broad interpretation of 'sale' within the meaning of Article 4(2) as comprising 'all forms of product marketing characterized by the grant of a right to use a copy of a computer program, for an unlimited period, in return for payment of a fee designed to enable the copyright holder to obtain a remuneration corresponding to the economic value of the copy of the work of which he is the proprietor'. If rightholders had the opportunity to qualify the agreement as a 'license' instead of a sales contract, the rule on exhaustion could be circumvented. This solution is in contrast with widespread practice in US case law, which in many cases has embraced software exceptionalism<sup>77</sup> and has held that software licenses do not transfer ownership and cannot be deemed 'sales' for 'first sale doctrine' or 'essential step defense' purposes.<sup>78</sup>

### III. Exhaustion applies only to software copies but not to other digital copies downloaded from the Internet

86 The Court also disregards the application of the 'right of making available to the public' established in Article 3(1) of the Information Society Directive to software downloads. According to this provision, copyright holders have a right to make their works available to the public in such a way that members of the public may access them from a place and at a time individually chosen by them; and this right shall not be exhausted.<sup>79</sup> The Software Directive constitutes a *lex specialis* in relation to the provisions of the Information Society Directive (Para. 51). Moreover, the existence of a transfer of ownership of the intangible copy transforms an act of communication to the public into an act of distribution (Para. 52). Therefore, there is a stark difference in the EU between software that is downloaded from the Internet and other digital works – such as e-books, digital music and videogames – that are also accessed through the Internet. In the latter category, as no distribution acts occur, exhaustion does not apply and rightholders have greater control powers over the aftermarket. This conclusion does not fit with the findings of this article, according to which exhaustion of copyright makes more sense in works with few productive uses and weak interoperability. In general, computer programs pose a higher degree of interoperability and productive uses than digital works.

87 However, it must be taken into account that the productive uses in question in the case only concerned the functioning of companies or other Oracle clients but did not really have an impact on the creation of new innovations in the software field. In this regard, they did not constitute software license agreements covered by the TTBER, since they were not agree-

ments where the licensor permitted the licensee to exploit the licensed technology, possibly after further research and development by the licensee, for the production of goods or services. The software at issue in the case is basically company application software that comprises several business-oriented tools. None of those tools was seemingly licensed to permit the research and development of new goods and services.

### IV. The irrelevance of tangibility

88 The Court finally disregards that exhaustion within the meaning of the Software Directive applies only to the distribution of tangible copies. As established in the Judgment, 'it does not appear from Article 4(2) of Directive 2009/24 that the exhaustion of the right of distribution [...] is limited to copies of programmes on a material medium such as a CD-ROM or DVD. On the contrary, that provision [...] makes no distinction according to the tangible or intangible form of the copy in question' (Para. 55). The Software Directive, which is *lex specialis* in relation to the Information Society Directive, applies broadly to computer programs, comprising 'programs in any form, including those which are incorporated into hardware' (Recital 7). The Court again refers to the economic reality involved in the different acts: 'from an economic point of view, the sale of a computer program on CD-ROM or DVD and the sale of a program by downloading from the Internet are similar. The on-line transmission method is the functional equivalent of the supply of a material medium' (Para. 61).

### V. Creating monsters: Artificially indivisible goods by way of contract and the numerus clausus narrative

89 According to the Court, exhaustion applies only to the whole group license sold by Oracle (Para. 69). In this regard, the acquirer is not authorized to divide the license and resell only the user rights corresponding to a number of users determined by the customer. On the contrary, Oracle's clients may only sell the entire group license to UsedSoft. Division of the license would constitute a breach of contract – and supposedly a copyright infringement – since this would mean that the customer does not make his own copy unusable at the time of its resale (Para. 70). The Court thus safeguards Oracle's commercialization scheme: customers are prevented from selling individual licenses, which was what they intended and what UsedSoft induced them to do. It is likely that if UsedSoft cannot meet a lower price for the group licenses, potential customers would prefer to buy the group licenses directly from Oracle,

for reputational reasons. This legal solution respects the price discrimination strategy devised by Oracle, which may thus reap the anticipated profits arising from using this distribution system. According to the Court, restrictions to resell the whole goods are not enforceable, whereas restrictions to resell only a part thereof are deemed valid. In light of the *numerus clausus* analytical narrative, this legal outcome seems to exacerbate measurement costs for potential acquirers of used software in the market. Artificial indivisibility of entertainment goods and other copyrighted products creates a sort of monster in secondary markets: purchasers of encyclopaedias, double packs of CDs or the entire DVD collection of *The Sopranos* would presumably have a property right to sell just one of the volumes, one of the CDs or just the first season of the TV show. However, according to the ECJ, software products are different and artificial indivisibility is enforceable against both first acquirers and subsequent acquirers of software licenses.

- 90 Notwithstanding the application of the Judgment conclusion to the specific Oracle facts, the ECJ assumes a strong rule of exhaustion in the field of used software. As explained above, this result may impinge upon the ability of rightholders to prevent arbitrage. Applying a strong rule of exhaustion for software copies may discourage efficient price discrimination and encourage rightholders to market software with costly technical protection measures or other alternatives which involve a waste of resources. In fact, the Court expressly states that it is permissible for the rightholder to make use of technical protective measures such as product keys (Paras. 79 and 87).<sup>80</sup>
- 91 The Court seems to forget that implementing further technical protective measures can be costly, both socially and privately. In the end, enforcement of post-sale restrictions may be less costly from a social point of view than achieving the same result through technology.
- 92 Article 5(1) of the Software Directive states that, in the absence of specific contractual provisions, the reproduction of a computer program does not require author authorization where the reproduction is necessary for the lawful acquirer's use of the computer program in accordance with its intended purpose, including error correction. When UsedSoft's clients download a copy of the program in question and install it in their computers, they are making a reproduction that is regarded to be necessary to enable the new acquirer to use the program in accordance with its intended purpose (Para. 81).
- 93 In order not to infringe the rightholder's exclusive right of reproduction, exhaustion requisites must concur and, in particular, resellers must have made the copy which was downloaded onto their computers unusable at the time of resale.<sup>81</sup>
- 94 Rightholders are not required to authorize these acts of reproduction under a license agreement concluded directly with the final user. As explained by the Court, requiring a direct agreement with the rightholder or complying with all the terms in the agreement would have the effect of allowing the rightholder to prevent the effective use of any used copy in respect of which his distribution right has previously been exhausted (Para. 83). In these scenarios, an expansive right of reproduction would work as a form of indirect control over users' activities and a means to circumvent exhaustion effects.
- 95 The ECJ concludes that in the event of the resale of a user license involving the resale of a software copy downloaded from the copyright holder's website, the second acquirer of the license, as well as any subsequent acquirer, will be able to rely on the exhaustion of the distribution right under Article 4(2) of the Software Directive, and hence be regarded as the lawful acquirer of the copy within the meaning of Article 5(1) and benefit from the right of reproduction provided for in that provision.

## VI. Acts that are necessary for lawful acquirers to use the computer program

- 92 After examining how exhaustion applies to reselling used software downloaded from the Internet, the Court discusses questions 1 and 3 in a joint section of the Judgment. According to the Court, as the copyright holder can no longer oppose the resale of a copy by virtue of the exhaustion doctrine, purchasers such as UsedSoft customers may be reputed as 'lawful acquirers' within the meaning of Article 5(1) of the Software Directive.

## F. Conclusions

- 97 This article provides an analytical framework built upon the traditional rationales of IP exhaustion doctrine which identifies factors that can be considered by courts and policymakers in applying rules on exhaustion more flexibly in some settings.
- 98 In deciding whether copyright holders should be allowed a greater degree of control over the distribution of copyright-protected goods in the aftermarket, courts and policymakers might consider (i) the personal features of acquirers of the goods, distinguishing between consumers and commercial users; (ii) whether post-sale restrictions have been adequately communicated to acquirers and have been agreed in the contract or license; (iii) the degree

of complexity of the goods and their prospects of productive uses and interoperability; (iv) the role of other exclusive rights in providing rightholders with indirect control over uses of the copies in the aftermarket; (v) the impact of post-sale restraints in preventing opportunism in long-term contracts and in reducing deadweight losses created by IP pricing; and (vi) the temporal scope of post-sale restraints. Rightholders engaged in pro-competitive post-sale restrictions that can show the concurrence of most of these factors in a particular distribution setting may be awarded the possibility to enforce a contractual agreement limiting the legal effects of exhaustion rules.

- 1 See Ohly, "Economic Rights", in: Derclaye (ed.), *Research Handbook in Intellectual Property*, p. 219 (Edward Elgar, Cheltenham/Northampton, 2009).
- 2 Directive 2001/29/EC of the European Parliament and of the Council of 22 May 2001 on the harmonization of certain aspects of copyright and related rights in the information society (OJ 2001 L 167, p.10) (hereinafter, Information Society Directive).
- 3 Article 4(2): "The distribution right shall not be exhausted within the Community in respect of the original or copies of the work, except where the first sale or other transfer of ownership in the Community of that object is made by the rightholder or with his consent". This provision has been adopted by the different EU domestic laws, even in countries like France which traditionally recognized a broad right to control commercial uses of copies (*droit de destination*). See Dusollier, 'Le droit de destination: une espèce franco-belge vouée à la disparition', 20 *Propriétés Intellectuelles* 281-289 (2006). The exhaustion doctrine in EU Law is a product of ECJ case law prior to the Information Society Directive. See ECJ, 8 June 1971, case C-78/70, *Deutsche Grammophon Gesellschaft mbH v. Metro-SB-Großmärkte GmbH & Co. KG*. (holding that the distribution right does not allow its rightholder to control the distribution of phonographic copies in a domestic jurisdiction if they had previously been put into circulation in another Member State); ECJ, 18 March 1980, case C-62/79, *SA Compagnie générale pour la diffusion de la télévision, Coditel and others v. Ciné Vog Films and others* (holding that the freedom to provide services does not involve the exhaustion of the performing right in a cinematographic film in a Member State where the film had previously been shown in another Member State); ECJ, 20 January 1981, joined cases C-55/80 and 57/80, *Musik-Vertrieb GmbH and K-Tel international v. GEMA* (holding that national exhaustion is incompatible with the principle of free movement of goods); ECJ, 22 January 1981, case C-58/80, *Dansk Supermarked A/S v. A/S Imerco* (holding that national exhaustion is incompatible with the principle of free movement of goods); ECJ, 9 February 1982, case C-270/80, *Polydor Limited and RSO Records Inc. v. Harlequin Records Shops Limited and Simons Records Limited* (holding that importation of records into the United Kingdom from Portugal – when this country was not a Member State – can be prevented by the distribution right assignee in the former country); ECJ, 17 May 1988, case C-158/86, *Warner Brothers Inc. and Metronome Video ApS v. Erik Viuff Christiansen* (holding that national exhaustion is incompatible with the principle of free movement of goods); ECJ, 24 January 1989, case C-341/87, *EMI-Electrolav. Patricia*, (holding that national exhaustion is incompatible with the principle of free movement of goods in a case where the rights over the work had expired in the country where the copies were put into circulation); and ECJ, 28 April 1998, case C-200/96, *Metronome Musik GmbH v. Music Point Hokamp GmbH* (holding that the introduction of Community legislation of an exclusive rental right cannot therefore constitute any breach of the principle of exhaustion of the distribution right). Following the introduction of the Information Society Directive, exhaustion has also been interpreted by the ECJ. See ECJ, 12 September 2006, case C-479/04, *Laserdisken ApS v. Kulturministeriet* (holding that Art. 4(2) of Directive 2001/29 is to be interpreted as precluding national rules providing for exhaustion of the distribution right in respect of the original or copies of a work placed on the market outside the European Community by the rightholder or with his consent); ECJ, 17 April 2008, case C-456/06, *Peek & Cloppenburg KG v. Cassina SpA* (resorting to Art. 6(1) WIPO Copyright Treaty 1996 to define distribution as "making available through sale or other transfer of ownership"); and ECJ, 3 July 2012, case C-128/11, *UsedSoft GmbH v. Oracle International Corp.* (holding that, in the field of software law, distribution of intangible copies downloaded from the internet exhausts the right of distribution).
- 4 Directive 2009/24/EC of the European Parliament and of the Council of 23 April 2009 on the legal protection of computer programs (OJ 2009 L 111, p. 16) (hereinafter, Software Directive).
- 5 Art. 4(2): "The first sale in the Community of a copy of a program by the rightholder or with his consent shall exhaust the distribution right within the Community of that copy, with the exception of the right to control further rental of the program or a copy thereof". On the doctrine's geographical application, contrast with the recent US Supreme Court decision in *Kirtsaeng v. John Wiley and Sons, Inc.*, 568 U.S. \_\_\_ (2013) (holding that exhaustion – "first sale doctrine" – applies to copies of a copyrighted work lawfully made abroad).
- 6 Absent consent or authorization by the rightholder, buying a used copy of a book in a bookstore, giving it to a friend as a birthday present or even leaving it on a park bench or in a tree hollow may constitute copyright infringement. See Rothchild, "The Incredible Shrinking First-Sale Rule: Are Software Resale Limits Lawful?", 57 *Rutgers L. R.* 11 (2004) (arguing that gifts constitute distribution acts in US copyright law). On abandonment of copyrighted works and exhaustion, see Kermel, "Off the Walls: Abandonment and the First Sale Doctrine", 45 *Col. J. of Law and Soc. Probl.* 353 (2012).
- 7 See *infra* Section C.
- 8 See *infra* Section B.
- 9 See Perzanowski & Schultz, "Digital Exhaustion", 58 *UCLA L. Rev.* 889 (2011), pp. 894-901. Positive externalities are benefits of an exchange that are not captured by the parties thereto but that spill over onto other third parties. Negative externalities are costs of an exchange that are not borne by the parties but spread to individuals not engaged in the exchange. See Cooter & Ulen, *Law and Economics* (Pearson Education, Boston, 2011), p. 39; and Frischmann & Lemley, "Spillovers", 107 *Col. L. Rev.* 257 (2007).
- 10 Reese, "The First Sale Doctrine in the Age of Digital Networks", 44 *B. C. L. Rev.* 577 (2003), pp. 585-594.
- 11 Gordon, "Intellectual Property as Price Discrimination: Implications for Contract", 73 *Chi.-Kent L. Rev.* 1367 (1998), pp. 1383-1390.

- 12 For instance, more than 10,000 books were published in the US in 1930 but only 174 of them were commercially available in 2001. See Landes & Posner, *The Economic Structure of Intellectual Property Law*, p. 212 (Belknap Press of Harvard University Press, Cambridge, 2003). Moreover, it is estimated that only 20% of the films that were produced during the 1920s can be accessed nowadays and that 40% of all phonograms produced during last century are not commercially available. In this regard, see Hinkes, “Access Controls in the Digital Era and the Fair Use/First Sale Doctrines”, 23 *Santa Clara Computer and High Tech. L. J.* 685 (2006), p. 702.
- 13 Due to ignorance as to the rightholder’s identity and the potential infringement risk, incentives for engaging in a new economic exploitation of orphan works are dramatically reduced. Given the difficulties in supplying brand new copies of orphan works, access to their content is highly dependent on the availability of secondary markets.
- 14 See Cohen, “The Right to Read Anonymously: A Closer Look at Copyright Management in Cyberspace”, 28 *Conn. L. Rev.* 981 (1996).
- 15 See Milton, *Areopagitica*, 1644 (an online version may be found at <<http://www.gutenberg.org/files/608/608-h/608-h.htm>>); and Mill, *On Liberty*, 1859 (an online version may be found at <<http://www.gutenberg.org/files/34901/34901-h/34901-h.htm>>).
- 16 See Posner, “Free Speech in an Economic Perspective”, 20 *Suffolk U. L. Rev.* 1 (1986); and Farber, “Free Speech Without Romance: Public Choice and the First Amendment”, 105 *Harv. L. Rev.* 554 (1991).
- 17 See *infra* Section D.II.
- 18 Secondary literature on decentralized innovation is quite extensive. Two classic references are Von Hippel, *Democratizing Innovation* (MIT Press, Cambridge (MA), 2005); and Benkler, *The Wealth of Networks: How Social Production Transforms Markets and Freedom* (Yale University Press, New Haven, 2006). See also Fisher, “The Law of User Innovation”, 94 *Minnesota Law Review* 1417 (2010) and Lessig, *Remix: Making Art and Commerce Thrive in the Hybrid Economy*, (Penguin Press, NY, 2008).
- 19 Perzanowski & Schultz, *supra* note 9 at 899-900.
- 20 Van Houweling, “The New Servitudes”, 96 *Geo. L. J.* 901 (2008).
- 21 See Kohler, *Deutsches Patentrecht*, pp. 160 *et seq.* (Bensheimer, Mannheim, 1878); and Kohler, *Handbuch des Deutschen Patentrechts in rechtsvergleichender Darstellung*, pp. 452 *et seq.* (Bensheimer, Mannheim, 1900).
- 22 In the US the reward rationale in patents has also been accepted by the Supreme Court: “Whilst the remuneration of genius and useful ingenuity is a duty incumbent upon the public, the rights and welfare of the community must be fairly dealt with and effectively guarded. [...] The test has been whether or not there has been such a disposition of the article that it may fairly be said that the patentee has received his reward for the use of the article” (*United States v. Masonite Corp.*, 316 U.S. 265 (1942)).
- 23 The doctrine developed by Kohler improved on his former conception based on the idea of giving the purchaser of a patented product an implied license to perform acts of exploitation without requiring the patent owner’s express consent. Given the traditional principle of privity of contract (“*Beschränkung der Rechtswirkungen auf die direkt beteiligten Vertragsparteien*” as implicit in current §311 BGB), resorting to an implied license rationale was dogmatically unworkable in relation to subsequent purchasers of the patented product or the product that was obtained through the process claimed by the exclusive right. Implied licenses are also unworkable under the scope of a contract for the benefit of third parties (“*Verträge zugunsten Dritter*”, §328 BGB) provided the need for expressed terms to establish such agreements.
- 24 1902, RGZ 50, 229 “Kölnisch Wasser”; and 1902, RGZ 51, 263 “Mariani”.
- 25 1906, RGZ 63, 394 “Koenigs Kursbuch”.
- 26 Berger, “Die Erschöpfung des urheberrechtlichen Verbreitungsrecht als Ausprägung der Eigentumstheorie des BGB”, 201 *AcP* 418-419 (2001). In the same regard, see Loewenheim, *Urheberrecht Kommentar*, Sec. 17 Copyright Act, No. 44 (4th ed., C.H. Beck, Munich, 2010).
- 27 See Loewenheim, *supra* note 26 at No. 44.
- 28 Among the most relevant critiques, see Dagan, “The Craft of Property”, 91 *Cal. L. Rev.* 1517 (2003); Merrill & Smith, “What Happened to Property in Law and Economics?”, 111 *Yale L.J.* 357 (2001); and Penner, “The ‘Bundle of Rights’ Picture of Property”, 43 *UCLA L. Rev.* 711 (1996).
- 29 In short, the existence of a promise or a contractual obligation between the parties would require that the restrictions were deemed legally valid and incorporated into the sales contract or the gift. The discussion of these issues exceeds the scope of this article, and questions about their enforceability are only referred to incidentally.
- 30 Legal validity and enforceability of simple communications conveyed by the copyright holder to the user of a copy – for instance, through a printed or attached notice in the product – in which the terms of use are displayed is a contested issue. However, in products that are not technologically complex – such as a printed book, for instance – enforceability of terms of use through notice would be rather limited. See Lemley, “Terms of Use”, 91 *Minn. L. Rev.* 459 (2006).
- 31 But see Commission Regulation (EU) No 330/2010 of 20 April 2010 on the application of Art. 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices (OJ L 102, 23.4.2010, p. 1). According to Art. 2 of this Block Exemption Regulation, some vertical restraints in particular chains of production or distribution may be efficiency-enhancing and thus permitted by the law.
- 32 With respect to the interrelation between different computer programs, see Van Rooijen, *The Software Interface Between Copyright and Competition Law – A Legal Analysis of Interoperability in Computer Programs*, pp. 13 *et seq.* (Kluwer Law International, Alphen aan den Rijn, 2010), and Determann, “Dangerous Liaisons – Software Combinations as Derivative Works? Distribution, Installation, and Execution of Linked Programs under Copyright Law, Commercial Licenses, and the GPL”, 21 *Berkeley Tech. L. J.* 1421 (2006).
- 33 Perzanowski, “Fixing RAM Copies”, 104 *Nw. U. L. Rev.* 1067 (2010). For most courts and authors, RAM copies are acts of reproduction within the meaning of copyright law. The exceptions to this understanding are rather limited (1999 LG Mannheim, CR, 360-62, *apud* Determann & Fellmeth, “Don’t Judge a Sale by Its License: Software Transfers Under the First Sale Doctrine in the United States and the European Community”, 36 *U.S.F. L. Rev.* 1 (2001), pp. 74-75). In the US, see specially *MAI Sys. Corp. v. Peak Computer, Inc.*, 991 F.2d 511 (9th Cir. 1993); and *Sony Computer Entertainment, Inc. v. Connectix Corp.*, 203 F.3d 596 (9th Cir. 2000): “Any purchaser of a copyrighted software program must

- copy the program into the memory of a computer in order to make any use at all of the program”.
- 34 In the same regard, concerning the right of reproduction for digital music copies, see Davis, “Reselling Digital Music: Is There A Digital First Sale Doctrine?”, 29 *Loy. L.A. Ent. L. Rev.* 363 (2009).
  - 35 Determann, *supra* note 32 at 1458 *et seq.*
  - 36 Merrill & Smith, “Optimal Standardization in the Law of Property: The Numerus Clausus Principle”, 110 *Yale L.J.* 1 (2000).
  - 37 See also Hansmann & Kraakman, “Property, Contract, and Verification: The Numerus Clausus Problem and the Divisibility of Rights”, 31 *J. Leg. Stud. (Supp.)*, S373 (2002).
  - 38 See *infra* section D.III.
  - 39 Long, “Information Costs in Patent and Copyright”, 90 *Va. L. Rev.* 465 (2004), p. 470.
  - 40 Smith, “Institutions and Indirectness in Intellectual Property”, 157 *U. Pa. L. Rev.* 2083 (2009).
  - 41 Smith, *supra* note 40 at pp. 2119-2120.
  - 42 Actually Smith suggests that supplementary mechanisms aiming at conveying information to potential acquirers exist, but in any case their positive impact on social welfare needs to be empirically assessed and confirmed. See Smith, *supra* note 40 at p. 2121. According to Smith, the problem in practice does not concern the amount of information but of attention (quoting Herbert Simon [Smith, *supra* note 40 at p. 2121]).
  - 43 Van Houweling, *supra* note 20 at 933; see also Merges, “The End of Friction? Property Rights and Contract in the ‘Newtonian’ World of On-Line Commerce”, 12 *Berkeley Tech. L.J.* 115 (1997), p. 122.
  - 44 However, disclosure of terms of use may prove counterproductive in many scenarios. Providing purchasers with a large amount of information may discourage acquirers from reading and comprehending the intended allocation of property rights. In this regard, see Ben-Shahar & Schneider, “The Failure of Mandated Disclosure”, 159 *U. Pa. L. Rev.* 647 (2011).
  - 45 It must be taken into account that a more flexible regime to alter legal rights and the correlative increase in measurement costs may create barriers to entry for non-specialized agents in that market, i.e. only sophisticated parties may actually understand the market.
  - 46 Van Houweling, *supra* note 20 at pp. 932-939.
  - 47 See Hovenkamp, “Post-Sale Restraints and Competitive Harm: The First Sale Doctrine in Perspective”, 66 *N.Y.U. Annual Survey Am. L.* 487 (2011); and Hovenkamp, “The Law of Vertical Integration and the Business Firm: 1880-1960”, 95 *Iowa L. Rev.* 863 (2010), pp.882-885.
  - 48 See Hovenkamp (2011), *supra* note 47 at pp. 488-490.
  - 49 The US Supreme Court has modified its antitrust legal approach to most post-sale restrictions. Instead of considering them illicit *per se*, the “rule of reason” standard is used to assess its validity. *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977): a vertical restraint aiming at a geographical segmentation is not illicit *per se* (reversing *U.S. v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967)); *State Oil Co. v. Khan*, 522 U.S. 3 (1997): a maximum resale price maintenance agreement is not illicit *per se* (reversing *Albrecht v. Herald Co.*, 390 U.S. 145 (1968)); and *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007): a minimum resale price maintenance agreement is not illicit *per se* (reversing *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911)). The turning point in Europe came with the ECJ Judgment in Case C-258/78, *Nungesser v. Commission*, which pointed out the pro-competitive effects of exclusive IP rights licenses. Afterwards, Commission Regulation (EC) No 772/2004 of 27 April 2004 on the application of Art. 81(3) of the Treaty to categories of technology transfer agreements (OJ L 123/11, 27.4.2004) has also promoted a less refractory approach to vertical restraints.
  - 50 See Bar-Gill & Parchomovsky, “Law and the Boundaries of Technology-Intensive Firms”, 157 *U. Pa. L. Rev.* 1649 (2009); and Barnett, “Intellectual Property as a Law of Organization”, 84 *S. Cal. L. Rev.* 785 (2011). This line of scholarship has its origins in Ronald Coase’s famous essay on the nature of the firm, which showed that contracts and equity ownership are two ways of pursuing the same goal within a firm. See Coase, “The Nature of the Firm”, 4 *Economica* 386 (1937).
  - 51 Commission Regulation (EC) No 772/2004 of 27 April 2004 on the application of Art. 81(3) of the Treaty to categories of technology transfer agreements (OJ L 123/11, 27.4.2004). Discussion of the Regulation exceeds the scope of this paper. For a detailed analysis, see Speyart, “Technology Transfer Block Exemption Regulation. Introductory Remarks”, in: Cottier & Véron (eds.), *Concise International and European IP Law. TRIPS, Paris Convention, European Enforcement and Transfer of Technology*, (Wolters Kluwer, Alphen aan den Rijn, 2011).
  - 52 Guidelines on the application of Art. 81 of the EC Treaty to technology transfer agreements (2004/C 101/02) (OJ C 101/2, 27.4.2004).
  - 53 Para. 17 of the Guidelines.
  - 54 Para. 17 of the Guidelines.
  - 55 In this regard, see Katz, “What Antitrust Law Can (and Cannot) Teach About the First Sale Doctrine”, 2012 (available at: <<http://ssrn.com/abstract=1845842>>), at p. 4.
  - 56 Secondary literature on price discrimination and intellectual property rights is abundant. Wendy J. Gordon has suggested that many institutions in intellectual property law can be explained through price discrimination (Gordon, *supra* note 12 at pp. 1367 *et seq.*). Other important references include Fisher, “Reconstructing the Fair use Doctrine”, 101 *Harv. L. Rev.* 1659 (1988); Besen, Kirby & Salop, “An Economic Analysis of Copyright Collectives”, 78 *Va. L. Rev.* 383 (1992); Lunney, “Reexamining Copyright’s Incentives-Access Paradigm”, 49 *Vand. L. Rev.* 483 (1996); Meurer, “Price Discrimination, Personal Use and Piracy: Copyright Protection of Digital Works”, 45 *Buff. L. Rev.* 845 (1997); Fisher, “Property and Contract on the Internet”, 73 *Chic-Kent L. Rev.* 1203 (1998); Benkler, “An Unhurried View of Private Ordering in Information Transactions”, 53 *Vand. L. Rev.* 2063 (2000); Boyle, “Cruel, Mean, or Lavish? Economic Analysis, Price Discrimination and Digital Intellectual Property”, 53 *Vand. L. Rev.* 2007 (2000); Cohen, “Copyright and the Perfect Curve”, 53 *Vand. L. Rev.* 1799 (2000); Meurer, “Copyright and Price Discrimination”, 23 *Cardozo L. Rev.* 55 (2001-2002); Fisher, “When Should We Permit Differential Pricing of Information”, 55 *UCLA L. Rev.* 1 (2007); Conley & Yoo, “Nonrivalry and Price Discrimination in Copyright Economics”, 157 *U. Pa. L. Rev.* 1801 (2009).
  - 57 Fisher, *supra* note 56 at 3. A technical definition of price discrimination is attributed to economist George J. Stigler (1911-1991), according to whom price discrimination is used when two identical or similar products with the same marginal cost of production are sold at different prices (Stigler, *Theory of Price*, 4th ed., [MacMillan, New

- York, 1987]). Nevertheless, definitions of this technique and the delimitation of its contours are critical. In this regard, see Motta, *Competition Policy. Theory and Practice*, p. 491, n. 106 (Cambridge University Press, Cambridge, 2004).
- 58 Effective price discrimination requires that the producer may prevent consumers who can buy the product at a low price from reselling it to other users who assign a higher value to the product. In *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996), Judge Easterbrook holds that “[t]o make price discrimination work, however, the seller must be able to control arbitrage [...]. Instead of tinkering with the product and letting users sort themselves out — for example, furnishing current data at a high price that would be attractive only to commercial customers, and two-year-old data at a low price — ProCD turned to the institution of contract”.
- 59 See Epstein, “ProCD v. Zeidenberg: Do Doctrine and Function Mix?”, in Baird (ed), *Contract Stories* (Foundation Press, New York, 2007), pp. 94 et seq.
- 60 A strong critique to the conventional view can be found at Lunney, “Copyright’s Price Discrimination Panacea”, 21 *Harv. J.L. & Tech.* 387 (2008).
- 61 See Burk, “The Law and Economics of Intellectual Property Rights: In Search of First Principles”, University of California at Irvine, School of Law, *Legal Studies Research Paper Series* No. 2012-60 (2012).
- 62 In this respect, see, for instance, Rub, “Contracting around Copyright: The Uneasy Case for Unbundling of Rights in Creative Works”, 78 *U. Chi. L. Rev.* 257 (2011), pp. 267 et seq.
- 63 Meurer, “Copyright and Price Discrimination”, 23 *Cardozo L. Rev.* 55 (2001-2002).
- 64 Hausman & MacKie-Mason, “Price Discrimination and Patent Policy”, 19 *RAND J. Econ.* 253 (1988).
- 65 For instance, there are no conclusive articles or reports showing the impact on social welfare of norms that forbid circumvention of technical protection measures and therefore indirectly facilitate discrimination of prices. See Rothchild, “Economic Analysis of Technological Protection Measures”, 84 *Or. L. Rev.* 489 (2005); and Rothchild, “The Social Costs of Technological Protection Measures”, 34 *Fla. St. U. L. Rev.* 1181 (2007).
- 66 This article does not discuss whether post-sale restrictions affecting copies of copyright protected works should be enforced according to contract law or copyright law, that is, whether the violation of a post-sale restriction gives rise to copyright infringement or only to breach of contract. See Ben Shahar, “Damages for Unlicensed Use”, 78 *U. Chi. L. Rev.* 7 (2010).
- 67 BGH, Beschluss v. 03.02.2011, Az. I ZR 129/08.
- 68 ECJ, Judgment of 3 July 2012, Case C-128/11, *UsedSoft GmbH v. Oracle International Corp.*
- 69 See Varian, *Intermediate Microeconomics*, 7th ed., p. 445 (W. W. Norton & Company, New York, 2005): “Second-degree price discrimination means that the monopolist sells different units of output for different prices, but every individual who buys the same amount of the good pays the same price. Thus prices differ across the units of the good, but not across people. The most common example of this is bulk discounts. Third-degree price discrimination occurs when the monopolist sells output to different people for different prices, but every unit of output sold to a given person sells for the same price. This is the most common form of price discrimination, and examples include senior citizens’ discounts, student discounts, and so on”.
- 70 LG München I, 15.03.2007 - 7 O 7061/06 (ZUM 2007, 409).
- 71 OLG München, 03.07.2008 - 6 U 2759/07 (ZUM 2009, 70).
- 72 Case C-128/11, *Usedsoft GmbH v. Oracle International Corp.* (OJ C-194/8, 2.7.2011).
- 73 In the field of copyright law, see, *inter alia*, ECJ Judgments of 16 July 2009, Case C-5/08, *Infopaq International A/S v. Danske Dagblades Forening*; and 26 April 2012, Case C-510/10, *DR and TV2 Danmark A/S v. NCB—Nordisk Copyright Bureau*.
- 74 Para. 41: “A uniform interpretation of the term ‘sale’ is necessary in order to avoid the protection offered to copyright holders by that directive varying according to the national law applicable”.
- 75 This pragmatic notion of “sale” contrasts with the differences highlighted by EU institutions between sales contracts and contracts for the supply of digital content, including computer programs. See, in this vein, the Proposal for a Regulation of the European Parliament and of the Council on a Common European Sales Law, 11.10.2011 (COM (2011) 635 final).
- 76 See Opinion of Advocate General Yves Bot delivered on 24 April 2012.
- 77 See, among other cases, *MAI Systems Corporation v. Peak Computer, Inc.*, 991 F.2d 511 (9th Cir. 1993); *Triad Sys. Corp. v. Se. Express Co.*, 64 F.3d 1330 (9th Cir. 1995); *DSC Commc’ns Corp. v. Pulse Commc’ns, Inc.*, 170 F.3d 1354 (Fed. Cir. 1999); *Adobe Systems, Inc. v. One Stop Micro, Inc.* 84 F. Supp. 2d 1086 (N.D. Cal. 2000); *Adobe Systems, Inc. v. Stargate Software Inc.*, 216 F. Supp.2d 1051 (N.D. Cal. 2002); *Wall Data, Inc. v. Los Angeles County Sherriffs Dep’t*, 447 F.3d 769 (9th Cir. 2006); *Vernor v. Autodesk, Inc.*, 621 F.3d 1102 (9th Cir. 2010); and *MDY Indus., LLC v. Blizzard Entm’t, Inc.*, 629 F.3d 928 (9th Cir. 2010). For a contrasting solution in the field of promotional CD copies, see *UMG Recordings, Inc. v. Augusto*, 628 F.3d 1175 (9th Cir. 2011).
- 78 US case law in the issue in question is rich. Courts have used different criteria to deny application of the first-sale or exhaustion doctrine to software licenses. For a detailed discussion, see Carver, “Why License Agreements Do Not Control Copy Ownership: First Sales and Essential Copies”, 25 *Berkeley Tech. L. J.* 1887 (2010).
- 79 See Recital 29 in the Preamble of the Information Society Directive: “The question of exhaustion does not arise in the case of services and on-line services in particular. This also applies with regard to a material copy of a work or other subject-matter made by a user of such a service with the consent of the rightholder. Therefore, the same applies to rental and lending of the original and copies of works or other subject-matter which are services by nature. Unlike CD-ROM or CD-I, where the intellectual property is incorporated in a material medium, namely an item of goods, every on-line service is in fact an act which should be subject to authorisation where the copyright or related right so provides”.
- 80 In practice, technical protective measures may eliminate exhaustion’s legal effects. In this regard, see BGH 11.2.2010 -I ZR 178/08-, “*Half Life 2*”, in which the German Supreme Court held that a prohibition on transferring an user account provided to access a computer game, which was sold on DVD, does not violate the principle of exhaustion, even if this means that the acquirer of the used DVD cannot in fact play the videogame.
- 81 It should be highlighted that the main actors in the digital markets have started to pave the way and protect themselves through technologies that would prevent resellers

from accessing digital content after the transaction occurs. In this respect, Amazon was issued a US patent in January 2013 describing “an electronic marketplace facilitating a secondary market for digital objects” that discloses a system that uses deletion to prevent reproduction of digital content after a transaction takes place. *See* Villasenor, “Rethinking A Digital First Sale Doctrine In A Post-Kirtsaeng World: The Case For Caution”, *CPI Antitrust Chronicle*, May 2013(2).

# Bittorrent Loses Again

## A Recent Lithuanian BitTorrent Case and What It Means for the Construction of the E-commerce Directive

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**Abstract:** This article first discusses a recent Lithuanian BitTorrent case, Linkomanija, with its shortcomings and perspectives. It then compares the outcomes of the Lithuanian case with recent court practice in Scandinavian countries (the Swedish Pirate Bay and Finnish Finreactor cases). Finally, it poses some questions as to whether BitTorrent sites

should be qualified as hosting services under Article 14 of the EU E-commerce Directive (2000/31/EC) and whether the application of the limited liability standard, as developed by the Court of Justice of the European Union, would be reasonable for BitTorrent file-sharing services in general.

**Keywords:** BitTorrent, File Sharing, E-commerce Directive, Intermediary Liability, Internet Service Provider, Hosting, Lithuania, Sweden, Finland, Linkomanija, Pirate Bay, Finreactor

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### A. Introduction: Copyright piracy and enforcement in Lithuania

- 1 Copyright enforcement in cyberspace (the Internet) is an important and difficult-to-tackle problem in Lithuania, as in the rest of the world. There are no reliable statistics on copyright violation rates in Lithuania in general. In regard to software, according to the survey conducted by the Business Software Alliance (BSA), software piracy in Lithuania accounted for 54 per cent of all software in 2011 (i.e. more than half of the software has been acquired and used illegally), whereas the commercial value of unlicensed software had reached around 44 million USD.<sup>1</sup> In the regional context, Lithuania is not unique, since the average piracy rate in Central and Eastern European countries is 62 per cent.<sup>2</sup> In the music and audio-visual sectors, online piracy levels are likely to be even higher.
- 2 The enforcement of online infringements in Lithuania is in its very first stages. The two main collecting societies in Lithuania (LATGA, representing authors, and AGATA, representing neighbouring rights

holders) have been individually consulting and assisting members who are trying to protect their online rights. Most disputes are solved through online notification systems and informal negotiation procedures; hardly any infringement cases reach the courts. The Lithuanian Anti-Piracy Association (LANVA), the association primarily focused on software piracy, has been more active and has initiated several – unsuccessful – court proceedings in the field. For example, in 2009 an individual user S. B. was accused of illegally downloading Microsoft Windows 7 and making this software publicly available on the Internet for non-commercial purposes using BitTorrent protocol. However, the case was dismissed due to procedural violations.<sup>3</sup> As another example, in 2012 the German company Digiprotect Gesellschaft zum Schutz Digitaler Medien mbH requested the main Lithuanian telecommunications company TEO to disclose the identities of its customers for the purpose of starting proceedings against them for illegal file sharing. After TEO refused to disclose the information, Digiprotect approached the court. However, the Vilnius Regional Court rejected the request, stating that revealing

such data to a private company would be contrary to the personal data protection laws, and this data can only be collected by pre-trial investigation officers.<sup>4</sup>

- 3 The first successful result in online copyright enforcement was reached in the *Linkomanija* case. In November 2012, the Vilnius Regional Court issued a ruling that the company N5 and its manager, K.E., were fully liable for contributing to copyright infringement occurring over the BitTorrent <www.linkomanija.net> website.<sup>5</sup> Although the process is not over (on 14 January 2013, defendants appealed the case to the Court of Appeal), this ruling may be a sign of a tougher stance towards online copyright protection in Lithuania.
- 4 This article will provide a more careful look at the weaknesses and perspectives of the *Linkomanija* case (part B). We will then briefly discuss what the *Linkomanija* case and other recent European BitTorrent cases (the Swedish *Pirate Bay* and Finnish *Finreactor* cases) mean in a broader European context, and whether the limited liability regime as provided under the EU E-commerce Directive should apply to such cases (part C).

## B. Linkomanija case: a right or wrong solution?

- 5 The *Linkomanija* case is a typical example of cases dealing with BitTorrent file-sharing services. The <www.linkomanija.net> website enables users, with the help of BitTorrent protocol, to download various (mostly illegal) content, including illegal copies of computer programs. The website contains a database of torrent files and a search function that gives users the opportunity to connect with each other and exchange content they store on their computers. Using torrent files and the information of the central station, it is possible to copy and distribute illegal copies of music, video works or software. Microsoft Co., the right holder of various computer programs illegally shared by users, requested the court to stop the illegal dissemination of software by closing down the <www.linkomanija.net> website; it also requested the operators of the website to pay maximum statutory damages equivalent to 130,000 LTL (approximately 37,680 EUR). On 10 December 2012, after more than three years of trial, the Vilnius Regional Court decided to fully satisfy the claim. Attention should be drawn to the interpretation of several important issues in the case.

### I. Unlawful activity

- 6 First, the court examined whether the defendants' actions should be considered illegal. The court found that the defendants themselves do not directly re-

produce or make copyrighted content publicly available. However, the defendants allow users to reproduce and share such content without the authorization of the right holder: "The defendants' unlawful actions consist of the fact that the defendants' file sharing service allows third parties to upload torrent files and provides a database of torrent files that allows third parties to search for and download torrent files...". It was also pointed out that the defendants support the functional operation of the *Linkomanija* website knowing that users are constantly infringing copyright and neighbouring rights, thus promoting such illegal activity and receiving a direct commercial benefit from it. Consequently, pursuant to Article 6.246(2) of the Civil Code of the Republic of Lithuania<sup>6</sup> and case law of the Supreme Court of Lithuania,<sup>7</sup> the court found that the defendants, by enabling reproduction and dissemination of illegal computer programs, indirectly made them publicly available. That is, the defendants are not accused of directly committing copyright infringement. Rather, they are responsible for contributing to the infringement based on the fact that they knew about the illegal activities occurring on their website and encouraged them.

- 7 Generally, the position of the court regarding the defendants' unlawful conduct looks reasonable. The "Linkomanija Project" was broadly known in Lithuanian society as basically designed for the illegal sharing of copyrighted content. On the other hand, the court's reasoning is weak (or non-existent) on certain aspects. First of all, it is not clear how concrete the knowledge about illegal activities of users should be. The court does not specify whether general knowledge about continuing violations is sufficient or whether the defendant must be aware of concrete infringing cases. Second, although the court notes that the defendant was commercially benefiting from this conduct, it remains unclear whether this is a mandatory condition of intermediary liability or a complementary one. Will the Internet service provider still be considered liable if s/he does not acquire commercial benefit from illegal activities? Third, the content of "promotion" of infringing conduct is not revealed either. Does a mere creation of a virtual platform intended for file sharing qualify as "promotion" of illegal conduct by end users? Or, rather, do more specific acts of promotion need to be proven? Also, there is no explanation as to what actions could be deemed "discouraging" (as opposed to promotion) of the illegal conduct (warning on liability for sharing of illegal content, content filtering, disclaimers, etc.). The court's reasoning regarding these aspects remains somewhere "between the lines". At the same time, these issues may be important for future cases of a similar nature. Other service providers who may be willing to develop legitimate online services are facing a difficulty in understanding what kind of actions should (or should not) be taken in order *not* to be held con-

tributorily liable for infringements carried out by the website users.

## II. Limited liability rules

- 8 Second, the defendants argued that illegal conduct was carried out by third parties and, therefore, the defendants' conduct should be subject to limited liability rules. According to Article 14 (1) and (2) of the Information Society Services Law (ISSL)<sup>8</sup> (corresponding to Article 14 of the EU E-commerce Directive<sup>9</sup>), a service provider is not responsible for information s/he stores if s/he is not aware of the on-going unlawful activity or, upon acquiring such knowledge, expediently takes action to terminate access to such information. The court declined the application of this provision, stating that the defendants

*...initiated the copyright infringements done by the users of the "Linkomanija Project", had absolutely all possibilities to control the users of the project and the content submitted by them, knew about specific copyright infringements and, if needed, had all possibilities to eliminate them. Consequently, the exemption provided in Article 14 of the Law cannot be applied in this case.*

### 1. Active vs. passive

- 9 As a first important aspect, the court states that the defendants were "initiating" and had "absolutely all possibilities" to control the users. Meanwhile, Article 14 of the Directive (as well as Article 14 of the ISSL) covers intermediary service providers that merely host information provided by end users (are passive) and do not initiate, select, modify or in any other way control the information (do not play an active role).<sup>10</sup> The court, unfortunately, did not specify what actions indicate that the service provider initiated illegal reproduction and distribution of copyrighted content or what means it had to control the users.
- 10 On the one hand, one could argue that the "Linkomanija Project" acts as an intermediary, a certain data "bridge" between users who exchange content. Defendants merely provide a platform where end users can upload torrent files (referring to any kind of information, both legal and illegal), search them, and, after identifying, download from computers of other end users. As already noted above, there was no evidence in the decision that the defendants in any way promoted (or initiated) the exchange of illegal files in particular. Creation of a virtual platform designed for file sharing does not necessarily mean that it was done on purpose to initiate copyright infringements, as such a platform can be used for an exchange of both legal as well as illegal content. On the other hand, the court's brief argumen-

tation on this issue can be justified by the fact that the <www.linkomanija.net> website has been widely known as one of the main sites in Lithuania whose *intent and purpose* is to facilitate the sharing of *illegal* content, and there is no evidence that the service provider denied it. There is also no evidence that the service provider had taken steps to promote the exchange of lawful content or restrict the sharing of illegal content.

- 11 Still, a brief statement that the service provider has initiated the infringement (without additional explanations of which conduct leads to that assumption) can lead to serious consequences for the Internet services market. Namely, one could argue that any website containing a search engine that enables users to search and download any (legal or illegal) information is actively promoting (the initiation of) illegal conduct by users. For example, with the help of the search engine Google Search, it is easy to locate illegal computer programs and download them. Would the mere fact that Google provides a search engine function be sufficient to claim that Google plays an active role in promoting infringements done by end users using the search engine? Here again one should refer to the founding goal and primary purpose of the particular Internet service. Google Search is a service which to a large extent is used for legitimate purposes (users search for a variety of information). Meanwhile the ultimate goal of the "Linkomanija Project", as was stated above, was the exchange of illegal copyrighted content. For this reason it can be said that the court was correct in stating that the defendants were not mere passive intermediaries but rather played an active role ("initiated" the infringements). Nevertheless, the argumentation and explanation could have been more detailed.

### 2. Actual knowledge

- 12 A second important issue is whether the defendants had actual knowledge about the infringements occurring through their website. Under Article 14 of the E-commerce Directive, the provider is not liable if s/he does not have actual knowledge of illegal activity or information and, as regards claims for damages, is not aware of facts or circumstances from which the activity or information is apparent. When applying this provision, the court states that the defendants "knew about specific copyright infringements". However, again, the court does not provide any evidence to support this statement.
- 13 On the one hand, when the main purpose of a particular website is facilitating the exchange of illegal content, the service provider cannot deny s/he knew about the illegal activities of end users. In the case at stake, the defendants did not dispute that they knew about the on-going infringements either. Therefore,

there is no need in this case to discuss in detail the “actual knowledge” or “awareness” requirement.

- 14 On the other hand, stating that the service provider “knew about *specific* copyright infringements” (emphasis added) and had a possibility to eliminate them goes slightly too far. If upheld by courts of higher instance and followed in later court practice, such an interpretation may have negative effects on the businesses of legitimate online service providers. First, one should look at criteria showing how an intermediary could acquire actual knowledge about specific copyright infringement. Under Article 15 of the E-commerce Directive, an intermediary does not have a general obligation to monitor the hosted content. Following this provision, Article 14(3) of the Lithuanian ISSL indicates that the criteria which indicate that the service provider had acquired knowledge about the illegal conduct or illegal content should be defined in a special governmental order.<sup>11</sup> Under this order, the service provider is considered to have acquired the knowledge only upon receiving a notification about the illegal conduct of users or illegal content hosted on his/her servers.<sup>12</sup> That is, from the wording of the order it seems that, as long as the specific copyright infringement was not properly notified to the intermediary, no “actual knowledge” can be established. The second question would then be whether the intermediary was “aware of facts and circumstances” from which the illegal activity or information is “apparent”. Here the court has to specify the evidence which shows that defendants had such an awareness (e.g. email communication of intermediary managers, widely accessible and read press publications on this issue, etc.). The mere statement that the intermediary “had actual knowledge” or “was aware” of infringements occurring over his/her website should in no case be sufficient.

### III. Defendant’s fault

- 15 Another important issue is the formation of fault. It is of special importance when determining the amount of damages. In the case at stake, the court stated that

*...the defendants knew (and even encouraged) placement of the torrent files on the website www.linkomanija.net and its database. Using these files plaintiff’s programs were made publicly available online and users of the system downloaded and reproduced illegal copies of software, while the defendants knowingly allowed the damage to occur.*

- 16 It concluded that the defendants acted intentionally. In particular, the court relied on Article 6.248(3) of the Civil Code and held that “the defendants failed to provide the required diligence, care and degree of caution which was necessary to ensure the legitimate use of the website owned by the defendants”.

- 17 The overall conclusion may seem reasonable. Since the founding purpose of the “Linkomanija Project” was to enable sharing of illegal copyrighted contents, one could assume that the defendants acted intentionally. At the same time, the court does not mention any evidence to support such a conclusion. Other intermediaries wishing to act legitimately may miss more elaborate explanations as to what should be the appropriate degree of diligence, care and caution in order to avoid liability. As has been repeatedly noted, the information service providers have neither a general obligation to monitor the information which they transmit or store, nor a general obligation to actively seek facts or circumstances indicating illegal activity. Since there is no such obligation, the degree of diligence, care and caution in each specific case could be measured by taking into account all circumstances of the case. When there is a risk that the website may be used for illegal purposes, the court may take into account e.g. whether the service provider is informing consumers that the exchange of files without the author’s consent is illegal, whether s/he is warning users against illegal use of the website, whether any filtering of legal and illegal content is applied, and whether the service provider has a notification system that enables reporting of infringing content and other applied measures. In the case at stake, there is no information whether any of these or other measures have been used by the defendant. At the same time certain guidance by the court as to required diligence criteria could be helpful for other service providers in deciding what actions they should take in order to ensure the appropriate level of diligence, care and caution when pursuing their online businesses.

### IV. Remedies

- 18 The final question is the proportionality of the remedies granted by the court. In the *Linkomanija* case, the defendants were ordered to shut down the <www.linkomanija.net> website as well as to pay maximum statutory damages equal to 130,000 LTL (appr. 37,680 EUR). These are the most stringent and maximum remedies available for copyright infringement.
- 19 As far as the injunction is concerned, its purpose stated by the court is “... to prevent the plaintiff’s rights violations referred to and further illegal activities...”. At the same time, as has been mentioned earlier, the website at stake can be used to distribute both legal and illegal content. It is not specified in the court decision to which extent <www.linkomanija.net> was used to distribute legal content and which part of all its content was illegal. These questions are of crucial importance when determining the severity of the sanctions. The obligation to close down the website is a sufficiently robust remedy that should be used when other measures (such

as an obligation to filter the content or terminate access to illegal information) are not effective.

20 Even if such a measure were reasonable in the case of Linkomanija (due to its illegal purpose), this case should be clearly distinguished from other online business models where the exchange of both legal and illegal content is taking place. For example, the popular website YouTube allows users to upload video clips and share them with others. While there is myriad legal and socially valuable content available through the platform, there is also a great deal of unauthorized copyrighted material on the YouTube website. It is virtually impossible to ensure that only legal content is distributed (and if it were possible, the costs would be too high). To cope with this problem, YouTube takes measures to promote legitimate content, enables right holders to notify them about infringing content and promptly removes the notified illegal information. Therefore, there is a significant difference between the websites where predominantly illegal content is being exchanged (like Linkomanija) and primarily (or partly) legitimate websites (like YouTube). It could be useful if this difference were reflected in the *Linkomanija* decision. The court could emphasize that the overall closure of the website was ordered because the website was enabling the distribution of mainly illegal content (based on specific evidence) and there is no proof that the defendants took any measures to limit such unauthorized use or promote the exchange of legitimate content.

21 The last issue to be considered is the amount of damages. Lithuanian laws allow claiming actual damages or requesting statutory damages. The plaintiff chose the latter option and, on the basis of Article 83 (4) of the Law on Copyright and Related Rights,<sup>13</sup> claimed the maximum statutory damages equal to 1,000 minimal living standards. According to this Article, statutory damages should take into account such criteria as the offender's fault, financial position, reasons for illegal conduct and other significant circumstances of the case, as well as criteria of fairness, justice and reasonableness. When applying this provision, the Vilnius Regional Court stated as follows:

*[E]very time s/he downloads a torrent file the user also downloads a copy of the claimant's copyrighted program. The factual analysis on 28 May 2009 demonstrated how it is possible to download files using the system operated by the defendants. It is clear that a considerable number of users were able to download programs and then distribute or otherwise use them. For this reason, also considering the extent and duration of violations and the defendants' intent, bad faith and reasonableness criteria, the court decided that there are grounds to fulfil the plaintiff's request for the maximum statutory damages - 130,000 LTL (i.e. 1000 minimal living standards).*

22 Without questioning the amount of compensation awarded, it should be noted that it is not clear how

the court applied some of the above-mentioned criteria. In particular, the judgment mentions "extent and duration of violations" but does not provide any details on this (e.g. how many illegal copies of the software have been downloaded or the time frame during which the violation took place). Similarly, the criterion of reasonableness is merely mentioned without providing any comments on its application.

23 Overall, the above analysis demonstrates that the overall conclusions of the court in the *Linkomanija* case are reasonable; however, the reasoning behind many of the issues is weak or entirely absent. It does not give sufficient clarity or guidance for other Internet service providers wishing to develop legitimate online businesses and not to be held liable for the illegal conduct carried out by end users of the service.

### C. The Linkomanija case in the European context

24 The next question is how the *Linkomanija* case looks in the European context and what questions it raises in relation to EU rules on intermediary liability.

#### I. European experience in fighting illegal content online

25 The Lithuanian *Linkomanija* case fits quite well into the recent European legal context. Since the appearance of BitTorrent technology,<sup>14</sup> file-sharing websites based on it have been closed down in several EU member states (e.g. Slovenia,<sup>15</sup> Netherlands,<sup>16</sup> UK,<sup>17</sup> Sweden<sup>18</sup> and Finland<sup>19</sup>). The most famous is the Swedish *Pirate Bay* case.<sup>20</sup> Despite the protests of the online community all around the world, in 2010 the Stockholm Court of Appeal confirmed the judgment of the first instance court and found the administrators of the Pirate Bay website criminally liable (with only certain adjustments in punishments). In 2012 this example was followed in Finland. The Finnish Supreme Court confirmed that the administrators of the largest Finnish BitTorrent file-sharing website Finreactor could incur criminal liability for copyright violation.<sup>21</sup> Therefore, the results in the *Linkomanija* case came to nobody's surprise. Although the Lithuanian *Linkomanija* case is weak in argumentation, the decision follows the recent European trends.

26 What should Lithuania (and other countries starting the fight against illegal online content) expect next? In a broader European context, the closure of obviously illegal file-sharing websites is just one of the (first) tactics that are used when fighting copyright infringements online. Right holders in Western European countries have been experimenting

with other legal measures as well. For instance, when a website is not easily reachable in a particular jurisdiction (e.g. it is established in another country), right holders can request the national Internet access service providers to block access to the website.<sup>22</sup> In order to discourage private consumers from file sharing, right holders can request Internet service providers to disclose the identities of their consumers,<sup>23</sup> and afterwards can sue them for illegal downloading (reproduction) and sharing (making available) of the content.<sup>24</sup> In most cases these claims are brought through civil proceedings, but criminal prosecutions have also been successfully tried.<sup>25</sup> Finally, the websites that make available both legal and illegal content (the “semi-legal” websites) are requested not only to take down the notified illegal content but also to ensure that it will not appear again (i.e. apply monitoring or filtering technologies and even manual checking systems).<sup>26</sup>

- 27 These legal battles have been more successful in some countries than in others, and there is no unified European practice in this field. Therefore, it will be even more interesting to see in which direction Lithuania and other countries with first enforcement experiences will move. Up to now, Lithuanian courts have rejected, for different reasons, both requests by private companies to disclose user identities and claims against private persons for file sharing.<sup>27</sup> As the pressure from right holders inside and outside the country gets higher and there is a chance to learn from more successful colleagues in other countries of the EU, upcoming enforcement attempts might be more successful. Therefore, closing down the illegal file-sharing websites such as Linkomanija is likely to be just a first step in right holders’ (long) fight against illegal copyrighted content online.

## II. E-commerce Directive: issues that still need to be clarified

- 28 As more cases against online intermediaries running BitTorrent websites might be expected across Europe, it is worthwhile to highlight some of the issues of the EU law that may raise some questions, in particular limited liability rules under the E-commerce Directive.<sup>28</sup> The three most recent cases concerning BitTorrent websites – the Swedish *Pirate Bay*, the Finnish *Finreactor* and the Lithuanian *Linkomanija* cases – demonstrate that some rules of the E-commerce Directive may need some clarification in order to be unitarily applied for BitTorrent sites throughout the EU.

### 1. Do BitTorrent sites provide “information storage” services?

- 29 First of all, the Swedish court in the *Pirate Bay* case, the Finnish court in the *Finreactor* case and the Lithuanian court in the *Linkomanija* case (explicitly or implicitly) found that BitTorrent websites meet the definition of information society services. Moreover, without much argument the courts assumed that these services fall in the scope of national provisions on hosting (i.e. those transposed from Article 14 of the E-commerce Directive).<sup>29</sup> Such a conclusion is not as self-evident as it might seem at first glance.
- 30 A torrent metafile in itself does not store the copyrighted content. Rather, these files merely serve as links to the content that is stored in users’ computers. This also means that BitTorrent websites do not store copyrighted content but are merely (searchable) collections of “links” that refer to such content. With the help of these search engines, users identify the needed torrent file and then, by clicking on the one chosen, download the copyrighted content that is stored in the computers of private users. Here the question emerges whether such a website should be considered to provide hosting services. In particular, was Article 14 of the E-commerce Directive meant to provide limited liability for service providers that store the illegal content itself, or also service providers which store information that is not infringing itself but that may lead or facilitate access to illegal information stored somewhere else?
- 31 Article 14 of the Directive does not directly refer to *illegal* information,<sup>30</sup> and none of the recitals specifically address this issue either.<sup>31</sup> The Court of Justice of the European Union (CJEU) case law interpreting Article 14 also does not directly specify on this. For instance, in the *Google v. Luis Vuitton* case,<sup>32</sup> the CJEU finds that the fact that the advertiser “stores, that is to say, holds in memory on its server, certain data, such as the keywords selected by the advertiser, the advertising link and the accompanying commercial message, as well as the address of the advertiser’s site” is sufficient for the service to fall in the scope of Article 14.<sup>33</sup> Here the CJEU mentions not only content that is claimed to be illegal (keywords that contain a protected mark) but also other information which is not illegal *per se* (link and advertising message). Therefore, it may seem that Article 14 concerns not only websites that directly store illegal (and also legal) copyrighted content (e.g. YouTube or Rapidshare) but also those that store not-copyrighted information that facilitate access to copyrighted content stored elsewhere (e.g. file-sharing sites that store torrent files). Such an interpretation would mean that both kinds of websites fall under the limited liability regime offered by Article 14 of the E-commerce Directive.

32 On the other hand, such an extensive interpretation would mean that Article 14 applies not only to BitTorrent file-sharing sites, but also to websites containing any other information facilitating the access to illegal content, such as lists of links to illegal material or search engines (as a result of a requested search, search engines provide links to illegal material *inter alia*). From a technological point of view, BitTorrent websites are a mixture of links (BitTorrent files) and search engines (searchable databases that help to find the needed BitTorrent files) rather than information storage services. Therefore, if BitTorrent websites were subject to Article 14 of the E-Commerce Directive, the same legal treatment of linking services and search engines could be expected.

33 At the same time, information location tools (such as links and search engines) were intentionally not included in the E-Commerce Directive.<sup>34</sup> For good or bad reasons, EU legislators at that time decided to leave the question of liability for the provision of links and search engines to the discretion of the Member States. Up to now, cases concerning links and search engines have normally been solved under the national liability rules of the EU Member States.<sup>35</sup> Therefore, as BitTorrent sites function in a similar way to information location tools (they do not contain information themselves but rather facilitate the access to information stored elsewhere by providing a searchable database of links), it would be more logical to exclude them from the scope of Article 14 of the Directive. In that case, for good or for ill, BitTorrent websites would be subject to the national liability rules of EU Member States.

## 2. Torrent website – “passive” or “active” service?

34 If a limited liability regime as suggested under Article 14 of the E-commerce Directive were applied anyway to BitTorrent file-sharing services,<sup>36</sup> one of the main questions would be whether a BitTorrent service could be qualified as a mere (“passive”) intermediary or rather as an “active” participant in the illegal conduct of its end users.

35 According to the CJEU, a service provider should be “neutral, in the sense that its conduct is merely technical, automatic and passive, pointing to a lack of knowledge or control of the data which it stores”.<sup>37</sup> Otherwise, a service provider does not qualify for a limited liability regime under Article 14 of the E-commerce Directive. Which conduct is considered active involvement has to be decided on a case-by-case basis. For instance, in the *Google v. Vuitton* case, the CJEU points out that

*the mere facts that the referencing service is subject to payment, that Google sets the payment terms or that it provides*

*general information to its clients cannot have the effect of depriving Google of the exemptions from liability provided for in Directive 2000/31. Likewise, concordance between the keyword selected and the search term entered by an Internet user is not sufficient of itself to justify the view that Google has knowledge of, or control over, the data entered into its system by advertisers and stored in memory on its server.*<sup>38</sup>

36 On the other hand, “the role played by Google in the drafting of the commercial message which accompanies the advertising link or in the establishment or selection of keywords is relevant”.<sup>39</sup> In the *eBay v. L’Oreal* case, the CJEU concluded that

*[w]here, by contrast, the operator has provided assistance which entails, in particular, optimising the presentation of the offers for sale in question or promoting those offers, it must be considered not to have taken a neutral position between the customer-seller concerned and potential buyers but to have played an active role of such a kind as to give it knowledge of, or control over, the data relating to those offers for sale.*<sup>40</sup>

37 The courts in the analysed national cases concerning BitTorrent file-sharing services (*Pirate Bay*, *Finreactor* and *Linkomanija*) have established the active role of the service providers. For instance, in the Lithuanian *Linkomanija* case, the court merely stated that “from the case materials it could be seen that the defendants initiated the copyright infringements done by the users of the ‘Linkomanija Project’, they had absolutely all possibilities to control the users of the project and the content submitted by them (...)”.<sup>41</sup> In the Finnish *Finreactor* case, the court was a bit more detailed and explained that

*[t]he Finreactor file-sharing network has come down to united action between the administrators and the users, aiming at and leading to the infringement of the economic rights of the copyright holders on a large scale. The defendants have been aware of this purpose of the network and through their administration they have participated in the copyright infringements carried out in the network together with the network users in a manner that constitutes liability as perpetrators or abettors, respectively.*<sup>42</sup>

38 In the *Linkomanija* case, the court did not specify which conduct indicated that the service provider “initiated” and had “absolutely all possibilities to control the users [...] [and] all possibilities to eliminate [infringements]”. There is no information in the case that the intermediary did more than create a website infrastructure that allowed users to search and share torrent files. If this is all that was done, one could argue that evidence is lacking that could prove the intermediary’s sufficiently active role. Google or eBay have also created the websites and infrastructure for users that allowed not only uploading the link but also uploading the potentially infringing content itself, searching it and using (viewing, downloading, etc.) the identified material. Still, this was not considered sufficient by the CJEU to establish the active role by the service providers.

- 39 In regard to the *Finreactor* case, the court claims that Finreactor administrators played an active role mainly because they knew about the purpose of the website users to illegally share copyrighted material, and administrated the website knowing this purpose. Apart from knowledge, however, the court does not indicate what specific conduct shows that the intermediary's role was more than to create and administer the searchable database of torrent files that may lead to sharing of both legal and illegal content.
- 40 This demonstrates that in the analysed BitTorrent cases, national courts applied a much broader definition of "active". Namely, in the *Linkomanija* case, the mere creation of a website and its administration implied an active role. In the *Finreactor* case, the court mixed up this requirement with a knowledge requirement: as the service provider knew about illegal purposes of website users and still administrated it, its role was considered active. Although the final result of the court analysis – the non-application of limited liability rules – may be correct, such an extensive definition of "active" does not follow the more narrow approach proposed by the CJEU.<sup>43</sup> Meanwhile, as already mentioned earlier, a broad construction of an "active role", as applied by national courts, may cause problems for other websites (e.g. "semi-legal" websites where the website is used for sharing both legal and illegal content, such as YouTube or Daily Motion). If an "active role" is construed broadly, service providers will be excluded from the limited liability regime merely because they created and administer a website which, to a certain extent, is also used for illegal purposes. It is therefore suggested that courts, when determining the active role of the service provider, should more clearly indicate the conduct by which the service provider actively intervenes in the conduct of users (e.g. by checking or controlling their content, promoting certain content, etc.). Only if specific and significant intervention by the service provider into the activities of end users can be identified can the "active role" be considered proven.

### 3. Did BitTorrent service operators "know" about the infringements?

- 41 Finally, national courts in intermediary liability cases often find it difficult to determine whether a service provider had (sufficient) knowledge about the illegal information stored in their websites. Under Article 14 of the E-commerce Directive, the provider is not liable if it does not have actual knowledge of illegal activity or information and, as regards claims for damages, is not aware of facts or circumstances from which the activity or information is apparent; or upon acquiring knowledge or awareness expediently acts to remove the illegal content. From
- the context of the Directive it is clear that a general awareness of the service provider about the possibility (or certainty) of some illegal content on the website does not automatically exclude the provider from the limited liability regime. However, it has been disputed how specific the knowledge should be. Service providers normally want exact information and proof of which file is illegal and where it could be found. Meanwhile, if right holders cannot expect service providers to monitor their contents (such a general duty is prohibited by the E-commerce Directive), then at least they expect them to take measures to check for illegal information and remove or block it upon obtaining any kind of warning or information.
- 42 In all the national cases analysed (*Pirate Bay*, *Finreactor* and *Linkomanija*), the courts found that the service providers had knowledge about the infringing conduct of end users, even if service providers were not specifically notified and did not know about the specific infringing files. For instance, in the *Pirate Bay* case, the court explained that
- [i]t has not been demonstrated that the defendants knew that the specific works listed in the indictment had been made available via The Pirate Bay. The defendant's intent does not, however, have to cover the specific works which it is alleged have been made available. It is, rather, sufficient for them to have had the intent to bring about the existence of copyright-protected material on the website (...). The examination of the defendants, the letters from rights holders published on the website, The Pirate Bay, and the e-mail correspondence indicating that the operation involved pirate copying make it clear that the defendants have been aware that copyright protected works were available via the website, and were shared via the tracker embedded within the framework of The Pirate Bay's operation. Despite this knowledge, they have elected to take no action to prevent the infringement of copyright.*<sup>44</sup>
- 43 The court also pointed out that "[i]t must have been obvious to the defendants that the website contained torrent files which related to protected works".<sup>45</sup> In comparison, in the *Linkomanija* case, the court was very short on this and just stated, without additional argument, that the defendants "knew about specific copyright infringements and in case of need had all possibilities to remove them".<sup>46</sup> Unfortunately, no more proof or discussion on the extent of knowledge was provided by the court.
- 44 It is questionable whether the knowledge standard set in these national BitTorrent cases is compatible with the interpretation of knowledge requirement under the E-commerce Directive as defined by the CJEU. In the *eBay v. L'Oréal* case, the CJEU pointed out that "it is for the referring court to consider whether eBay has, in relation to the offers for sale at issue and to the extent that the latter have infringed L'Oréal's trade marks, been aware of facts or circumstances from which the illegal activity or information is apparent"<sup>47</sup> (emphasis added). This implies that it is not sufficient for the service provider to generally be

aware that there is some illegal content on the website at stake. Rather, s/he has to be aware of facts and circumstances from which it is clear that the specific object of the dispute (here L'Oreal trademarks used on eBay) is illegal. Furthermore, the court specifies the situations in which awareness could be acquired, in particular (but not exclusively?), when “the operator of an online marketplace uncovers, as the result of an investigation undertaken on its own initiative, an illegal activity or illegal information, as well as a situation in which the operator is notified of the existence of such an activity or such information”.<sup>48</sup> This implies that, in order to acquire awareness of the violations, certain procedures (such as own investigation or notification by any person) are normally needed that lead to certain facts or information that make it apparent for the intermediary that the disputed content is illegal.

- 45 In all three BitTorrent cases, national courts found that it was obvious for the service providers that their websites are used for illegal file sharing. Since the intent or founding purpose of the websites was to enable illegal file sharing, the courts found no need to more specifically prove that the service provider knew that the website contained torrent files referring to specific illegal content (e.g. Microsoft's programmes in the *Linkomanija* case). The courts also did not request an indication of the facts and circumstances from which it should have been apparent to the service provider that his/her service hosted the disputed illegal content. This means that the courts have applied a much more “loose” knowledge requirement than the one adopted by the CJEU.
- 46 At the same time, it is questionable whether the rather strict knowledge standard adopted by the CJEU would be suitable to the BitTorrent cases at stake. In all three cases it was found that the founding purpose essentially was to enable predominantly illegal file sharing. In such cases, the requirement to prove the specific knowledge or awareness of specific infringements may seem unnecessary or even an excessive requirement. When the obviously illegal file-sharing website is at stake, it would be unreasonable to require right holders to prove that service providers had knowledge of each specific infringement. And if sufficient evidence on specific knowledge or awareness is not provided, it would be unfair to apply limited liability rules to such obviously illegal websites.
- 47 At the same time, as has been noted earlier, such predominantly illegal file-sharing services should be clearly separated from the services which are to a significant extent used for legal purposes (e.g. YouTube, Dailymotion or Rapidshare websites). Here, the tougher CJEU knowledge standard is reasonable. In the case of such “primarily legal” services, the application of the limited liability regime could be rejected only if it is proven that the service provider

had actual knowledge of a specific infringement or, for example, due to its own investigation or other notifications, was aware of facts and circumstances from which it was obvious that the specific information or conduct is illegal. The difficult question in such cases is how active the service provider should be in seeking knowledge about potential infringements and preventing them. For instance, the German Supreme Court has set rather high monitoring requirements. In a case concerning a file-hosting website Rapidshare,<sup>49</sup> the court found that when the service provider is informed about the infringing content hosted on the website, it not only has to prevent the access to this content but also check link collections on other websites in order to identify and block links referring to the notified illegal content hosted on its servers. One may question whether such a monitoring duty is compatible with the prohibition of a general monitoring duty under Article 15 of the E-commerce directive and as recently confirmed by the CJEU.<sup>50</sup>

## D. Conclusions

- 48 The *Linkomanija* decision is a first successful attempt by right holders in fighting online copyright infringements in Lithuania. The outcome of the case is generally correct, though the argumentation of the court on many of the issues is weak (or entirely absent). It does not make it clear for other Internet service providers how they should meet the conditions of Article 14 of the Information Society Services Act (and Article 14 of the E-commerce Directive). A more careful and differentiated analysis of limited liability rules is needed, and specific evidence to prove or deny the existence of each condition of the limited liability regime should be identified.
- 49 In a broader European context, the Lithuanian *Linkomanija* decision does not suggest much that is new; instead, it shows that the wave of stronger copyright enforcement online is moving to smaller European markets. The comparison of the three most recent national cases on BitTorrent websites (the Swedish *Pirate Bay*, Finnish *Finreactor* and Lithuanian *Linkomanija* cases) raises some additional questions in regard to the applicability of the EU E-commerce Directive to BitTorrent services. First of all, it is questionable whether Article 14 of the E-commerce Directive is applicable to BitTorrent file-sharing services at all. BitTorrent sites do not *strictu sensu* provide hosting (storage) services (they do not host copyrighted content). They rather resemble information allocation tools (links and search engines) that were intentionally left outside the scope of the E-commerce Directive. Second, it is doubtful whether limited liability rules, as interpreted by the CJEU, are suitable and reasonable for the BitTorrent file-sharing cases analysed. For instance, BitTorrent service

providers could be potentially qualified as “passive” intermediaries as long as they merely create and administer the platform for sharing of any kind of content (and do not promote specific content, select it, modify it or in any other way intervene in the conduct of users). Also, as long as BitTorrent service providers are not notified about the specific illegal conduct, it may be difficult to prove that they have more than a general awareness about (possibly) illegal conduct occurring over their website. It may therefore happen that BitTorrent websites – “passive” and with no “actual knowledge” about the infringements – may meet the conditions of Article 14 of the E-Commerce Directive and in this way escape liability. At the same time it is highly doubtful whether websites widely known for their illegal purposes should be given a chance to “hide” in the “safe harbour” provided by the EU law.

- 1 BSA, Global Software Piracy Study: Shadow Market (9th ed., 2011), p. 8, <[http://portal.bsa.org/globalpiracy2011/downloads/study\\_pdf/2011\\_BSA\\_Piracy\\_Study-Standard.pdf](http://portal.bsa.org/globalpiracy2011/downloads/study_pdf/2011_BSA_Piracy_Study-Standard.pdf)>.
- 2 In comparison, in Western Europe this figure is appr. 32 - 33 per cent, id, p. 8-9.
- 3 Supreme Administrative Court of Lithuania, administrative case No. N62-902/2011.
- 4 Vilnius District Court, civil case No. 2S-1416-302/2012.
- 5 Vilnius District Court, civil case No. 2-742-262/2012 - Linkomanija.
- 6 Civil Code of the Republic of Lithuania, 18 July 2000, No.VIII-1864.
- 7 Supreme Court of Lithuania, civil case No. 3K-3-270/2006.
- 8 Information Society Services Law of the Republic of Lithuania, 25 May 2006, No. X-614.
- 9 Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market (“Directive on electronic commerce”), OJ L 178 , 17/07/2000 p. 0001 - 0016.
- 10 For more about this requirement, see *infra* text.
- 11 This order was adopted by the Government of the Republic of Lithuania on 22 August 2007, No. 881.
- 12 See Order, id, Art. 22.
- 13 Law on Copyright and Related Rights of 18 May 1999, No. VIII-1185 (with subsequent amendments).
- 14 For a short description of emergence and functioning of BitTorrent protocol, see Vincents, “*Secondary Liability for Copyright Infringement in the Bit Torrent Platform: Placing the Blame Where It Belongs*”, 30/1 European Intellectual Property Review 4, 6 (2008).
- 15 In Slovenia, the website SuprNova was closed down after legal threats in 2004; see “*SuprNova - Back with a bang?*”, posted on 14 September 2005, available at: <[http://www.slyck.com/story908\\_SuprNova\\_Back\\_with\\_a\\_bang](http://www.slyck.com/story908_SuprNova_Back_with_a_bang)>.
- 16 In the Netherlands, a BitTorrent site Leaseweb was said to be a “hybrid of links and file sharing” that “structurally facilitates the infringement of copyright and related rights”; see *Stichting Brein v. Leaseweb*, No. 369220/KG ZA 07-850 AB/MV (D.Ct. Amsterdam, Civ. Sector, 21 June 2007), *aff’d*, LJN: BD 6223, Amsterdam court, 106.007.074/01 KG (Amsterdam Ct. App. 3 July 2008).
- 17 In UK, the website OiNK was closed in 2007. In December 2008 four of the former OiNK members pleaded guilty at Teesside Crown Court, where they were charged with copyright infringement offences. Three were sentenced to a total of 330 hours of community service and court costs of £378 each, and the other was fined £500; see “Police shut down website after two-year music piracy inquiry”, *The Guardian*, 24 October 2007, available at: <<http://www.guardian.co.uk/technology/2007/oct/24/piracy.crime>>.
- 18 Stockholm District Court decision B 13301-06 of 17 April 2009 – *The Pirate Bay*, unofficial translation was available at: <[www.ifpi.org](http://www.ifpi.org)> (2009-12-30); appeal was lost on 26 November 2010, see “Pirate Bay co-founders lose appeal”, *The Guardian*, 26 November 2010, available at: <<http://www.guardian.co.uk/technology/2010/nov/26/pirate-bay-founders-appeal>>.
- 19 Decision of the Supreme Court of Finland (Korkeinoikeus), 30 June 2010 - KKO 2010:47, translation available in IIC 2012, 43(6), 725-734, (Finreactor).
- 20 *Supra* note 18.
- 21 *Supra* note 19.
- 22 E.g. Sonofon, a Danish Internet access provider was ordered to terminate access in Denmark to the Swedish website the Pirate Bay (Supreme Court of Denmark, 27 May 2010, IFPI v. Sonofon (DMT2) (Denmark)); in Norway, an Internet service provider was held not responsible for blocking BitTorrent file-sharing services in Norway (*Bonnier Amigo Music Norway AS v. Telenor ASA*, Unreported, February 9, 2010 (Norway), translation and comment in 21(6) Ent. L.R. 237 (2010)).
- 23 Disclosure of user identities in civil enforcement cases was said to be compatible with EU law (CJEU decision C-461/10 of 19 April 2012 - *Bonnier Audio AB and Others v. Perfect Communication Sweden AB*); such disclosure is being applied in most countries, e.g. UK (*Golden Eye (International) Ltd v. Telefonica UK Ltd* [2012] EWHC 723 (Ch)), also Germany; but denied in others, e.g. Switzerland (*Bundesgericht Urteil vom 8. September 2010 1C\_285/2009, EDÖB v. Logistep AG*), also Spain, Lithuania.
- 24 E.g. in Scotland, *Anne Muir*, 58, was convicted for distributing £54,000 worth of copyrighted music files by making them available to others via a peer-to-peer file sharing application (*Ayr Sheriff Court, Scotland*, 11 October 2011).
- 25 E.g. Swedish Pirate Bay, Finnish Finreactor case, see *supra* notes 18 and 19; for outside Europe, see e.g. Australian Big Crook case of 2005 as discussed in Steven Gething, “Criminal Infringement of Copyright: The Big Crook Case”, in: Fitzgerald et al. (eds), *Copyright law, digital content and the Internet in the Asia-Pacific* 367-380 (Sydney University Press 2008).
- 26 E.g. the German Supreme Court confirmed that the file-hosting website Rapidshare, after being notified, has to take all economically and technically feasible measures so that the notified illegal content does not reappear on the website (BGH of 12 July 2012 I ZR 18/11-*Alone in the Dark*); the CJEU confirmed that a broad general monitoring duty violates the EU law (CJEU decision C-70/10 of 24 November 2011 *Scarlet Extended SA v. SABAM*).
- 27 See *supra* notes 3 and 4.
- 28 Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market (“Directive on electronic commerce”), OJ L 178, 17.7.2000, p. 1-16.
- 29 See Stockholm District Court - *The Pirate Bay*, unofficial translation, p. 56: (“The fact that The Pirate Bay offered a service where the user could upload and store torrent files on the website means, instead, that it is a matter of the type of storage service covered by the provisions of § 18 of the Electronic Commerce Act” (Bill 2001/02:150, p. 21)). Finreactor case, para. 30 (“The Finreactor network involved, among other things, storing torrent files uploaded by network users to the server administered by the defendants. From this perspective, Sec. 15 of the E-Commerce Act, which provides for

exemption from liability in hosting services, could, as the defendants have argued in the appealed case, be applicable”).

- 30 Article 14 reads “Where an information society service is provided that consists of the storage of information provided by a recipient of the service, Member States shall ensure that the service provider is not liable for the information stored at the request of a recipient of the service (...)”.
- 31 Recital 46 of the Directive specifically commenting on Article 14 does not mention this issue at all.
- 32 CJEU decision C-236/08 to C-238/08 of 23 March 2010, Google France SARL and Google Inc. v. Louis Vuitton Malletier SA and Others.
- 33 CJEU - Google v. Louis Vuitton, para. 111.
- 34 Even before the adoption of the EU Directive, such a special provision was included in the US Digital Millennium Copyright Act DMCA § 512(d); however, EU legislators decided to specifically leave it off in the case of the Directive; see also Verbiest, Spindler, Riccio, der Perre, “*Study on the liability of Internet intermediaries*”, 12 Nov 2007, available at: <[http://ec.europa.eu/internal\\_market/e-commerce/docs/study/liability/final\\_report\\_en.pdf](http://ec.europa.eu/internal_market/e-commerce/docs/study/liability/final_report_en.pdf)> (2013 05 15), p. 17.
- 35 Some EU member states have adopted specific rules for search engines and linking services in their national laws (often similar to limited liability rules applied to host providers); some others apply in such cases general liability rules. For more, see Verbiest, Spindler, Riccio and der Perre, supra note 34, pp. 88-99.
- 36 EU Member State courts have often applied, on a different legal basis, the limited liability regime to search engines and linking websites; see Verbiest, Spindler, Riccio and der Perre, supra note 34, pp. 88-99.
- 37 See CJEU - Google v. Louis Vuitton, paras.114 and 120.
- 38 CJEU - Google v. Louis Vuitton, paras. 116-117.
- 39 CJEU - Google v. Louis Vuitton, para. 118.
- 40 CJEU decision C-324/09 of 12 July 2011- L’Oréal SA v. eBay Int., para. 116.
- 41 Vilnius District Court - Linkomanija, p. 4.
- 42 Supreme Court of Finland - Finreactor, paras. 31-32.
- 43 See also Bassett, “*Unanswered Arguments after the Pirate Bay Trial: Dropping Sail in the Safe Harbors of the EU Electronic Commerce Directive*”, 12 N.C. J.L. & Tech. 67 (2010-2011), pp. 94-95 (“the concordance between user-created torrent files and the search term entered by a user to find a particular file may not be sufficient of itself to justify the view that The Pirate Bay has knowledge of, or control over, the data entered into its system by users and stored in memory on its server.”).
- 44 Stockholm District Court - Pirate Bay, p. 52.
- 45 Stockholm District Court - Pirate Bay, p. 56.
- 46 Vilnius District Court - Linkomanija, p. 4.
- 47 CJEU – L’Oréal SA v. eBay Int, para. 120.
- 48 CJEU – L’Oréal SA v. eBay Int, para. 122.
- 49 German Supreme Court decision of 15 August 2013, I ZR 80/12.
- 50 CJEU decision C-360/10 of 16 February 2012 – SABAM v. Netlog NV.

# Facebook's Real Name Policy

## Bye-Bye, Max Mustermann?

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**Abstract:** Facebook requires all members to use their real names and email addresses when joining the social network. Not only does the policy seem to be difficult to enforce (as the prevalence of accounts with people's pets or fake names suggests), but it may also interfere with European (and, in particular, German) data protection laws. A German Data Protection Commissioner recently took action and ordered that Facebook permit pseudonymous accounts as its current anti-pseudonymous policy violates § 13 VI of the German Telemedia Act. This provision requires telemedia providers to allow for an anonymous or pseudonymous use of services inso-

far as this is reasonable and technically feasible. Irrespective of whether the pseudonymous use of Facebook is reasonable, the case can be narrowed down to one single question: Does German data protection law apply to Facebook? In that respect, this paper analyses the current Facebook dispute, in particular in relation to who controls the processing of personal data of Facebook users in Germany. It also briefly discusses whether a real name policy really presents a fix for anti-normative and anti-social behaviour on the Internet.

**Keywords:** Facebook, Real Names, Data Protection, Personal Data, Germany

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## A. Introduction

1 One of the appealing integral characteristics of the Internet is anonymity, meaning the ability to conceal one's identity while communicating.<sup>1</sup> The real author of a message is then not identifiable. In this context, if we speak of anonymity, this also encompasses the use of pseudonyms. On the Internet, users often use screen names, i.e. pseudonyms, when they post messages, chat or are otherwise communicating. The advantage of using a pseudonym instead of remaining completely anonymous is that while concealing one's real identity, it is possible for third parties to recognise that different messages are written by the same author. Pseudonyms allow the allocation of postings to a specific user whose real name is not known to the public. Even where real identity

becomes important for the recipients of the communication – for example, on online auction sites like eBay – the real identities of users are not revealed to the general public. Only where a contract of sale is established will the anonymity of seller and buyer be lifted to allow the performance of the sales contract. Of course, there are also online transactions that require a priori real identity verification, such as banking transactions, for example. However, recently Internet service providers like Google (in relation to their Google+ service) and Facebook have forbidden the use of pseudonyms, demanding from members that their online identity be the same as in the offline world.<sup>2</sup> More than the world's largest social network, Facebook in particular is a huge data-mining machine capturing and processing every click and interaction on its platform. Obviously,

the harvested data becomes more valuable if it can be linked to real persons with real names. Hence, it is no surprise that Facebook vigorously advocates the use of real names in the online world. Officially, they do so in the interest of their users, arguing that a real name policy may serve as a fix for bad behaviour, in particular cyberbullying, trolls and illegal activities. The underlying assumption in this respect is that users will refrain from anti-social and anti-normative behaviour if their name is attached to a posting.

- 2 It is not surprising that Facebook appealed orders by a German data protection authority which required Facebook to allow pseudonyms on user profiles. Under German law, telemedia service providers are obliged to allow the pseudonymous or anonymous use of their service as long as this is reasonable and technically feasible. While primarily the question of the legitimacy of the mandatory real name policy was in the public eye, the court did not discuss this question in detail as the outcome of the case depended on one single question: Does Facebook have to respect German data protection law? This would be the case if German data protection applied to Facebook. The whole discussion thus centres around the basic question of applicable law for a globally active service provider.
- 3 In order to answer this question, it is crucial to determine whether there has been a valid choice of German law, and to determine where and by whom data is being processed. In the following, this paper will look into Facebook's corporate structure and its terms of use before focussing on the order of the German data protection authority and the subsequent court proceedings.

## 1. The corporate structure of Facebook and its terms of use

- 4 While Facebook users in general use the notion "Facebook" interchangeably for the service and the service provider, it is important to know that there is not one single Facebook company. Though most official statements of Facebook spokespersons also just refer to Facebook as such, for the determination of applicable law it is of fundamental importance to distinguish between the global player Facebook Inc., its European subsidiary Facebook Ireland Ltd. and further smaller Facebook subsidiaries which are all in some way involved in providing and/or administering the platform Facebook.<sup>3</sup> As the major part of the lawsuits deal with the relation of Facebook Inc. towards Facebook Ireland Ltd., it is necessary to have a basic understanding of the corporate structure of Facebook and its rules on jurisdiction and applicable law.

## 1. Corporate structure of Facebook

- 5 Facebook, which was founded in 2004, is operated by Facebook Inc., a US multinational Internet corporation. Facebook has its key assets, its headquarters and the site of its corporation in the US.
- 6 In 2008, Facebook established its European headquarters in Dublin. The role and position of the Irish subsidiary, Facebook Ireland Ltd., in relation to users from outside the US and Canada was enhanced in 2010 when Facebook's Statement of Rights and Responsibilities was amended to set forth that these users have contracts with Facebook Ireland Ltd. and not Facebook Inc.<sup>4</sup> With Facebook Ireland Ltd. being in charge of all users outside the US and Canada, Facebook avoids material jurisdiction for corporation tax on all international revenue in the US.<sup>5</sup> Beside Facebook Ireland Ltd., there are four additional subsidiaries in Ireland: Facebook Ireland Holdings; Facebook International Holdings I; Facebook International Holdings II; and Facebook Payments International Ltd. In Germany, Facebook seems to have only one local subsidiary, Facebook Germany GmbH, which is in charge of marketing and acquisition for the local market.

## 2. Facebook's rules on jurisdiction and choice of law

- 7 Facebook's terms of use are entitled "Statement of Rights and Responsibilities". The Statement constitutes Facebook's terms of service that "govern (Facebook's) relationship with users and others that interact with Facebook".<sup>6</sup> Users "agree" to these terms by simply using or accessing Facebook.<sup>7</sup>
- 8 The Statement also contains a choice-of-law clause. Section 16.1. provides that "any claim, cause of action or dispute (claim) [a user has with Facebook] ... arising out of or relating to the Statement or Facebook" will be resolved:
 

*Exclusively in a state or federal court located in Santa Clara County. The laws of the State of California will govern this Statement, as well as any claim that might arise between you and us, without regard to conflict of law provisions. You agree to submit to the personal jurisdiction of the courts located in Santa Clara County, California for the purpose of litigating all such claims.*
- 9 In accordance with the Statement, users will thus have to resolve disputes with Facebook in California under Californian law, even if they are from outside the United States.<sup>8</sup>
- 10 However, for users in Germany, section 17.3 of the Statement<sup>9</sup> exclusively provides that section 16.1 is replaced by the following clause:

“This Statement is subject to German law”.<sup>10</sup>

- 11 In relation to data protection rules, the current data policy, last updated on 11 December 2012, states that Facebook Ireland Ltd. is the data controller responsible for the personal information of users from outside the US and Canada.<sup>11</sup>

## II. Facebook’s real name policy

- 12 Browsing Facebook, users were likely to meet Max Mustermann<sup>12</sup> or variations thereof as well as numerous teenage girls with the last name “Bieber”.<sup>13</sup> While Max Mustermann, which might easily be identified as a fake name, has lately disappeared from Facebook, users are turning to much subtler tricks to avoid being banned from Facebook: they may use a middle name as a last name, turn to a fictional character’s name, invent a real-sounding name, borrow their mother’s maiden name or a common last name, an abbreviation, or other pseudonyms that equally violate Facebook’s real name policy. This mandatory real name policy is enshrined in Facebook’s community standards and requires all users to use their real identities including their real names on Facebook:

- *The name you use should be your real name as it would be listed on your credit card, student ID, etc.*

- Nicknames can be used as a first or middle name if they’re a variation of your real first or last name (like Bob instead of Robert)
  - You can also list another name on your account (ex: maiden name, nickname, or professional name), by adding an alternate name to your timeline
  - Only one person’s name should be listed on the account – timelines are for individual use only
  - Pretending to be anything or anyone is not allowed.<sup>14</sup>
- 13 Facebook often emphasises that Facebook is for real people using their real identities. According to the community standards, real identities and real names are required to keep the social network “safe” and guarantee that users know whom they are connecting with.<sup>15</sup>
- 14 For those who want to represent a business, brand or even a pet, Facebook allows the creation of a so-called “Facebook page”.<sup>16</sup> In addition, users may also list their professional title as an alternate name on their personal timelines. However, this still meant that Stefani Germanotta could not run her Facebook profile under her stage name Lady Gaga.<sup>17</sup> In a bid to attract more celebrities, which in turn may attract more users, Facebook slightly diluted its strict application of the real name policy and now allows celebrities – following a verification of their identity – to use their well-established stage names on their per-

sonal accounts.<sup>18</sup> However, they need to include their real name in the information section of the profile. In order to guarantee that only “real” celebrities make use of this exception, a user will need at least 20,000 subscribers to be allowed to benefit from this new pseudonym privilege. Ultimately, Facebook relies on the honesty of its customers, as from a technological perspective anyone can still open an account under a false identity or pseudonym.

## III. The right to pseudonymous use of media services under German law

- 15 In general, users in Germany have a *per se* reasonable expectation of privacy with respect to the revelation of their identity to the general public.<sup>19</sup>
- 16 A unique feature of the German law on Internet services is that the possibility of anonymous or pseudonymous use of Internet services is prescribed by law. § 13 VI of the Telemedia Act of 2007 (TMG) foresees the anonymous or pseudonymous use of Internet services as well as the anonymous or pseudonymous payment of these services. The wording of § 13 VI TMG is as follows: “The service provider must allow the anonymous or pseudonymous use of telemedia services and their payment, insofar as this is technically feasible and reasonable. The user must be informed about this possibility.”<sup>20</sup>
- 17 This is not a novel principle in German law. Even the predecessors of the TMG, the Teleservices Data Protection Act, which came into force on 1 January 2000, and the State Treaty on Media Services, which came into force 1 August 1997, contained identical provisions.<sup>21</sup>
- 18 § 3 VI a of the Federal Data Protection Act (BDSG<sup>22</sup>) defines “rendering pseudonymous” as meaning replacing the data subject’s name and other identifying features with another identifier in order to make it impossible or extremely difficult to identify the data subject.<sup>23</sup>
- 19 The provision recognises that the success of the Internet is inter alia based on the possibility of the anonymous use.<sup>24</sup> The anonymous as well as the pseudonymous use follows the basic principle of data reduction and data economy, meaning that as little personal data as possible shall be collected, processed and used.<sup>25</sup> The principle of data reduction and data economy can also be found in Article 6 I c) and e) as well as in Recital 46 of the EU Data Protection Directive.<sup>26</sup> This principle is explicitly set forth in § 3a BDSG<sup>27</sup> and also derives from the constitutional right to informational self-determination.<sup>28</sup> Under the right to informational self-determination, every individual is in principle entitled to determine the disclosure and use of his/her personal data.<sup>29</sup> If

individuals are not sure whether dissenting behaviour is noticed and whether information is permanently stored, used and passed on, they may try to avoid dissenting behaviour in order to not attract attention. This may even result in abstaining from making use of their basic human rights.<sup>30</sup> The purpose of § 13 VI TMG is to avoid the generation of personal data right from the start.<sup>31</sup>

- 20 Allowing a user the anonymous or pseudonymous use of telemedia services does not mean that the user has a right to stay anonymous in front of the service provider.<sup>32</sup> There is no right to an anonymous or pseudonymous contractual relationship.<sup>33</sup> This means that while users are entitled to use a screen name, this does not exclude the possibility of the telemedia service provider asking for the user's real identity in their internal relationship.
- 21 Even in Germany, the right to anonymous or pseudonymous use is not granted without limits. The right finds its limits where the granting of anonymous or pseudonymous use would be unreasonable for the service provider.<sup>34</sup>
- 22 What is important to keep in mind is that § 13 VI TMG only concerns the possibility of anonymous or pseudonymous use and does not prohibit disclosure orders against Internet service providers by injured parties. In simple terms, the provision only prohibits service providers to ask for a user's real name and display his real name when it is not necessary to do so.

## B. ULD v. Facebook

- 23 When Facebook took rigorous steps against some German users who had not obeyed its real name policy by suspending their accounts, the Unabhängiges Landeszentrum für Datenschutz (ULD) Schleswig-Holstein<sup>35</sup> took action against Facebook. Schleswig-Holstein's Privacy Commissioner and Head of ULD, Thilo Weichert, announced that it cannot be accepted "that a U.S. portal like Facebook violates German data protection law unopposed and with no prospect of an end".<sup>36</sup> However, Facebook only violates German data protection law if § 13 VI TMG constitutes a data protection norm, and if German data protection law applies to Facebook. With regard to the applicable law, the determining factor is the location of the data controller of Facebook's user data. Only where the data controller is located in Germany, or is not located on Community territory at all, must German data protection law be obeyed. With regard to the latter, Article 4 I c) Data Protection Directive foresees the application of national law, where the data controller is not located on Community territory, whereas if the data controller has an establishment in another EU Member State, Article 4 I a) prescribes the application of the

law of this EU Member State. Hence, the whole case centred around the debate on which of Facebook's companies does what and where.

## I. The administrative proceedings

- 24 As a first step, the ULD issued administrative orders against Facebook Inc. and Facebook Ireland Ltd. to refrain from enforcing the real name policy in relation to users in Schleswig-Holstein and allow pseudonymous accounts as required by the TMG.<sup>37</sup>

### 1. The orders of the ULD

- 25 The orders of 14 December 2012 stipulated that Facebook Inc. as well as Facebook Ireland Ltd. would be fined 20,000 euro if they did not comply with the orders within two weeks.<sup>38</sup> In German administrative law, the effect of any decision is immediate when notified. The ULD also ordered that an appeal would not have suspensory effect, meaning that Facebook had to implement the ordered measures irrespective of an appeal. Hence, Facebook was obliged to allow users from the German state of Schleswig-Holstein (for which the ULD has competence) to use pseudonyms immediately.
- 26 With regard to Facebook's real name policy, the ULD found the policy to be in violation of § 13 VI TMG. The decision and orders issued by ULD can be summarized as follows:
  - The permission to use pseudonyms on Facebook is reasonable. The real name obligation neither prevents abuse of the service for insults or provocations nor does it help prevent identity theft. Against this other precautions are necessary.
  - To ensure the data subjects' rights and data protection law in general, the real name obligation must be immediately abandoned by Facebook.
- 27 Orders were issued to both companies, Facebook Ireland Ltd. and Facebook Inc., as they were found to be joint data controllers. Although all Facebook users from outside the US and Canada have contracts with Facebook's Irish subsidiary Facebook Ireland Ltd., the ULD concluded that, as regards the real name policy, Facebook Inc. and Facebook Ireland Ltd. were jointly responsible in legal terms.<sup>39</sup> Nevertheless, the ULD applied § 1 V 2 BDSG, which transposes Article 4 I c) Data Protection Directive into national law. Under this provision, German law is applicable if a data controller who collects, processes or uses personal data inside Germany is not located in an EU or EEA Member State.<sup>40</sup> Although Facebook Ireland Ltd. is located in a Member State, the ULD found that it only played a rather subordinate role in the data

processing, while from an objective point of view, the actual control over the data and all authority in terms of purposes and means of processing remained with Facebook Inc.<sup>41</sup> Hence, Facebook was ordered to observe German data protection laws, and in particular § 13 VI TMG, in relation to Facebook users in Germany.

## 2. The ULD's reasoning

28 In the proceedings following Facebook's appeal, the ULD specified its position and provided further arguments supporting its claim. These arguments are well worth mentioning as they also deal with the role of Facebook Germany GmbH.

### a.) The ULD's reasoning in relation to Facebook Inc. USA

29 According to the ULD, Facebook Inc. collects, processes and uses personal data in the meaning of § 3 VII BDSG, Article 2 d) Data Protection Directive: During the registration process on [www.facebook.com](http://www.facebook.com), Facebook Inc. collects personal data; in addition, Facebook Inc. installs cookies on the computers of its users when they access the website. All data that is collected is stored and processed on servers of Facebook Inc., which are currently all situated in data centres in the US.<sup>42</sup>

30 Thus, the ULD was not satisfied that Facebook Ireland Ltd. was processing personal data in the context of its own activities.<sup>43</sup> It is not sufficient to just hold an office in a Member State while the business policy is exclusively determined by a company in the US.<sup>44</sup> Moreover, Facebook Inc. is factually in charge of the data processing as it has the authority to determine the purposes and means of processing. The notion of context of activities in Article 4 I a) Data Protection Directive, however, requires more than the existence of a mere establishment, namely the active involvement in activities relating to personal data processing.<sup>45</sup> Pursuant to Article 2 b) Data Protection Directive, processing of personal data shall mean

*any operation or set of operations which is performed upon personal data, whether or not by automatic means, such as collection, recording, organisation, storage, adaptation or alteration, retrieval, consultation, use, disclosure by transmission, dissemination or otherwise making available, alignment or combination, blocking, erasure or destruction.*

31 In this regard the degree of involvement of the establishment in the activities in the context of which personal data are processed is crucial.<sup>46</sup> The question is "who is doing what": only where an establishment processes personal data in the context of its own activities will the applicable law be that of the place of establishment. The ULD was not convinced that

Facebook Ireland Ltd. carries out the processing of the relevant user data in the context of the activities of an establishment of Facebook Inc. in Ireland, nor does Facebook Ireland Ltd. instruct Facebook Inc. to process the relevant data.<sup>47</sup> As regards the latter, Facebook Ireland Ltd. did not provide evidence of contractual agreements that determine inter alia the purpose of processing of personal data, the types of personal data, the technical-organisational data security measures, and details about controls of Facebook Ireland Ltd.<sup>48</sup> Article 17 III Data Protection Directive requires the existence of a contract or legal act binding the processor to the controller and stipulating in particular that "the processor shall act only on instructions from the controller".

32 In consideration of the registration process on [www.facebook.com](http://www.facebook.com) where Facebook Inc. collects personal data and makes use of automated equipment (the users' computers) by installing cookies on these as well as using equipment in Germany via the content delivery network Akamai,<sup>49</sup> the ULD concluded that German national law has to be applied in relation to Facebook users in Germany in accordance with Article 4 I c) Data Protection Directive (data controller of personal data outside the EU/EEA, which makes use of equipment situated on German territory).

### b.) The ULD's reasoning in relation to Facebook Ireland Ltd.

33 Facebook Ireland Ltd. qualified as a controller in the sense of § 3 VII BDSG and Article 2 d) Data Protection Directive when it collects, processes and uses personal data in relation to the blocking of accounts and asking users to utilise their real names.<sup>50</sup> Further objective control of data processing could not be established.

34 The application of German law to Facebook Ireland Ltd. was also based on the role of Facebook Germany GmbH.<sup>51</sup> According to the ULD, Facebook Germany GmbH is an establishment of Facebook Inc. in Germany. This was based on the assumption that the role of Facebook Germany GmbH goes beyond marketing and acquisition for the local market as it is also a communication channel for Facebook Ireland Ltd. and Facebook Inc.<sup>52</sup> The Irish Data Protection Commissioner had received copies of data-processing contracts entered into by Facebook Ireland Ltd. as data controller and inter alia Facebook Germany.<sup>53</sup> Unfortunately, the ULD had no knowledge of the content of these contracts, but the mere existence was used as an indication that Facebook Germany is also involved in data processing. Accordingly, the ULD concluded that the controller of personal data (Facebook Inc.) is established on the territory of several Member States (here: Ireland and Germany), and thus, pursuant to Article 4 I a) Data Protection Di-

rective, must take the necessary measures to ensure that each of these establishments complies with the obligations laid down by the national law applicable. Hence, the services offered on [www.facebook.com](http://www.facebook.com) must comply with German data protection law.

### c.) The ULD's determination of joint control

35 Although the ULD could not be convinced that Facebook Ireland Ltd. is the sole data controller for personal data of European users, it was satisfied that Facebook Ireland Ltd. and Facebook Inc. USA control the data jointly.<sup>54</sup> Joint control in the context of Article 2 d) Data Protection Directive does not require that all controllers equally determine and are equally responsible for a single processing operation; "jointly" rather needs to be interpreted as meaning "together with" or "not alone".<sup>55</sup> In case of several actors, they may have a very close relationship (sharing, for example, all purposes and means of processing) or a more loose relationship (for example, sharing only purposes or means, or a part thereof).<sup>56</sup>

### d.) Choice-of-law clause

36 The ULD also argued that the application of German data protection law is supported by the "Statement of Rights and Responsibilities" of Facebook, section 16.1., which provides that the Statement is subject to German law.

### e.) The ULD's conclusion: applicability of § 13 VI TMG

37 As Facebook Inc. and Facebook Ireland Ltd. were both considered providers of telemedia services,<sup>57</sup> they were obliged to allow the pseudonymous use of the social network insofar as this is technically feasible and reasonable. The registration procedure at [www.facebook.com](http://www.facebook.com) which requires users to enter their real name, and the blocking of users who did not register under their real name, violates § 13 VI TMG.<sup>58</sup>

38 When examining whether there are legally permissible, less restrictive means which could lead to equivalent results, the ULD stressed that Facebook basically has a monopoly when it comes to social networks; in particular, communication of minors in many regards (e.g. spare time activities) takes place only on Facebook.<sup>59</sup> Hence, the ULD established a certain necessity of users to register on Facebook and, subsequently, to give up privacy.<sup>60</sup> The ordered measures were thus considered reasonable, even in light of the competing interests of Facebook at hand. Facebook's freedom to conduct their busi-

ness model as well as its obligations under §§ 7 – 10 TMG (transposing Article 12-15 E-Commerce Directive<sup>61</sup> into national law) did not outweigh the interests of the users.<sup>62</sup>

## 3. The position of Facebook

39 As mentioned above, the discussion of which data protection regime has to be applied to German Facebook users can be narrowed down to one single question: Who is the data controller of the personal data of Facebook's users? According to Facebook, the answer to that question is clear: the data controller of the personal data of European users is Facebook Ireland Ltd. and not Facebook Inc.<sup>63</sup>

40 Facebook Ireland Ltd. is an establishment of Facebook Inc. pursuant to Recital 19 Data Protection Directive.<sup>64</sup> Article 4 I a) Data Protection Directive then provides that each Member State shall apply the national provisions to the processing of personal data where "the processing is carried out in the context of the activities of an establishment of the controller on the territory of the Member State".

41 According to the submission of Facebook Ireland Ltd. in the following court proceedings, Facebook Inc. processes data on behalf of its Irish subsidiary. Thus, Facebook Inc. informed the ULD that for matters regarding European users, all enquiries must be directed to Facebook Ireland Ltd.<sup>65</sup>

42 In addition, the existing German Facebook subsidiary (Facebook Germany GmbH) is expressly not involved in the processing of any personal information. It merely handles marketing and acquisition for the local market only, and thus cannot be considered an establishment of the controller of personal data.<sup>66</sup>

43 Finally, Facebook Ireland Ltd. fully complies with Irish data protection laws, which are themselves compliant with European data protection law.<sup>67</sup> In Facebook's view, this was confirmed by the Irish Data Protection Authority as part of its audit reports dated December 2011 and September 2012.<sup>68</sup> As Irish law applies, § 13 VI of the TMG is not applicable to Facebook. In addition, this section of the TMG would infringe higher-ranking European law.

44 Even if § 13 VI TMG were applicable, a departure from its real name policy would not be reasonable for Facebook as it would put Facebook's "culture of true identity" at risk.<sup>69</sup> Facebook stressed that it intends to replicate the social norms of the real world in an online environment by "emphasizing the human qualities of conversation and sharing".<sup>70</sup> According to Facebook, users want and expect their relations on Facebook to be authentic.<sup>71</sup> The pseudonymous use of Facebook would destabilize the integrity of Facebook and undermine the trust that is necessary

to interact on Facebook.<sup>72</sup> The requirement of true identity is furthermore intrinsically tied to the security of users on the platform and an essential part of the security measures it implements.<sup>73</sup> Without these measures, safety, security and the integrity of the platform would be compromised significantly.<sup>74</sup> This reasoning was supported by Facebook's allegation that the vast majority of disabled Facebook accounts could be linked to spamming, distributing malware, phishing, trolling, cyber mobbing, dissemination of hate speech, distribution of child abuse materials and gaming cheats.<sup>75</sup>

## II. The court proceedings

- 45 Facebook lodged an objection to the order with the responsible administrative authority. It also filed an appeal to the Verwaltungsgericht (administrative court) and succeeded in restoring the suspensory effect of the objection, hence making the order not immediately enforceable.<sup>76</sup> The decision was subsequently affirmed by the appeal court.<sup>77</sup> Accordingly, Facebook does not have to unlock the accounts of those users in Schleswig-Holstein who used Facebook under a pseudonym and had been blocked.
- 46 Although the court held that the mandatory real name policy violates § 13 VI TMG, this was of no relevance as neither the TMG nor German data protection laws were applicable. Irish data protection law, which instead applies, does not foresee an explicit right to pseudonymous or anonymous use of telemedia services.
- 47 Unfortunately, the courts did not really question the facts presented by Facebook, because proceedings for preliminary measures require only a summary examination of the merits of the claim. Thus, there was no need to examine how and by whom data processing in the case in question takes place. For this reason, the decisions of the courts will only be discussed briefly.

### 1. No choice of law by Section 16.1 of the Statement of Rights and Responsibilities of Facebook

- 48 First of all, section 16.1 of Facebook's "Statement of Rights and Responsibilities" does not stipulate an application of material German data protection law.<sup>78</sup> In general, parties to a contract can agree that the contract shall be governed by the law chosen by them (Art. 3 I Rome I Regulation<sup>79</sup>). However, § 1 V BDSG, which prescribes the application of German law, constitutes an overriding mandatory provision in the sense of Article 9 Rome I Regulation. Hence, the application of German data protection law is not at the disposal of the parties, but has to be deter-

mined solely on the basis of § 1 V BDSG.<sup>80</sup> § 1 V BDSG, which transposes Article 4 I Data Protection Directive into German law, sets forth that the BDSG, and thus German data protection, shall not apply in so far as a controller located in another EU/EEA Member State collects, processes or uses personal data inside the country, except where such collection, processing or use is carried out by an establishment inside the country. The BDSG shall, however, apply in so far as a controller not located in an EU/EEA Member State collects, processes or uses personal data inside the country.

## 2. Data controller and establishment

- 49 The court based its findings primarily on the fact that the processing of personal data was not carried out at the German subsidiary "Facebook Germany GmbH". The court was satisfied that the processing of personal data actually took place in Ireland by Facebook Ireland Ltd. in the context of its own activities.<sup>81</sup> Thus, it concluded that Irish data protection law is exclusively applicable in accordance with Article 4 I a) Data Protection Directive.<sup>82</sup> As opposed to Facebook Germany GmbH, Facebook Ireland Ltd. was considered to be an establishment of Facebook Inc. in the sense of Article 4 Data Protection Directive. It was of no relevance that the traffic data of Facebook is processed in the US, and most content data are collected in Germany and stored and processed in Germany by the service provider Akamai. The court argued that whenever a data controller has an establishment in the EU/EEA Member State, it is of no relevance for the determination of applicable law whether he uses equipment in a third Member State.

## III. The question of "who is doing what?"

- 50 As mentioned previously, neither the Verwaltungsgericht (VG) Schleswig nor the appeal court, Oberverwaltungsgericht (OVG) Schleswig, asked Facebook to provide evidence on where the data is actually processed and by whom, because this was not necessary in preliminary proceedings where only a summary examination of the submissions of the parties is conducted. The courts merely accepted Facebook's submission as indicating data processing in Ireland. At this stage of the proceedings, there was little more to expect by the judges.
- 51 There are strong indications that Facebook Ireland Ltd. only plays a minor role in the processing of personal data, if it plays any at all. For example, Facebook Ireland Ltd. repeatedly argued that "certain things are not possible because the management of Facebook Inc. would never agree to them".<sup>83</sup> This

raises the question whether Facebook Ireland Ltd. has any control over the www.facebook.com platform that is technically hosted in the US. If Facebook Ireland Ltd. is not the actual data controller, but just a branch that has been set up to benefit from advantageous Irish tax law and fulfil some alibi tasks, then Article 4 I a) Data Protection Directive does not lead to an application of Irish data protection law. If the ULD pursues the matter further, then Facebook Ireland Ltd. will need to prove that it processes the personal data in question itself. It is not established that the court in the main proceedings will be satisfied as easily as the administrative court in the proceedings for interim measures. Thus, it is not unlikely that in the main proceedings, a court will come to a different conclusion. Also, another conclusion must not necessarily be contrary to the findings of the Irish Data Protection Commissioner in his Audit Reports of Facebook Ireland Ltd. He did not legally assess whether Facebook Ireland Ltd. is a data controller pursuant to Article 2 d) Data Protection Directive. Although there are indications as to Facebook Ireland Ltd.'s role ("It is the only office, and legal entity, within the Facebook group with control over non-North American user data." and "FB-I's staff (around 326 Full Time Employees and 75 contractors) are responsible for the development and maintenance of the Facebook platform, the protection of Facebook users, the corporate administration of many of Facebook's non-North American activities and the sale of advertising to customers."),<sup>84</sup> the Data Protection Commissioner refrained from analysing the control element of Facebook Ireland Ltd. In this context, the function of Facebook's offices in other Member States also need to be assessed. In the Audit Report of Facebook Ireland Ltd., it has been stated that

*[t]hese offices have no role in the development or maintenance of the platform or the control of user data. Their functions are limited to the sale of advertising, local PR and, in limited cases, addressing queries from local app developers. In the context of carrying out these duties, these offices may process a limited amount of user data relating to the pages of advertisers and prospective advertisers pursuant to processing agreements entered into with FB I[reland].<sup>85</sup>*

- 52 Here, the scope of "limited amount of user data" needs to be assessed.
- 53 Beside Facebook's submissions, there is not yet enough evidence on where data is processed and by whom. The ULD now even succeeded in using some findings in the Audit Reports of the Office of the Irish Data Protection Commissioner to support its position.<sup>86</sup> In its Audit Report of 2012, the Irish Commissioner expressed concerns that "products and features developed by engineers predominantly based in California ... will not be capable of fully understanding and complying with Irish and EU data protection requirements".<sup>87</sup> Thus, Facebook Ireland Ltd. had to commit itself in the 2012 Re-Audit to imple-

ment measures "for ensuring that the introduction of new products or uses of user data take full account of Irish data protection law"<sup>88</sup>. Hence, the Facebook Ireland Ltd. data protection compliance team now examines compliance with Irish law.<sup>89</sup> This, however, rather indicates that the policies are determined by Facebook Inc., with Facebook Ireland Ltd. only having the possibility to intervene. Consequently, it is not Facebook Ireland Ltd. that determines the means and purposes of data processing on its own.<sup>90</sup>

- 54 A similar practice was identified by the Irish Data Protection Commissioner in relation to the implementation of new features, such as the "find your friends nearby" feature, for example: Facebook Inc. determines practices in the US while only foreseeing "input" from Facebook Ireland Ltd.<sup>91</sup> One may thus question whether Facebook Ireland Ltd. may instruct Facebook Inc. in any way in relation to the processing of personal data. It seems to have no competence to oversee the data processing by its parent company.
- 55 In addition, several incidents in the past show that the role of Facebook Ireland Ltd. with regard to data processing is less than clear. For example, in relation to Facebook's face recognition feature, Facebook did not succeed in proving that Facebook Ireland Ltd. guided and directed Facebook Inc. regarding the processing of personal data of European users.<sup>92</sup> In this case, it was not the ULD but the Data Protection Commissioner of Hamburg who issued an order against Facebook claiming that the feature violates German data protection law.<sup>93</sup> There was not sufficient evidence to prove that Facebook Ireland Ltd. was the actual data processor or directs the data processing of Facebook's face recognition feature.<sup>94</sup> The Hamburg Data Protection Commissioner's reasoning was very similar to that of the ULD, holding that the mere establishment of Facebook in Ireland does not automatically lead to the application of Irish data protection law; only where an establishment holds actual control for the data processing may it fall within the Data Protection Directive's definition of establishment. In relation to the face recognition feature, all decisions regarding the collecting, processing and use of data that were of relevance were taken by Facebook Inc. outside of the European Union.<sup>95</sup> Unfortunately, this case did not reach the trial stage as Facebook disabled the face recognition feature for European users.<sup>96</sup> Thus, until now, there is no precedent that has thoroughly examined Facebook's data processing.
- 56 Of particular interest in that context are furthermore the experiences of the Ministry of Justice of the German State of Baden-Württemberg with Facebook Ireland Ltd. when it comes to judicial cooperation requests in criminal matters and the access of German law enforcement agencies to data held by Facebook. To the knowledge of the Ministry of Justice, all of

Facebook's data are stored solely in the USA, and neither the establishment of Facebook in Germany nor Facebook Ireland Ltd. has direct access to the data.<sup>97</sup> This is a strong indication that Facebook Ireland Ltd. is not even involved in the data processing. Furthermore, Facebook Germany GmbH stated in criminal proceedings before a German criminal court that all servers that contain personal data of Facebook users are possessed and operated by Facebook Inc. in the US.<sup>98</sup> Facebook Germany could not tell whether the data requested in these proceedings were stored on servers of Facebook Inc. as only competent staff of Facebook Inc. could do so.<sup>99</sup> Again, there was no mention of the role of Facebook Ireland Ltd. in the actual processing. This shows, however, that Facebook is actually skating on very thin ice in the real name policy case when they argue that the data controller of personal data of European users is Facebook Ireland Ltd. and not Facebook Inc. In light of the above-mentioned incidents, it seems rather unlikely that they would succeed in proving that Facebook Ireland Ltd. is controlling the platform.

### C. The case in a wider context: The benefits of anonymity v. the drawbacks of anonymity

- 57 Irrespective of the applicable law, one should not lose sight of the initial question of the *ULD v. Facebook* case, namely whether real name policies may efficiently ban anti-normative and anti-social behaviour.
- 58 Facebook's main argument for enforcing its real name policy is that it is a fix for trolling and other unwanted behaviour. Clearly, it is not just teenage girls who change their last name to Bieber to imply marriage to the pop star Justin Bieber who are choosing to use a made-up name on a social network. But whether people really "behave a lot better when they have their real names down"<sup>100</sup> has not been proven by Facebook. Whether anonymity or pseudonymity mitigates social norms and establishes conditions to neglect principles of mutual respect in such a dimension as to outweigh the benefits of pseudonymous use is questionable.
- 59 Anonymous speech existed well before the advent of the Internet. But as the Internet magnifies speech to an exceptional level,<sup>101</sup> a new dimension is added to anonymous speech which also includes pseudonymous speech. Postings are instantaneously accessible worldwide, and thus are communicated to an undefined audience largely without any restrictions. A user may have good reasons to preserve his anonymity, especially where strong opinions are concerned. Anonymity may encourage people to express opinions, reveal something personal about themselves or engage in online activities that they otherwise would not express if the opinion or activity could be attributed to them.<sup>102</sup> Such cases include abuse victims who may wish to remain anonymous, or anyone else who fears unpleasant consequences when identified.<sup>103</sup> This could most recently be witnessed during the Arab spring, where many political dissidents posted information about the regimes' repercussions against civilians. It was the perceived anonymity on the Internet that allowed them to disseminate material without fear of consequences. Research in the early days of the Internet also proved that membership in gay/lesbian newsgroups and the available opportunity to share one's experiences and emotions anonymously and freely led to an increased self-acceptance of these individuals.<sup>104</sup> Online anonymity may also help young people in their own personal development as they express themselves without any negative social consequences.<sup>105</sup> These speakers do not commit any wrong by posting their opinions or experiences but may fear becoming subject to backlashes.
- 60 While there are good reasons to remain anonymous and anonymity may encourage free speech, it may also discourage responsibility.<sup>106</sup> Online anonymity is not always used for a good purpose: users may abuse anonymity to engage in anti-normative or anti-social behaviour. Undeniably, anonymity constitutes a disinhibiting factor that affects what people are prepared to say in computer-mediated communication.<sup>107</sup>
- 61 Anonymity has traditionally been thought to be more likely to create negative outcomes.<sup>108</sup> Obviously, anonymous as well as pseudonymous speech poses challenges to the tort of defamation and other unwanted behaviour.<sup>109</sup> Hence, Facebook argues that by enforcing the real name policy, it is pursuing a mission of trust and security. Google CEO Eric Schmidt went even a step further and called online anonymity "dangerous".<sup>110</sup> This may refer to the fact that people may hide behind their perceived anonymity and defame third parties; but it also may refer to the fact that although an Internet service provider is not liable for all content, it may be equally responsible for the content to some extent.
- 62 The use of nicknames and fake names may put victims of cyber bullying and defamation in a difficult position: where there are no clues and evidence in relation to the true identity of the perpetrator, the victims need to obtain a disclosure order against the Internet service provider in order to obtain further information so that the perpetrator may be held accountable. Even then the disclosure of the identity of an anonymous poster is only possible to a certain extent, namely tracing back his IP address, which can be time- and cost-consuming.<sup>111</sup> A defamation victim will have to obtain an order against the Internet service provider for disclosure of the registration data provided by the alleged tortfeasor, in-

cluding his email address and the IP addresses of all computers used to access the Internet service using that particular registration data. In the following a further disclosure order against the Internet access provider is needed to obtain the account subscriber's details. An IP address alone is not sufficient to identify the actual tortfeasor. Even where the Internet access provider holding information about the subscriber of a specific IP address at a certain time discloses the identity information following a court order, the information may not be sufficient to identify the tortfeasor where a connection is shared by several users. Thus, instead of trying to uncover the identity of an author and then proceed in suing him directly, defamation victims may turn to bringing an action against the Internet service provider to block access to the defamatory post if it does not do so voluntarily.<sup>112</sup> In this regard, due to the ubiquitous nature of the Internet, they may also be faced with questions of jurisdictions and immunities afforded to online intermediaries, such as those stemming from the E-commerce Directive.<sup>113</sup> A real name policy, where each communication can be attributed to a real person, would immediately eliminate these problems for defamation victims. However, a real name policy can only work where the registration data has been verified. Even then, someone may get access to a third party's account, most likely where unsecure passwords are used.

- 63 There clearly is a conflict between protecting online anonymity/pseudonymity and the equally privacy-related question of accountability for anti-normative behaviour. As relates to a mandatory real name policy, one should take into consideration whether a real name policy can succeed in fixing anti-social and anti-normative behaviour. In this respect, there is even evidence from a country that experimented with mandatory real names on a large scale. In 2007, South Korea implemented a real name verification law. The law required participants of discussions on the Internet to pass a verification process in order to express their opinions on websites with over 100,000 viewers.<sup>114</sup> The goal of this law was to reduce undesirable and anti-normative postings by changing the level of anonymity in which linkability and traceability are enhanced.<sup>115</sup> Although some suggested that the law had some effects on user behaviour,<sup>116</sup> a study by the Korea Communications Commission found that the system had been ineffective in preventing people from posting abusive messages.<sup>117</sup> In fact, malicious comments decreased by only 0.9% in 2008.<sup>118</sup> The Korean case provides real-life evidence that fear of judgement will not significantly change online behaviour for the better.<sup>119</sup>
- 64 The effect on other anti-social or illegal behaviour also has not been clearly proven. Facebook Ireland Ltd. described that Facebook's User Operations Team takes substantial efforts to investigate potential fake and imposter accounts created by adults

to make contact with teenagers, created by teenagers to bully other teenagers and created by adults to harass others.<sup>120</sup> Unfortunately, Facebook has refrained from making publicly available any statistics of fake identities used for anti-normative or anti-social behaviour. Instead it emphasises the importance of real identities to protect children in the online space.<sup>121</sup> This argument is weak considering that Facebook does not allow children under the age of 14 to register. Obviously, grooming is a problem on the Internet, but a real name policy does not prevent grooming, nor is grooming a substantial problem for Facebook where users usually interact with "friends".

- 65 Facebook's long-standing policy of making people use their real name also did nothing to prevent people using the social network to insult others. A real name policy is also no fix to the phenomenon of cyber bullying. Cyber bullying continues regardless of whether real names are used or not. Research has shown that cyber bullying often occurs in the context of social relationships, which challenges the assumption that it is anonymous.<sup>122</sup> In the recent prominent case of Amanda Todd, who committed suicide after being bullied on Facebook, bullying occurred by classmates and acquaintances.<sup>123</sup> It seems that online communication is merely an additional channel for traditional bullying, though anonymity may have a disinhibiting effect on what is posted. Other than the slanderous words, bullying on Facebook is fixed. However, the roots for bullying lie in the real social environment.<sup>124</sup>
- 66 Thus, Google CEO Eric Schmidt's assumption that online anonymity is "dangerous" is not true as such. Similarly, the argument that Facebook pursues a mission of trust and security does not seem convincing. Anonymous speech has its pros and cons, but there is nothing to suggest that a real name policy is a fix to anti-normative or anti-social behaviour. It may limit such behaviour, but whether that extent outweighs the advantages of anonymous speech is questionable. Allowing the pseudonymous use would also not hinder Facebook from employing security measures such as access control and authentication mechanisms, which can still be used where pseudonyms are permitted.

## D. Conclusion

- 67 It is of particular interest how this case will proceed – not so much in terms of the real name policy but the applicable law to Facebook. The real name policy is what triggered the discussion of a much wider issue, namely whether Facebook can carry on showing little regard for the privacy of its users and ignore national privacy laws.

- 68 The question of who controls Facebook is substantial. Are national efforts to regulate futile against a globalised multinational cooperation? If each state asserts jurisdiction over the same website, then inevitably the rules for users around the world will vary depending on their residency. Facebook rules already vary to some extent, with a special set of rules applying only to users in Germany.<sup>125</sup> Germany has been deemed the fiercest critic of Facebook due to its deep commitment to privacy.<sup>126</sup>
- 69 Facebook can escape the application of strict German law only if Facebook Ireland Ltd. is the controller of personal data processing and no establishment of Facebook controls user data in Germany. The Facebook companies thus will have to disclose their internal organisational structure for the processing of personal data. As of now, Facebook's external presentation does not distinguish between Facebook Ireland Ltd. and Facebook Inc., so the companies and their activities are difficult to separate from each other.<sup>127</sup>
- 70 In a wider context and with regards to competent supervisory authority in such matters, the case could set a precedent and render the implementation of a one-stop-shop solution as favoured by European Commissioner for Justice Viviane Reding unnecessary. Reding has been supporting "one-stop shop" for the clarification of data protection questions – a unified EU policy and a clear point of contact for every company. The European Commission's draft for a new EU data protection regulation proposes that in situations where Internet companies have several offices in Europe, the supervisory authority for those companies should be handled by the Member State in which they have their European headquarters.<sup>128</sup> For Facebook, this would mean that the Irish government's Data Protection Commissioner would be responsible for the concerns of all EU citizens relating to the company's privacy policies because the headquarters are in Ireland. Such a centralisation of supervisory authority has been criticised by the Committee on Civil Liberties, Justice and Home Affairs of the European Parliament under Rapporteur Jan Philipp Albrecht. Under his draft of a new data protection regulation, EU data subjects would still be able to address the authority in their place of residency and in their own language.<sup>129</sup> Each applicable data protection authority would be competent to supervise processing operations within its territory or affecting local data subjects. The local supervisory authority in the Member State would be competent but not solely responsible. There will be a lead supervisory authority at the place of the main establishment which acts as a single contact point for the controller or the processor and ensures coordination with all other data protection authorities involved.<sup>130</sup> The lead authority shall also consult the other authorities before adopting a measure.<sup>131</sup> Under the Albrecht Draft, there would also be a European Data Protection Board equipped with a veto power which may adopt a final decision. Under the Reding Draft, the European Commission would have had the final word in unresolved disputes.
- 71 The Reding Draft as well as the approach by the appeals court OVG Schleswig are clearly advantageous for companies that process personal data. They have a single point of contact for resolving issues. As a consequence, this could lead to business corporations establishing their European headquarters where data protection supervision is weak. As of now, Facebook has chosen Ireland as the place for its European headquarters due to advantageous tax laws, but it is not unlikely that corporations may seek lax data protection supervision in future. The same competition between countries could occur in relation to data protection as is known from the field of tax law.<sup>132</sup>
- 72 As concerns real name policies in general, providers of social networks clearly have identified the potential of big data and aim to monetize the accumulated data as business entities. Specifically, Facebook is considered so valuable because it is in fact a data machine that retains every mouse click and interaction of its users.<sup>133</sup> With Facebook's vast database of users' likes, relationship statuses, personal information, photos and shares, it can offer advertisers the possibility to target their ads to the right audience.<sup>134</sup> By the ubiquitous "like" button, Facebook is able to compile consumer profiles. In addition, the Facebook Connect service allows users to log into millions of websites using their Facebook user ID and password, and also reports back about their activity on those sites.<sup>135</sup> In the following, Facebook can sell advertising space to advertisers that allows them to precisely address the audience they covet.<sup>136</sup> This function is not disabled by users using pseudonyms, however. Their consumer behaviour and consumer profile can still be tracked; the only difference is that the data subject acts under a fake name.
- 73 Being forced to abandon the real name policy would not jeopardise the future of Facebook. However, it influences the value of Facebook. Facebook's shares lost almost half their value following revelations that as many as 8.7% of Facebook's 955 million user accounts may be fake and up to 5% of active accounts duplicates.<sup>137</sup> It may also put at risk further business models of Facebook. Facebook already serves as an identity provider by offering other websites use of its identity system rather than requiring users to create a new profile. One may also think that user information on Facebook is used to determine the creditworthiness of said user. This idea is not as far-fetched as one might think. In 2012, a German credit agency commissioned a research project to use Facebook to study a person's relationships in order to determine how that might affect their ability to pay their bills.<sup>138</sup> Following protest by German pol-

iticians such as the German Justice Minister at that time, Sabine Leutheusser-Schnarrenberger (“It cannot be that Facebook friends and preferences lead to one, for example, not being able to get a cell phone contract”<sup>139</sup>), the research project was withdrawn.<sup>140</sup> Such a use of Facebook data would be an entirely new dimension. Although the study has never been conducted, the idea of the project highlights the potential of Facebook’s big data.

74 Finally, the legal battle against Facebook’s real name policy highlights the struggle of service providers operating worldwide to adapt their service to the legal regimes governing the markets they have entered. The number of legal actions, and in particular the case of *ULD v. Facebook*, is set to continue, but for now we have to say good-bye to Max Mustermann.

- 1 Sobel, “*The Process that ‘John Doe’ Is Due: Addressing the Legal Challenge to Internet Anonymity*” [2000] 5 Virginia Journal of Law and Technology 3.
- 2 Google+’s common name policy as of June 2013: <<http://support.google.com/plus/answer/1228271?hl=en&uls=en>>; Facebook’s real name policy as of June 2013: <<http://www.facebook.com/help/292517374180078/>> (accessed 3 June 2013).
- 3 In the following, the author tries to distinguish between statements by Facebook Inc. and its subsidiaries; however, where the distinction is of no relevance or statements are issued on behalf of Facebook in general, the author refers to “Facebook” only.
- 4 See sec. 19.1 of Facebook’s Statement of Rights and Responsibilities at <<http://www.facebook.com/legal/terms>> (accessed 3 June 2013).
- 5 Ireland has a 12.5% corporate tax rate; the rate in the US is 35%. By making use of the so called “double Irish” global tax strategy, which involves Irish subsidiaries and subsidiaries in offshore locations, the corporation tax can be reduced further to about 2-3% corporation tax on all international revenue. Keena, “Ireland helps Facebook save billions” (14 May 2012), <<http://www.irishtimes.com/newspaper/finance/2012/0514/1224316065838.html>> (accessed 3 June 2013).
- 6 See the introductory paragraph (last updated: 8 June 2012), <[https://www.facebook.com/legal/terms?locale=en\\_EN](https://www.facebook.com/legal/terms?locale=en_EN)> (accessed 3 June 2013).
- 7 Ibid.
- 8 As a contractual choice-of-law clause, this clause does not affect tort actions, of course.
- 9 According to sec. 17 of the Statement, Facebook “strive[s] to create a global community with consistent standards for everyone, but [...] also strive[s] to respect local laws”. Hence, this section contains provisions that apply only to users and non-users that interact with Facebook outside the US. While subsection 1 relates to data transfer and processing in the US and subsection 2 to an exclusion of commercial activities by countries embargoed by the US, subsection 3 provides a hyperlink to specific terms that apply only to Germany.
- 10 Section 5 of the rules for users with German residency (last revised 20 April 2012), original wording: “5. Ziffer 16.1 wird ersetzt durch: Diese Erklärung unterliegt deutschem Recht”, <<https://www.facebook.com/terms/provisions/german/index.php>> (accessed 3 June 2013).
- 11 See Facebook Data Use Policy (last revised 11 December 2012), <[https://www.facebook.com/full\\_data\\_use\\_policy](https://www.facebook.com/full_data_use_policy)> (accessed 3 June 2013).
- 12 Max Mustermann is the German “Joe Doe”.
- 13 The so-called “Beliebers”, fans of pop star Justin Bieber, change their name to give the impression that they are married to their pop idol. Adrienne Jeffries, “Facebook’s fake-name fight grows as users skirt the rules” (17 September 2012), <<http://www.theverge.com/2012/9/17/3322436/facebook-fake-name-pseudonym-middle-name>> (accessed 3 June 2013).
- 14 <<http://www.facebook.com/help/292517374180078/>> (accessed 3 June 2013).
- 15 Ibid.
- 16 Ibid.
- 17 Sengupta, “*Lady Gaga Now, Even on Facebook*” (16 February 2012), <[http://www.nytimes.com/2012/02/17/technology/new-facebook-policy-on-made-up-names-lets-gaga-be-gaga.html?\\_r=3&](http://www.nytimes.com/2012/02/17/technology/new-facebook-policy-on-made-up-names-lets-gaga-be-gaga.html?_r=3&)> (accessed 3 June 2013).
- 18 Ibid. The verification procedure requires users to send an image of their passport or other form of ID to Facebook.
- 19 See di Fabio in: Maunz, Dürig, et al. (eds.), *Grundgesetz* (Kommentar, Beck München 69th ed. 2013), Art. 2 paras. 173 to 191; Foster and Sule, *German Legal System and Laws* (Oxford, 4th ed. 2010), pp. 241 et seq.
- 20 Author’s own translation.
- 21 Respectively § 4 I (from 2001 onwards § 4 VI) Teledienstdatenschutzgesetz (TDDSG) and § 13 I (from 2002 onwards § 18 VI) Mediendienststaatsvertrag (MDStV).
- 22 The Bundesdatenschutzgesetz.(BDSG) transposes the Data Protection Directive 95/46/EC into German law.
- 23 In comparison, § 3 VI BDSG defines “rendering anonymous” as meaning the alteration of personal data so that information concerning personal or material circumstances cannot be attributed to an identified or identifiable natural person or that such attribution would require a disproportionate amount of time, expense and effort.
- 24 Müller-Broich, *Telemediengesetz* (Nomos-Kommentar, Nomos Baden-Baden 2012), § 13 TMG.
- 25 Ibid.; Spindler & Nink in: Spindler & Schuster (eds.), *Recht der elektronischen Medien* (Kommentar, Beck München 2nd ed. 2011), § 13 TMG para. 10.; Deutscher Bundestag, “Drucksache 13/7385” (1997), p. 23, <<http://dipbt.bundestag.de/dip21/btd/13/073/1307385.pdf>> (accessed 3 June 2013).
- 26 Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data, Official Journal L 281 (23 November 1995), pp. 31-50.
- 27 § 3a BDSG (Data reduction and data economy): Personal data shall be collected, processed and used, and data processing systems shall be chosen and organized in accordance with the aim of collecting, processing and using as little personal data as possible. In particular, personal data shall be rendered anonymous or aliased as allowed by the purpose for which they are collected and/or further processed, and as far as the effort required is not disproportionate to the desired purpose of protection.
- 28 Spindler & Nink (fn 25), § 13 para. 10.
- 29 BVerfGE 65, 1, 43; for an analysis of the population census decision and the “invention” of the basic right to informational self-determination, see Hornung & Schnabel, “Data protection in Germany I: the population census decision and the right to informational self-determination” [2009] 25 Computer Law & Security Review 84.
- 30 BVerfGE 65, 1, 43.
- 31 Spindler & Nink (fn 25), § 13 para. 10.
- 32 See OLG Hamburg, ZUM 2009, 417 at 420 – Long Island Ice Tea case.

- 33 OLG Düsseldorf, MMR 2006, 618 at 620.
- 34 Spindler & Nink (fn 25), § 13 para. 10.
- 35 The ULD Schleswig-Holstein (Independent State Centre for Privacy Protection of Schleswig-Holstein) is the office of the Data Protection Commissioner of the German state of Schleswig-Holstein. The ULD is the responsible authority to enforce data protection compliance at Facebook for data subjects in the German state of Schleswig-Holstein. Head of the ULD and Data Protection Commissioner of Schleswig-Holstein is Thilo Weichert, who has held the position since September 2004. The Commissioner is elected for a period of five years by the parliament of Schleswig-Holstein.
- 36 ULD, “ULD issues orders against Facebook because of mandatory real names” (17 December 2012), <<https://www.datenschutzzentrum.de/presse/20121217-facebook-real-names.htm>> (accessed 3 June 2013). See also Weichert, “Facebook, der Datenschutz und die öffentliche Sicherheit” in Möllers & van Ooyen (eds.), *Jahrbuch öffentliche Sicherheit 2012/2013* (Verlag für Polizeiwissenschaft Frankfurt 2012) p. 380.
- 37 The ULD – as the competent supervisory authority on data protection – is entitled to issue orders to ensure compliance with the Federal Data Protection Act (Bundesdatenschutzgesetz – BDSG) and other data protection provisions; see § 38 V BDSG. Such orders are not unfamiliar to Facebook. As recently as September 2012, the Hamburg Data Protection Commissioner issued an administrative order against Facebook in relation to the face recognition feature. Facebook was ordered to ask registered users for permission when generating and storing biometric profiles. In February 2013, the administrative proceedings were closed as Facebook was able to prove that its face recognition feature had been disabled in Europe. See press release of the Hamburgische Beauftragte für Datenschutz und Informationsfreiheit of 7 February 2013, <<http://www.datenschutz-hamburg.de/news/detail/article/facebook-gesichtserkennung-verwaltungsverfahren-eingestellt.html>> (accessed 3 June 2013).
- 38 See Order of the ULD against Facebook Ireland Ltd. of 14.12.2012, <<https://www.datenschutzzentrum.de/facebook/20121214-anordnung-fb-ltd.html>>.
- 39 See Order of the ULD against Facebook Ireland Ltd. of 14.12.2012, <<https://www.datenschutzzentrum.de/facebook/20121214-anordnung-fb-ltd.html>>; Order of the ULD against Facebook Inc. of 14.12.2012, available at <https://www.datenschutzzentrum.de/facebook/20121214-anordnung-fb-inc.html> (both accessed 3 June 2013).
- 40 In particular, the ULD applies § 1 V 2 BDSG: “This Act shall apply in so far as a controller not located in a European Union Member State or other state party to the Agreement on the European Economic Area collects, processes or uses personal data inside the country”. The section transposes Art. 4 I c) Data Protection Directive into national law.
- 41 See only Order of the ULD against Facebook Ireland Ltd. of 14.12.2012, <<https://www.datenschutzzentrum.de/facebook/20121214-anordnung-fb-ltd.html>>.
- 42 See also Data Protection Commissioner, “Facebook Ireland Ltd - Report of Audit, 21 December 2011” (2011), p. 26, <<http://dataprotection.ie/documents/facebook%20report/final%20report/report.pdf>> (accessed 3 June 2013).
- 43 In this context, the ULD cited an example from the Opinion on applicable law by the Art. 29 Data Protection Working Party, where a social network had its headquarters in a third country and an establishment within an EU Member State. The establishment defined and implemented the policies relating to the processing of personal data of EU residents. The social network actively targeted residents of all EU Member States, which formed a significant portion of its customers and revenues, and installed cookies on EU users” computers (Article 29 Data Protection Working Party, “Opinion 8/2010 on applicable law, 0836-02/10/EN, WP 179” (2010), p. 27, <[http://ec.europa.eu/justice/policies/privacy/docs/wpdocs/2010/wp179\\_en.pdf](http://ec.europa.eu/justice/policies/privacy/docs/wpdocs/2010/wp179_en.pdf)> (accessed 3 June 2013)). According to the Art. 29 Data Protection WP, the applicable law will be, as set forth in Art. 4 I a), the data protection law of the place of establishment of the company within the EU. The ULD distinguished the situation of Facebook Inc. and Facebook Ireland Ltd. from the one in the example as there apparently was no evidence that Facebook Ireland Ltd. determines the business policy of Facebook in Europe, and in this context also determines the purposes for which the personal data of European users are processed (e.g. advertising, customised design of the service).
- 44 See also Appeal of the ULD against the decision of the VG Schleswig of 14 February 2013 relating to Facebook Inc., <<https://www.datenschutzzentrum.de/facebook/20130312-beschwerdebegrueundung-facebook-inc.html>> (accessed 3 June 2013).
- 45 *Ibid.*, p. 12.
- 46 *Ibid.*, p. 14.
- 47 Facebook has not yet provided the relevant agreements between Facebook Inc. and Facebook Ireland Ltd.
- 48 Appeal of the ULD against the decision of the VG Schleswig of 14 February 2013 relating to Facebook Inc. (fn 43).
- 49 ULD, “Anordnung der sofortigen Vollziehbarkeit von Untersagungsverfügungen im Hinblick auf den Klarnamenzwang bei Facebook” (2013), <<https://www.datenschutzzentrum.de/facebook/20130204-facebook-klarnamen.html>> (accessed 3 June 2013), which refers to ULD, “Datenschutzrechtliche Bewertung der Reichweitenanalyse durch Facebook” (2011), pp. 16 et. seq., <<https://www.datenschutzzentrum.de/facebook/facebook-ap-20110819.pdf>> (accessed 3 June 2013).
- 50 According to § 3 VII BDSG, which transposes Art. 2 d) Data Protection Directive into German law, the responsible entity, i.e. the controller, “is any person or body which collects, processes or uses personal data on his, her or its or behalf, or which commissions others to do the same”.
- 51 ULD (fn 48), para. 3.
- 52 *Ibid.*
- 53 See Data Protection Commissioner (fn 41), p. 25.
- 54 See Order of the ULD against Facebook Ireland Ltd of 14.12.2012 (fn 39), para. B. a). Although the wording of the German transposition of Art. 2 d) Data Protection Directive does not explicitly mention the case of joint determination of purposes and means of data processing, the German provision has to be interpreted as also encompassing joint control. The ULD refers in this context to Article 29 Data Protection WP, “Opinion 1/2010 on the concepts of ‘controller’ and ‘processor’, 00264/10/EN, WP 169” (2010), p. 23 <[http://ec.europa.eu/justice/policies/privacy/docs/wpdocs/2010/wp169\\_en.pdf](http://ec.europa.eu/justice/policies/privacy/docs/wpdocs/2010/wp169_en.pdf)> (accessed 3 June 2013).
- 55 It seems that this wording is taken from *ibid.*, p. 19.
- 56 *Ibid.*
- 57 Cf. § 2 No. 1 TMG, which transposes Art. 2 b) E-Commerce Directive into German law.
- 58 A large part of the ULD’s order deals with the proportionality of the ordered measures, i.e. whether the registration under a pseudonym, the unlocking of blocked pseudonymous accounts and the information of users about the possibility of pseudonymous use of Facebook are suitable and necessary to protect the fundamental rights of Facebook users, and whether they are reasonable. First of all, these measures pursue a legitimate aim in protecting the right to informational self-determination (Art. 2 I in connection with Art. 1 I of the Basic Law of Germany) of individuals who wish to use Facebook. It also protects the user’s constitutionally guaranteed freedom of expression, enshrined in Art. 5 of the Basic Law: freedom of expression is affected when users must

fear sanctions for alleged trolling. Also, the fact that only those who registered under their real name may speak at all was criticised for interfering with the right to informational self-determination.

- 59 See Order of the ULD against Facebook Ireland Ltd of 14.12.2012 (fn 39), para. B. e) (2).
- 60 Ibid.
- 61 Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market ("Directive on electronic commerce"), Official Journal L 178 , 17.07.2000, pp.1 -16.
- 62 Order of the ULD against Facebook Ireland Ltd. of 14.12.2012 (fn 39), para. B. e) (4).
- 63 Hence, Facebook asked the ULD to issue all requests regarding the real name policy to Facebook Ireland Ltd. See Order of the ULD against Facebook Inc. of 14.12.2012, <<https://www.datenschutzzentrum.de/facebook/20121214-anordnung-fb-inc.html>> (accessed 3 June 2013).
- 64 An establishment in that sense requires "the effective and real exercise of activity through stable arrangements".
- 65 Order of the ULD against Facebook Inc. of 14.12.2012 (fn 62), para. B. a).
- 66 A detailed analysis of Facebook's position can be found in ULD (fn 48), para. 3.
- 67 Ibid.
- 68 The Irish Data Protection Commissioner published a report on its one-year-long audit procedure in December 2011 and a "review of the report" in September 2012.
- 69 See Order of the ULD against Facebook Ireland Ltd of 14.12.2012 (fn 39), para. B. e) (2), and Data Protection Commissioner (fn 41), p. 136.
- 70 Ibid.
- 71 See Order of the ULD against Facebook Ireland Ltd of 14.12.2012 (fn 39), para. B. e) (2).
- 72 Ibid.
- 73 Ibid.
- 74 Ibid.
- 75 Ibid, para. B. e) (3).
- 76 VG Schleswig, decision of 14 February 2013 – file no. 8 B 60/12 (ULD v. Facebook Ireland Ltd), <<https://www.datenschutzzentrum.de/facebook/Facebook-Ireland-vs-ULD-Beschluss.pdf>>; and 8 B 61/12 (ULD v. Facebook Inc.), <<https://www.datenschutzzentrum.de/facebook/Facebook-Inc-vs-ULD-Beschluss.pdf>> (both accessed 3 June 2013).
- 77 OVG Schleswig-Holstein, decision of 22 April 2013 – file no 4 MB 10/13 (ULD v. Facebook Ireland Ltd.), <<https://www.datenschutzzentrum.de/facebook/20130422-ovg-beschluss-facebook.pdf>>; and 4 MB 11/13 (ULD v. Facebook Inc.), <<https://www.datenschutzzentrum.de/facebook/20130422-ovg-beschluss-facebook-inc.pdf>> (both accessed 3 June 2013).
- 78 Ibid.
- 79 Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I Regulation).
- 80 See also Carlo Piltz, "Rechtswahlfreiheit im Datenschutzrecht, 'Diese Erklärung unterliegt deutschem Recht'", *Kommunikation und Recht* 2012, 645. However, there are strong arguments in favour of the choice of law also in relation to respective provisions of the BDSG and TMG as they do not only apply between public authorities and private parties but also between private parties as such; see LG Berlin, Decision of 06.03.2012 – case no. 16 O 551/10 (Facebook friends finder), *Kommunikation und Recht* 2012, 300, and Polenz, "Die Datenverarbeitung durch und via Facebook auf dem Prüfstand", *Verbraucher und Recht* 2012, 209, who additionally argues that even where there is a deriving choice of law, national law must be applicable for consumer contracts.
- 81 Cf. only VG Schleswig, decision of 14 February 2013 – file no. 8 B 60/12 (ULD v. Facebook Ireland Ltd) (fn 75).
- 82 Ibid.
- 83 Europe-v-Facebook.org, "Response to 'Audit' by the Irish Office for the Data Protection Commissioner on 'Facebook Ireland Ltd'". (2012), p. 17, <<http://www.europe-v-facebook.org/report.pdf>> (accessed 3 June 2013).
- 84 Data Protection Commissioner, "Facebook Ireland Ltd. - Report of Audit 21 December 2011, Appendices" (2011), p. 213, <<http://www.dataprotection.ie/documents/facebook%20report/final%20report/Appendices.pdf>> (accessed 3 June 2013).
- 85 Ibid, p. 215.
- 86 Although the Irish Commissioner was satisfied that he has jurisdiction over the personal data processing activities of Facebook Ireland Ltd., he emphasised in his initial audit report that this position shall not be interpreted as asserting sole jurisdiction over the activities of Facebook in the EU; see Data Protection Commissioner (fn 41), p. 21.
- 87 Data Protection Commissioner, "Facebook Ireland Ltd. - Report of Re-Audit 21 September 2012" (2012), p. 53, <[http://dataprotection.ie/documents/press/Facebook\\_Ireland\\_Audit\\_Review\\_Report\\_21\\_Sept\\_2012.pdf](http://dataprotection.ie/documents/press/Facebook_Ireland_Audit_Review_Report_21_Sept_2012.pdf)> (accessed 3 June 2013).
- 88 Ibid.
- 89 Ibid, p. 54.
- 90 ULD (fn 48).
- 91 Data Protection Commissioner (fn 82), p. 54 et seq.
- 92 Der Hamburgische Beauftragte für Datenschutz und Informationsfreiheit, "Rechtliche Bewertung der Gesichtserkennung und Zuständigkeit des Hamburgischen Beauftragten für Datenschutz und Informationsfreiheit" (2012), p. 4, <[http://www.datenschutz-hamburg.de/fileadmin/user\\_upload/documents/Gutachten\\_Facebook-Gesichtserkennung.pdf](http://www.datenschutz-hamburg.de/fileadmin/user_upload/documents/Gutachten_Facebook-Gesichtserkennung.pdf)> (accessed 3 June 2013).
- 93 The Hamburg Data Protection Commissioner also held that Facebook Ireland Ltd. is not an establishment of Facebook Inc. in the sense of Art. 4 I a) Data Protection Directive. Order of the Hamburgischer Beauftragter für den Datenschutz und die Informationsfreiheit against Facebook of 21 September 2012 (Facebook's face recognition), p. 17, <[http://www.datenschutz-hamburg.de/uploads/media/Anordnung\\_gegen\\_Facebook\\_2012-09-21.pdf](http://www.datenschutz-hamburg.de/uploads/media/Anordnung_gegen_Facebook_2012-09-21.pdf)> (accessed 3 June 2013).
- 94 Ibid.
- 95 Ibid.
- 96 Der Hamburgische Beauftragte für Datenschutz und Informationsfreiheit, Facebook Gesichtserkennung – Verwaltungsverfahren eingestellt (2013), <[http://www.datenschutz-hamburg.de/fileadmin/user\\_upload/documents/Presseerklaerung\\_2013-02-07-Facebook-Gesichtserkennung.pdf](http://www.datenschutz-hamburg.de/fileadmin/user_upload/documents/Presseerklaerung_2013-02-07-Facebook-Gesichtserkennung.pdf)> (accessed 3 June 2013).
- 97 See Appeal of the ULD against the decision of the VG Schleswig of 14 February 2013 relating to Facebook Inc., <<https://www.datenschutzzentrum.de/facebook/20130312-beschwerdebegrundung-facebook-inc.html>> (accessed 3 June 2013).
- 98 AG Reutlingen, order of 31 October 2011 – case no. Js 18155/10 jug, *Kommunikation und Recht* 2012, 303 et seq.
- 99 Ibid.
- 100 Former Facebook Marketing Director, Randi Zuckerberg, argued that she thinks "anonymity on the Internet has to go away....People behave a lot better when they have their real names down. ... I think people hide behind anonymity and they feel like they can say whatever they want behind closed doors". See Bosker, "Facebook's Randi Zuckerberg: Anonymity Online 'Has To Go Away'" (27 July 2011), <<http://www.huffing>

- tonpost.com/2011/07/27/randi-zuckerberg-anonymity-online\_n\_910892.html> (accessed 3 June 2013).
- 101 Murray, *Information Technology Law: The Law and Society* (1st ed. Oxford University Press 2010), p. 105.
- 102 Cassidy, Jackson & Brown, “Sticks and Stones Can Break My Bones, But How Can Pixels Hurt Me?: Students’ Experiences with Cyber-Bullying”, [2009] 30 *School Psychology International* 383; Maureen Daly, “Is there an entitlement to anonymity? A European and international analysis”, [2013] 35 *European Intellectual Property Review* 198, 198.
- 103 For further examples, see Vamialis, “Online defamation: confronting anonymity”, [2013] 21 *International Journal of Law and Information Technology* 31, 61.
- 104 See Christopherson, “The positive and negative implications of anonymity in Internet social interactions: On the Internet, Nobody Knows You’re a Dog”, [2007] 23 *Computers in Human Behavior* 3038, 3042 with further references.
- 105 Ibid.
- 106 Joint Committee on the Draft Defamation Bill, *Draft Defamation Bill 2010-12*, HL 203, HC 930-I, para. 102.
- 107 Cf. Eady in: Smith v. ADVFN Ltd [2008] EWHC 1797 (QB), para. 15. See also Chi En Kwan & Skoric, “Facebook bullying: An extension of battles in schools”, [2013] 29 *Computers in Human Behavior* 16, 18 et seq.
- 108 Christopherson (fn 103), 3050.
- 109 Vamialis (fn 102), 31.
- 110 See video of Techonomy conference at <http://techonomy.typepad.com/blog/2010/08/google-privacy-and-the-new-explosion-of-data.html>. The same policy was introduced by Google in relation to Google+ (accessed 3 June 2013).
- 111 In relation to English law, cf. for example Vamialis (fn 102), 43 et seq.
- 112 This problem has also been addressed by the Joint Committee on the Draft Defamation Bill, *Draft Defamation Bill 2010-12*, HL 203, HC 930-I, para. 100.
- 113 Cf. Arts. 12 to 15 E-Commerce Directive .
- 114 Cho, “Real Name Verification Law on the Internet - A Poison or Cure for Piracy?” (2011), p. 3, <http://weis2011.econinfosec.org/papers/Real%20Name%20Verification%20Law%20on%20the%20Internet%20-%20A%20Poison%20or%20Cu.pdf> (accessed 3 June 2013).
- 115 Ibid, p.5.
- 116 Ibid, pp. 9 et seq.
- 117 Chosun Media, “Real-Name Online Registration to Be Scrapped” (30 December 2011), <http://english.chosun.com/site/data/html\_dir/2011/12/30/2011123001526.html> (accessed 3 June 2013).
- 118 Ibid.
- 119 Ferenstein, “Surprisingly Good Evidence That Real Name Policies Fail To Improve Comments” (29 July 2012), <http://techcrunch.com/2012/07/29/surprisingly-good-evidence-that-real-name-policies-fail-to-improve-comments/> (accessed 3 June 2013).
- 120 Data Protection Commissioner (fn 41), p. 137.
- 121 Ibid.
- 122 Mishna and others, “Risk factors for involvement in cyber bullying: victims, bullies and bully-victims”, [2012] 34 *Children and Youth Services Review* 63, 64 with further references.
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# The Levy Runs Dry

## A Legal and Economic Analysis of EU Private Copying Levies

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**Abstract:** This article provides a legal and economic analysis of private copying levies in the EU, against the background of the Copyright Directive (2001/29), a number of recent rulings by the European Court of Justice and the recommendations presented by mediator Vitorino earlier this year. It concludes that notwithstanding these rulings and recommendations, there remains a lack of concordance on the relevance of contractual stipulations and digital rights management technologies (DRM) for setting levies, and the concept of harm. While Mr Vitorino and AG Sharpston (in the Opinion preceding *VG Wort v. Kyocera*) use different lines of reasoning to argue that levies raised on authorised copies would lead to double payment, the Court of Justice's decision in *VG Wort v. Kyocera* seems to conclude that such copies should nonetheless be levied. If levies are to provide fair compensation for harm resulting from acts of private copying, economic analysis suggests one should distinguish between various

kinds of private copies and take account of the extent to which the value said copies have for consumers can be priced into the purchase. Given the availability of DRM (including technical protection measures), the possibility of such indirect appropriation leads to the conclusion that the harm from most kinds of private copies is *de minimis* and gives no cause for levies. The user value of copies from unauthorised sources (e.g. from torrent networks or cyber lockers), on the other hand, cannot be appropriated indirectly by rightholders. It is, however, an open question in references for preliminary rulings pending at the Court of Justice whether these copies are included in the scope of the private copying exception or limitation and can thus be levied for. If they are not, as currently happens in several EU Member States, legal and economic analysis leads to the conclusion that the scope of private copying acts giving rise to harm susceptible of justifying levies is gradually diminishing.

**Keywords:** Private Copying, Exception or Limitation, Levies, Fair Compensation, Harm, Technological Protection

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### A. Introduction<sup>1</sup>

<sup>1</sup> In 1965, Germany was the first country to introduce a private copying (PC) levy on sound and video recording equipment, following landmark decisions by the German Federal Supreme Court between 1955 and 1964, namely in the *Grundig Reporter*<sup>2</sup> and *Personalaus-*

*weise*<sup>3</sup> cases.<sup>4</sup> In the ensuing decades, many countries followed suit and levies were introduced on a variety of recording or copying devices and blank media. At the present day, most countries within the European Union (EU) have some form of copyright levies, as well as the United States, Canada, Russia and several

countries in Latin America and Africa. In Asia, Japan is the only country with copyright levies.<sup>5</sup>

- 2 PC levies have long been one of the most hotly debated topics in EU copyright law and policy. It is a common area for discussion between rightholders, collective rights management organizations (CMOs), the consumer electronics and ICT industries and even consumer representative associations. At the EU level, PC levies have been on the harmonization agenda since the 1988 Green Paper on Copyright and the Challenge of Technology<sup>6</sup> and, following stakeholder consultations (in 2006 and 2008)<sup>7</sup> and the 2011 IPR Strategy,<sup>8</sup> remain an “on-going initiative” of D.G. MARKT.<sup>9</sup>
- 3 Notwithstanding the perennial attention for levies, in 2013 a number of developments came together which could lead to a leap forward in this debate. In January of this year, Mr António Vitorino, appointed in late 2011 by Internal Market Commissioner Michael Barnier as mediator to lead a stakeholder dialogue in this field, delivered his recommendations on the matter (hereinafter, the “**Recommendations**”).<sup>10</sup> The Commission has made clear that reform in this field is necessary from the single market perspective and presented the Recommendations as “non-binding provisions”.<sup>11</sup> However, despite these having merited discussion in the latest “competitiveness” meeting of the Council of the EU, there is no indication of legislative action in the field for 2013, as previously promised for 2012 in the IPR Strategy.<sup>12</sup>
- 4 This institutional backdrop is complemented by a confusing extant legal regime at the European level – namely, in what concerns the rules of the Copyright Directive on fair compensation for the private use exception or limitation<sup>13</sup> – which has spawned not only a number of divergent national implementations, but also a considerable number of European Court of Justice (ECJ) judgements and (a multitude of) pending preliminary references from national courts on the interpretation of said provisions.<sup>14</sup>
- 5 This article explores the current EU secondary law landscape on PC levies, with a special emphasis on the economic analysis of some of its most disputed issues, such as the correct definition of the concept of harm, the effect of authorisation acts by rightholders and the application of digital rights management (DRM) technology – in particular, technological protection measures (TPMs) – on the condition of fair compensation and its calculation, as well as its relationship with unauthorised file sharing on the Internet.
- 6 In order to do so, following this introduction, **Part B** provides a detailed and updated legal background on the framework of rules applicable to PC under the *acquis communautaire*.<sup>15</sup> It examines the relevant legal provisions in the Copyright Directive, as well

as the recitals commonly used to interpret them. It goes on to examine the multiple ECJ judgements that have attempted to fill gaps in the legal regime and interpret the provisions in question. This is complemented by a succinct overview of forthcoming ECJ cases that will address some of the remaining and still controversial aspects. **Part C** critically examines the Vitorino Recommendations against the extant legal regime and interpretation thereof by the ECJ, as well as economic arguments, thus highlighting its virtues and shortcomings. **Part D** facilitates the transition to economic analysis by establishing the baseline of the application of PC levies in Europe. **Part E** conducts the economic analysis proper. It provides a typology of PC acts, examines the concept of harm against that of indirect appropriability, and discusses the effect of DRM in the PC exception or limitation as well as in the calculation of levies. **Part F** concludes that the case for levies to compensate for harm caused by “classical” private copies is gradually diminishing as the utility consumers derive from offline private copies can to a large extent be appropriated indirectly. The choice *not* to apply TPMs is nowadays a rational choice that, from an economic perspective, should not be treated differently from the choice to apply TPMs or any other sort of DRM.

## B. Mapping the legal background

### I. The legal framework

- 7 The purpose of this part is to provide an updated overview of the legal framework applicable to PC at the secondary law level in the EU. As such, this part does not attempt an in-depth analysis of all the dimensions and nuances of the legal regime of this exception or limitation. This mapping exercise intends to shed light on some of the most relevant problems with extant legal rules, so as to subsequently introduce economic arguments that can assist in its elucidation. With that objective, this part looks first at the legal context of the exception, followed by an examination of its requirements.<sup>16</sup>

#### 1. The context of the private copying exception or limitation

- 8 Secondary European copyright law is constituted by a body of directives aimed at harmonizing the field, the so-called *acquis communautaire*. Under the *acquis*, it is possible to identify economic substantive rights that are either exclusive or non-exclusive, in the sense that they do not entitle rightholders to prohibit a specific use but merely to a claim for remuneration or compensation.

- 9 The Copyright Directive, which implemented the WIPO Internet Treaties,<sup>17</sup> horizontally harmonized several economic rights – reproduction, communication/making available to the public and distribution – and adjusted them to the digital age.<sup>18</sup> The reproduction right is granted both to authors and related rights owners. Performers and broadcasters have a specific right of first fixation,<sup>19</sup> meaning that the general reproduction right applies only to the reproductions of those fixations.<sup>20</sup> The relevant international treaty provisions referring to this exclusive right<sup>21</sup> clarify that it applies without restriction in the digital environment – arguably including all forms of incidental, transient or technical copies.<sup>22</sup> Similarly, the Copyright Directive’s reproduction right increasingly applies to online dissemination of content, of which reproduction is an essential constituent. Such a broad interpretation is clear not only from the letter of Article 2 but also from ECJ decisions dealing with its scope, which seem to apply an expansive reading of the concept of reproduction,<sup>23</sup> coupled with a likewise ample concept of protectable subject matter (the “work”, understood horizontally as the “author’s own intellectual creation”).<sup>24</sup>
- 10 Notwithstanding, (primary) exclusive rights in the *acquis* are in certain instances limited in their scope by the application of non-exclusive (secondary) rights and, where relevant, accompanying exceptions or limitations. Non-exclusive rights can be conceptually divided into myriad disperse harmonized rights of remuneration or fair compensation.<sup>25</sup>
- 11 Because PC involves acts of reproduction, it calls into application Article 2 of the Copyright Directive. This provision contemplates a broad exclusive right,<sup>26</sup> covering all digital reproduction acts made over the Internet, except transient copies; the latter are exempted by the sole mandatory exception/limitation in the Directive – Article 5(1)<sup>27</sup> – the main purpose of which is to enable transmission by Internet service providers or lawful use by end-users.<sup>28</sup> All remaining twenty exceptions or limitations in the Directive – which are listed *exhaustively* in Article 5(2)-(4) – are optional, including that for PC.<sup>29</sup> These optional exceptions apply to the reproduction right,<sup>30</sup> the distribution right<sup>31</sup> and the rights of communication/making available to the public.<sup>32</sup> Where Member States chose to implement such optional exceptions, certain provisions are conditional upon the grant of fair compensation – Article 5(2) (a), (b) and (e) – while others do not come with such conditions, though it is possible that national law provides for such compensation.<sup>33</sup> Furthermore, all exceptions are subject to the Directive’s version of the three-step test in Article 5(5).<sup>34</sup>

## 2. The requirements of the private copying exception or limitation

- 12 This Article focuses on the right to fair compensation for reproductions covered by the PC exception or limitation. This right is prescribed for in Article 5(2)(b) of the Copyright Directive, which states that:

*[... M]ember States may provide for exceptions or limitations to the reproduction right [...] in respect of reproductions on any medium made by a natural person for private use and for ends that are neither directly nor indirectly commercial, on condition that the rightholders receive fair compensation which takes account of the application or non-application of technological measures referred to in Article 6 to the work or subject-matter concerned.*

- 13 It is fundamental to understand the basics of the meaning and scope of this exception, so as to highlight the problems that underlie PC levy systems.<sup>35</sup> For that purpose, the following paragraphs will look at the legal requirements for PC, as they result from the text of the Directive and its Recitals.
- 14 First, its scope encompasses reproductions made on all technologies and media – whether analogue or digital.<sup>36</sup> Second, it applies to acts of reproduction of all subject matter (despite Recital 38 mentioning solely audio, visual and audio-visual material), with the exclusion of computer programs and databases.<sup>37</sup>
- 15 Third, the exception is purpose-bound in the sense that it applies only for *private use* and for *non-commercial ends*. Although there is no definition of what “private” is in the Copyright Directive, there is rough consensus that the beneficiaries of this provision must be *natural persons* making reproductions for their *personal purposes* and within the *private sphere* which, depending on the national implementation, may include a broader or narrower circle of (close) family and friends.<sup>38</sup> This would mean, in principle, that other related but potentially broader concepts in national law – such as “personal use” and “own use” (which may include professional and commercial use) – fall outside the scope of the provision.<sup>39</sup> Also, given that only reproductions by a natural person are allowed, acts carried out by the latter on behalf of a legal person are not exempted.<sup>40</sup> However, this does not mean that reproductions made by natural persons on behalf of another individual and/or for her private use are not allowed (as long as with non-commercial purpose), as these might fall in the private use category.<sup>41</sup> More problematic is the case of third-party copying by a legal person acting as a commercial provider that facilitates PC by a natural person for private purposes; here, it seems that Member States must regulate the effect of the intervention of intermediaries and service providers in the reproduction act.<sup>42</sup> To be sure, such leeway has led to divergent national implementations on the issue of third-party copying.<sup>43</sup> This brief sketch

is enough to highlight the potential legal certainty challenges facing national courts in defining what “private” means in this context, especially in light of its potential expansion in the digital environment (e.g. within social networking platforms) and in opposition to a dynamic concept of *public* in the *acquis*.<sup>44</sup>

- 16 Closely related to the private nature of the use is another *cumulative* requirement as to the purpose of the reproduction: it cannot be for *directly or indirectly commercial* ends.<sup>45</sup> Again, the scope of this requirement is not made clear by the wording of the Directive and is further confused by the fact that – whilst private acts are by definition non-commercial – non-commercial acts can fail the qualification as private.<sup>46</sup> Put differently: in mathematical terms, private acts are a subset of the set of non-commercial acts. The definition of commercial can encompass a wide range of meanings – from “commercial”, “economic”, “for profit”, “business” and the like – while the scope of non-commerciality is complex to define, especially in connection to online uses.<sup>47</sup> At the very least, it seems that the term *commercial* cannot be a synonym for *economic*, let alone welfare economic. This is because a PC exception excluding all welfare economic significant uses would be devoid of meaning and scope, as every PC act bears such a significance or consumers would not engage in them. Beyond that, it seems difficult to clearly define the scope of commerciality here. National legislators and courts have attempted to do so by setting forth subjective and objective criteria: the *infringing intent* of the copier (actual or constructive knowledge, linked to the profit-making aim) and the definition of a specific number of copies beyond which PC is not acceptable.<sup>48</sup> It is, however, difficult to transpose these criteria to define indirect commerciality in digital PC.<sup>49</sup>
- 17 Fourth, where the national legislator implements a PC exception or limitation, such an implementation must be accompanied by the provision of fair compensation, aimed at compensating authors for the harm caused by unauthorised reproductions. The meaning and scope of this requirement, as interpreted by the ECJ, are discussed in greater detail below.<sup>50</sup>
- 18 However, it bears mentioning from the outset **Recital 35**, which states that fair compensation is aimed at compensating rightholders “adequately for the use made of their protected works”. It adds that the determination of the “form, detailed arrangements and possible level of such fair compensation” must take into consideration the “particular circumstances of each case”. These should be evaluated according to several criteria, with a valuable one being the “possible harm to the rightholders resulting from the act in question”. The recital goes on to address cases where rightholders have already received payment in a form other than the fair compensation (e.g. via a license fee), raising the possibility that such cases might not give rise to separate (and hence double) payment. Regarding the *level* of fair compensation, “full account” must be taken of the “degree” of TPM usage; furthermore, in “certain situations where the prejudice to the rightholder would be minimal” (*de minimis*), no obligation to pay fair compensation may arise.<sup>51</sup> This recital, by linking fair compensation to a notion of harm, distinguishes it from the concept of equitable remuneration,<sup>52</sup> which is based on the value of the use in trade.<sup>53</sup>
- 19 Pursuant to Article 5(2)(b), the method for calculation of the amount of fair compensation must take into account whether the rightholder of the work or subject matter susceptible of reproduction has applied to the same any TPMs referred to in Article 6 of the Directive. This article instructs Member States to provide adequate legal protection against the circumvention of any effective TPMs, i.e. “any technology, device or component that, in the normal course of its operation, is designed to prevent or restrict acts, in respect of works or other subject-matter, which are not authorized by the rightholder”.<sup>54</sup> TPMs are *effective* when they provide rightholders control over the *access* to the work or to a *use* thereof.<sup>55</sup> *Access controls* are measures for protection of the work, such as encryption, scrambling or other transformation. *Use controls* refer to mechanisms that prevent, e.g., copies of the work from being made. The legal protection of TPMs is afforded both against circumvention and preparatory acts.<sup>56</sup>
- 20 Member States may limit the legal protection of TPMs by implementing *mandatory* measures regarding acts of circumvention in case rightholders do not implement such measures voluntarily. This is to ensure that rightholders make available to the PC beneficiary the means of benefiting from the exception (to the extent necessary for that purpose), *where that beneficiary has legal access to the work concerned*.<sup>57</sup> If legal access is a necessary requirement, it seems that the limitative measures in question can only target *copy control* TPMs. However, such measures cannot be triggered (i) if rightholders have already made PC acts possible, or (ii) vis-à-vis *copy control* TPMs that limit the number of reproductions made by users in accordance with such provisions.<sup>58</sup> Both voluntary and mandatory TPMs are afforded legal protection.<sup>59</sup>
- 21 **Recital 52** clarifies the Directive’s preference for the adoption of voluntary measures by rightholders, which Member States should promote; where no voluntary measures are taken, these should be imposed on rightholders, under the terms described above. Any measures (voluntary or imposed) must not only respect rightholders’ entitlement to use TPMs, but also “the condition of fair compensation under that provision and the possible differentiation between various conditions of use in accordance with Article 5(5)”.<sup>60</sup>

- 22 Furthermore, the Copyright Directive introduces a special rule for licensed interactive on-demand services.<sup>61</sup> According to the same, Member States are not allowed to implement measures limiting the effect of TPMs for purposes of enabling PC if the work in question is *made available online for interactive on demand transmission on agreed contractual terms*.<sup>62</sup> This allows for the elimination of the possibility to engage in PC by end-users where (i) the work is made available online, (ii) subject to specific licensing terms prohibiting those acts and (iii) accompanied by TPMs preventing them.
- 23 The principle at work here is that TPMs can theoretically be used to prevent or control acts of digital reproduction and subject them to additional payment by users (even where such acts would otherwise be lawful), a fact that would make indirect payment through a levy system unwarranted, insofar as there would be no unauthorised reproduction act and no harm to compensate.<sup>63</sup> To be sure, these considerations have raised an important discussion on the possibility of the “phasing-out” of PC levies in the digital environment.<sup>64</sup>

## II. ECJ case law

- 24 The ECJ has ruled on the definition of fair compensation for PC in Article 5(2)(b) of the Copyright Directive in *Padawan*,<sup>65</sup> *Stichting de Thuiskopie*<sup>66</sup> and, more recently, in joined Cases *VG Wort v. Kyocera*<sup>67</sup> (preceded by an Opinion by A.G. Sharpston<sup>68</sup>) and *Amazon.com v. Austro-Mechana*.<sup>69</sup> The combination of these four rulings provides a blueprint of fundamental aspects of the PC legal regime and fills some of its gaps, namely those relating to the meaning and scope of the concept of fair compensation, the criterion of harm, the effect of rightholders’ authorisation and TPM application in the right to fair compensation. This section looks in sequence at these topics.
- 25 Conversely, because it is outside of the questions examined herein, this article will not look at the parts of these judgements dealing with the *liability and effective burden of compensation*. Regarding this topic, it is sufficient to point out the general rule that, since the relevant harm is (likely) caused by the natural person engaging in PC acts, it is in principle this person that should be liable for financing the applicable fair compensation.<sup>70</sup> In practice, however, the identification of these end-users, the enforcement of this obligation and the minimal nature of each use are too complex and cumbersome.<sup>71</sup> The Copyright Directive recognizes as much, by allowing exceptions to the principle, such as the exemption from payment in cases of *de minimis* uses (cf. Recital 35, *in fine*) and, with the objective of financing fair compensation, the adoption of systems of PC levies (cf. Recital 38), imposed not on end-users but on intermediaries who either make digital reproduction equipment, devices and media available to the first or provide them with copying services.<sup>72</sup> Following this logic, *Padawan* has elucidated that PC levies cannot be applied indiscriminately to digital reproduction equipment/devices/media which are (i) not made available to private users, and (ii) reserved to uses with a different purpose than PC.<sup>73</sup>
- 1. Fair compensation as an autonomous concept of EU law and an unwaivable right**
- 26 No provision in the Copyright Directive makes reference to national laws in connection with the meaning and scope of the concept of “fair compensation”.<sup>74</sup> As such, both the need for uniform application of EU law and the principle of equality demand that the secondary law provision be given an EU-wide independent and uniform interpretation, taking into consideration both its context and the objective of the specific legislative instrument.<sup>75</sup>
- 27 In that light, as with equitable remuneration, the concept of fair compensation must be deemed an autonomous EU law concept, subject to uniform interpretation in countries that have implemented the exception.<sup>76</sup> This assessment is in line with the Copyright Directive’s objective of facilitating a harmonized framework on copyright and related rights (by establishing a high level of protection) and safeguarding competition in the internal market, for which a uniform interpretation of EU law is required. This much is noted in Recital 32, which mentions the need for the coherent application of exceptions or limitations with the objective of ensuring a functioning internal market.<sup>77</sup> Such coherent application, however, must be made against another of the Directive’s objectives, notably that of striking a “fair balance of rights and interests between the different categories of rightholders”, as well as between these and users.<sup>78</sup>
- 28 Furthermore, in light of the objectives of the Copyright Directive and the context of Article 5(2)(b), which impose an obligation of result on Member States, the Court has noted that the EU legislator did “not wish to allow the persons concerned to be able to waive payment of that compensation to them”.<sup>79</sup> In supporting this view, the Court relies on systematic interpretation of the *acquis*, drawing comparisons between the right of fair compensation and that of unwaivable equitable remuneration for rental.<sup>80</sup> In the Court’s view, for the right to be interpreted as waivable, there would have to be an express reference in the Directive’s text; as there is not, the right of fair compensation is unwaivable.<sup>81</sup> In other words, if the Directive imposes on Member States an obligation of result regarding the actual recovery of a fair

compensation,<sup>82</sup> this obligation “proves conceptually irreconcilable with the possibility for a rightholder to waive that fair compensation”.<sup>83</sup>

## 2. The criterion of harm

29 The autonomy and uniformity of this concept are to be understood without prejudice to the power of Member States to determine, in light of applicable EU law, “the form, detailed arrangements for financing and collection, and the level of that fair compensation”.<sup>84</sup> Recitals 35 and 38 of the Copyright Directive are indicative of the EU legislator’s intent to create a system designed at adequately compensating rightholders for the likely harm resulting from unauthorised acts of reproduction.<sup>85</sup>

30 As per the Court of Justice, both the notion and level of “fair compensation” have a connection to the criterion of harm suffered by the rightholders resulting from the introduction of the private use exception or limitation, meaning that this concept must be perceived “as recompense for the harm suffered by the author”,<sup>86</sup> and that its calculation should be based on said criterion.<sup>87</sup>

31 It should be noted that, while the Copyright Directive qualifies this harm as resulting from the act in question, i.e. the unauthorised reproduction (cf. Recital 35), the Court of Justice qualifies this harm (also) as that resulting from the introduction of the exception or limitation, a distinction with relevant economic consequences.<sup>88</sup> This point is addressed in greater detail below.<sup>89</sup>

## 3. The effect of (explicit or implicit) authorisation in the right to fair compensation

32 On the topic of the effect of explicit or implicit authorisation in the right to fair compensation, *VG Wort v. Kyocera* basically states that, where end-user acts fall within the scope of an exception or limitation, any authorisation of the same by rightholders is irrelevant for application or calculation of fair compensation.<sup>90</sup>

33 The Court’s reasoning can be summarized as follows. First, Member States can implement Article 5(2) and (3) either via the legal mechanisms of exceptions (a broader exclusion of exclusive rights) or limitations (a more restricted casuistic exclusion of certain acts from the scope of exclusive rights).<sup>91</sup> In both instances, either the Directive requires that some exceptions or limitations are accompanied by fair compensation or Member States opt to do so.<sup>92</sup> Where fair compensation is provided for, it must be based on the harm caused to rightholders by unau-

thorised reproductions. When particular reproduction acts fall within the scope of a compensated exception or limitation, such uses are possible despite authorisation by rightholders. Consequently, any authorisation by rightholders of the same “is devoid of legal effects under the law of that State” and cannot impact the harm caused by the reproduction.<sup>93</sup> This in turn means that these authorisations cannot be taken into consideration when calculating the level of fair compensation.<sup>94</sup> This understanding, it should be emphasized, represents a significant departure from the status quo in many Member States’ levy systems, which take into consideration such authorisation to either eliminate levies in certain cases or substantially limit their amount.

34 On this point, the Court strays from A.G. Sharpston’s Opinion. Although the Opinion shares the same basic understanding, the A.G. qualifies her position in light of the interpretation that “the legislature clearly intended there to be some possibility for contractual arrangements to coexist with such exceptions and limitations”.<sup>95</sup> The Directive not being clear, Member States should enjoy a level of discretion, which includes the possibility of rightholders either renouncing the claim for fair compensation or making their works available through contractual arrangements that price such fair compensation for future copying into the transaction; in either case, no fair compensation from PC levies is due for these acts (as the same would, quite curiously, be “exhausted”).<sup>96</sup> A similar outcome (although following a different logic) results from the Vitorino Recommendations, analysed below.<sup>97</sup>

35 The Court’s ruling on this point raises concerns that, in many instances of digital PC, end-users will now be subject to double payment: the amount paid for a licensed use (which already prices into the purchase subsequent acts of digital copying by the user); and a levy, which must be calculated as if no digital copying is priced into the purchase of a work. At least two arguments can be raised to potentially limit this negative consequence of the Court’s judgement.

36 The first is that the Court recognizes the relevance of the application of TPMs on the calculation of the levy, such as to allow an indirect adjustment of the levy rate which reduces the impact of the double payment problem. Second, many instances where levies are not being collected on the basis that subsequent digital copying is priced into the license or purchase (e.g. Apple’s iTunes) will likely fall squarely under the provision of Article 6(4), fourth subparagraph of the Copyright Directive. This provision, noted above, can be interpreted as allowing the contractual overridability of the PC exception or limitation for works made available online, with copy control TPMs and subject to a licensing agreement. In such cases, it can be argued that there is effectively

no PC act and therefore no levy to be paid. Consequently, no risk of double payment arises.

#### 4. The effect of TPM application in the condition of fair compensation

- 37 As noted above, Article 5(2)(b) of the Copyright Directive demands that fair compensation take account of the application or non-application of TPMs to the copied works. Recital 35 further provides that “full account” must be taken of the “degree” of TPM usage vis-à-vis determining the level of fair compensation.
- 38 When interpreting these provisions, the Court notes that TPMs are meant to allow rightholders to restrict the practice of unauthorised acts by end-users, whilst the PC exception or limitation is designed as a legislative permission for unauthorised reproduction acts.<sup>98</sup> As such, it is for the Member States to define the proper scope of PC, which should be done also by the encouragement and regulation of the voluntary application of TPMs by rightholders. In other words, the application of TPMs helps delimit the scope of PC. It is that delimited scope that forms the basis for the calculation of fair compensation. In this light and due to the voluntary nature of TPMs, even where these are *available* but not *applied*, the condition of fair compensation must remain applicable.<sup>99</sup> Member States may nonetheless adjust the level of fair compensation in light of the application of TPMs, thus encouraging its voluntary adoption and better application of the exception or limitation.<sup>100</sup>
- 39 Again, the Court’s judgement seems to stray away from A.G. Sharpston’s Opinion, which believes this to be a matter of policy not clarified by the Directive, thus being up to Member States to decide *whether* and to *what extent* fair compensation should be provided for where TPMs are available to but not applied by rightholders.<sup>101</sup> It now seems that Member States can only decide the *extent* of fair compensation.
- 41 At the time of writing, rulings are awaited in *UPC Telekabel v. Constantin Film*,<sup>102</sup> *Copydan Båndkopi v. Nokia*<sup>103</sup> and *ACI Adam and Others v. Stichting de Thuis-kopie*.<sup>104</sup> These cases address some of the issues still unresolved by the above legal framework and case law.
- 42 *Copydan Båndkopi v. Nokia* examines the concept of “fair compensation” in relation to levies on memory cards for mobile phones; it further addresses a multitude of related questions that read like a “treatise” on PC.<sup>105</sup> The latter relate to topics such as the subsistence of the right to fair compensation for reproductions made from various sources (e.g. paid and gratis licensed content, DRM-ed and non-DRM-ed content, subsequent copies from third-party copies, lawful and unlawful Internet copies), the adequate consideration of the application of TPMs, the scope of the *de minimis* exemption, and the correct articulation of concepts of “fair balance” (cf. Recital 31 of the Copyright Directive) and “fair compensation” in the selection of levy targets.<sup>106</sup>
- 43 The issue of the (un)lawful nature of the source of the copies from which the relevant reproductions are made features prominently in *ACI Adam and Others v. Stichting de Thuis-kopie*, which furthermore inquires as to the effect of the application of the three-step test (Art. 5(5)) on the scope of PC and its articulation with the Enforcement Directive.<sup>107</sup>
- 44 For its part, *UPC Telekabel v. Constantin Film* tackles the issue of the nature of the source of the copy through the lens of the interpretation of Article 8(3) of the Copyright Directive, on the application of injunctions against intermediaries (here: Internet Service Providers) whose services are used by users of infringing content made available online.<sup>108</sup>
- 45 The quantity and depth of the above requests for preliminary rulings will quite likely yield rulings that clarify most of the (many) questionable issues surrounding PC in the EU. Maybe for that reason, the Vitorino Recommendations analysed below shy away from some of the important issues raised in such requests, such as the nature of the source of the copy<sup>109</sup> or even the full impact of TPM application in the assessment of fair compensation, which has in the meantime been addressed in *VG Wort v. Kyocera*.<sup>110</sup>

### III. Colouring the remaining legal landscape: forthcoming ECJ case law (brief reference)

- 40 However clarifying the above-mentioned ECJ case law was, it has nonetheless left in its wake a patchwork harmonization of the PC exception/limitation. In fact, not only has there been an institutional effort to further harmonize this field – as noted by the mediation process leading to the Vitorino Recommendations – but it has also caused the ECJ to be flooded with multiple references for preliminary rulings.

#### C. The Vitorino Recommendations

- 46 The Recommendations, published on 31 January 2013, are relevant not only for their institutional weight, but mostly because they provide an adequate mapping of significant points of contention within the levies debate. They have furthermore been qualified as “non-binding provisions” on PC levies by the Commission.<sup>111</sup>

47 In order to be properly understood, the Recommendations must be read in light of both the then-pending requests for preliminary rulings by the ECJ (mentioned above) and the mediator's baseline understanding of key issues of the PC legal framework and debate. The latter can be inferred from his introductory remarks in the document.<sup>112</sup> First, Mr Vitorino believes that none of the currently proposed alternatives justify the "phasing out" of hardware-based levies.<sup>113</sup> Second, the link between the PC beneficiaries causing the "harm" and those liable for financing fair compensation "should not be severed".<sup>114</sup> Third, online business models are shifting from ownership to access-based models, leading to a future decrease in the level of levies collected.<sup>115</sup> In fact, where rightholders are remunerated via licensing agreements for uses through (typically DRM-ed) "online services" covering reproduction of their works, imposition of levies would configure a double payment. (This assumption, however, seems to have been challenged in the meantime by *VG Wort v. Kyocera*.) As such, the focus of the Recommendations is squarely placed on the "consistency, effectiveness and legitimacy" of current levy systems.<sup>116</sup>

48 The Recommendations are divided into two clusters: the first addresses new business models, licensed services and the PC exception or limitation;<sup>117</sup> the second is directed at levy systems in the internal market.<sup>118</sup> The following sections look at both clusters in sequence, focusing on those recommendations that are aimed at PC and the issues raised by the previous analysis of its legal framework.

## I. On new business models, licensed services and private copying

49 In this context, Mr Vitorino basically offers one recommendation regarding the clarification that end-user copies made for private purposes in the context of licensed services (by rightholders) cannot be considered to cause any harm giving rise to additional remuneration in the form PC levies.<sup>119</sup>

50 Although the current business market for online services is dynamic and evolving, Mr Vitorino identifies a tendency for comprehensive offers to consumers, comprising multiple features (device portability, synchronization, cloud "storage and matching", playlist sharing, etc.), for the most part falling outside the scope of the PC exception; as such, the argument goes, the lawful operation of these complex access-based services requires licensing agreements.<sup>120</sup>

51 If that assessment is true, the question then becomes how to qualify end-user copies made for private purposes under licensed services. Such a qualification depends on whether the rightholder's consent for PC acts is valid. If invalid, the use falls under the excep-

tion or limitation and (unless *de minimis*) should give rise to payment of fair compensation. Mr Vitorino considers the consent to be valid without explicitly laying out his legal arguments, instead echoing different stakeholders' opinions.<sup>121</sup> Such opinions can be structured as follows: a rightholder's authorisation for private use does not equate to the contractual overridability of the exception or limitation; it is instead a contractual disposition of an already exempted act; therefore, the rightholder is entitled to grant such authorisation against whichever counter performance is deemed adequate. The logical conclusion of this argument, and one which Vitorino endorses, is that PC acts so authorised (i.e. made in the context of a licensed service) will cause no "harm" and therefore give rise to no claim for fair compensation.<sup>122</sup>

52 It is noteworthy that A.G. Sharpston's Opinion, preceding the Court's judgement in *VG Wort v. Kyocera*, reaches a similar conclusion on this precise issue, albeit following a different reasoning.<sup>123</sup> A.G. Sharpston argues for the validity of national laws allowing rightholders to either "renounce any claim to fair compensation or make their works available for copying subject to contractual arrangements", thus enabling them to receive fair compensation in advance for future acts of PC; in either case, such rightholders would have no claim for fair compensation, which should be deemed "exhausted".<sup>124</sup> As noted above, the Court in *VG Wort v. Kyocera* took a different view, clearly stating that any authorisation of an act encompassed in the scope of a PC exception or limitation is void of legal effects and thus has no bearing on the fair compensation owed.<sup>125</sup>

53 Mr Vitorino's interpretation rests on a belief in online service providers' ability to cater to market needs via direct licensing. In this context, the mediator recognizes that a CMO-enabled private ordering regime may hinder authors and performers, due to their lack of bargaining power in negotiations with corporate rightholders, a fact often leading to the latter acquiring all economic rights on works and benefiting from direct licensing practices. Notwithstanding, he argues that these issues are not the province of the PC levies framework, and should instead be addressed in the forum of contract and labour law, as well as collective rights management.<sup>126</sup>

54 In sum, Mr Vitorino argues that licensed copies should not give rise to PC levies, as that would lead to double payment. This solution is supported by Recitals 35 and 45 of the Copyright Directive (opening the door for contractual stipulation in this field) and by the ECJ rulings in *Padawan* and *Stichting de Thuiskopie*, which link fair compensation to "harm" caused by *unauthorised* reproduction. Put differently, authorised uses cause no harm requiring (fair) compensation. Although the conclusion is legally sound, Mr Vitorino's road to reach it is criticisable, insofar as it

rests on an assumption of a universal licensing requirement for modern multi-feature service offers to end-users. This pro-licensing approach, increasingly advocated by the Commission for the online use of copyrighted works (as transpires from its “Licenses for Europe” initiative<sup>127</sup>), represents a policy trend whose effect is to endorse a restriction to the scope of the PC exception or limitation. A restriction of this magnitude may be legally questionable, on the grounds that it goes beyond ECJ interpretation of the PC exception’s scope, especially post-*VG Wort v. Kyocera*, thus raising questions of legal uncertainty. It also opens the door to some normative discussion on the justification of this exception in light of current contractual and technological possibilities in the digital realm.

## II. On levy systems in the Internal Market and in particular the concept of harm

- 55 In what concerns levy systems in the internal market, Mr Vitorino’s departure point is that, pursuant to *Padawan*, the sole condition for the “*leviability*” of products is their technical capability to make (or store) copies.<sup>128</sup> Beyond this condition, Member States (and not the EU legislator) should decide which products to levy, according to their specificities.<sup>129</sup> Notwithstanding, and with respect for the principles of subsidiarity and proportionality, levy systems should be reconciled with Internal Market objectives.<sup>130</sup> Several recommendations are advanced in this context, aimed at providing specific solutions to existing “cross-border issues” connected with the divergent application of the PC regimes. For the purposes of this article, these can be divided into recommendations that do not focus on the concept of harm, and those that do focus on that concept.<sup>131</sup>
- 56 The first group of recommendations is of reduced interest to our inquiry, as it relates to levy systems in the Internal Market in general. First, it is recommended that levies are collected “in cross-border transactions in the Member State in which the final customer resides”.<sup>132</sup> Second, the mediator addresses concerns with double payments in cross-border sales and payment liability, by presenting an alternative proposition: either (i) “*liability for paying levies should be shifted...to the retailer’s level while simplifying the levy tariff system and obliging manufacturers and importers to inform collecting societies about their transactions concerning goods subject to a levy*”, or (ii) “*clear and predictable ex ante exemption schemes should be established*.”<sup>133</sup> Third, it is recommended that levies “be made visible for the final customer”.<sup>134</sup> In the context of the adoption of ex-ante exemptions from payment by manufacturers/importers, a parallel solution would be imposing this transparency obligation throughout the sales chain.<sup>135</sup> Finally, Mr Vitorino recommends that the tariff-setting process be improved and made transparent, that equal representation of all stakeholders be implemented, and that the process be subject to supervision by national authorities (at interim and/or final level).<sup>136</sup> Furthermore, it is suggested that levy-setting decisions should be subject to judicial review, preferably under specific procedural rules, ensuring fast decisions and clearly defining the effective date of application of the rate.<sup>137</sup>
- 57 Turning to the concept of harm, Mr Vitorino believes that, in order to achieve coherence in the levy-setting process, it is necessary to define “‘harm’ uniformly across the EU as the value consumers attach to the additional copies in question (lost profit)”, and provide a “procedural framework that would reduce complexity, guarantee objectiveness and ensure the observance of strict time-limits”.<sup>138</sup>
- 58 In this respect, it is rightly noted that the notion of “harm” caused to authors for PC purposes is subject to different interpretations. Harm is both a *valuable* (cf. Recital 35 of the Copyright Directive) and *necessary* (cf. *Padawan*) criterion for calculating fair compensation.<sup>139</sup> What is not mentioned in the Recommendations is that, while Recital 35 discusses the harm *resulting from the act of PC*, *Padawan* shifts that interpretation to the harm *resulting from the introduction of the exception or limitation*. In any event, Mr Vitorino believes this concept requires uniform interpretation (similarly to the related concept of fair compensation), providing a clear link to the amounts levied.<sup>140</sup>
- 59 To that avail, he proposes to “look at the situation which would have occurred had the exception not been in place” and concretely “assess the value that consumers attach to the additional copies of lawfully acquired content that they make for their personal use.”<sup>141</sup> This “would allow the estimate of losses incurred by rightholders due to lost licensing opportunities (‘economic harm’), i.e. the additional payment they would have received for these additional copies if there were no exception”; in most cases, “this amount would neither reach the level comparable to the value of the initial copy nor would it be so negligible that it could be completely ignored”.<sup>142</sup> To make this definition workable, “it would be necessary to assess not the *actual* number of copies made but rather the *hypothetical* (lower) number of copies that could have been licensed in the absence of the exception”.<sup>143</sup> It is thus “fair and reasonable”, Mr Vitorino continues, to “compensate rightholders precisely for lost income opportunities, e.g. via the licence agreements they would have concluded if there were no exception”, and “for the level of compensation to reflect the actual value attached by consumers to such additional ‘private’ copies”.<sup>144</sup>

- 60 There are several possible criticisms to Mr Vitorino's proposed interpretation of the concept of harm, both from the economic and legal standpoints. The first relates to the identification of "the value that consumers attach to the additional copies", which in economic terms is in principle the entire consumer surplus of private copies, to "lost profit". Absent the PC exception, even very refined pricing schemes for licences would not be able to appropriate the entire consumer surplus and turn it in to revenues for rightholders. As such, the rightholders' "economic harm" as defined by Mr Vitorino should not, from the economic standpoint, be understood as the value that consumers attach to their private copies, as said amount will be in excess of that which would result even from the normal exploitation of exclusive rights through sophisticated price discrimination models.
- 61 Second, using the criteria of the hypothetical situation "which would have occurred had the exception not been in place" introduces the complex question of whether consumer behaviour would really be much different with or without a PC exception. Besides justifications based on fundamental rights such as privacy, this exception is to a large extent based on market failure considerations linked to high transaction costs in connection to the enforcement of previously mass infringing uses.<sup>145</sup> To the best of the authors' knowledge, there is no convincing empirical evidence that, in countries where no PC exceptions have been introduced (such as the UK, although implementation of a narrow uncompensated PC exception is forthcoming<sup>146</sup>), fewer private copies are made. To be sure, this is an empirical question. However, it is submitted that lacking the relevant data, it becomes nearly impossible to establish a realistic baseline from which to calculate harm.
- 62 Third, and related, Mr Vitorino's definition of harm seems to conflate the concepts of *lost profits* and *lost licensing opportunities*. This is made clear by the application of his hypothetical-scenario logic in the context of infringement of exclusive rights. In this scenario, an infringing practice (e.g. unauthorised reproduction) could trigger the payment of damages. Under the Enforcement Directive, it is possible to calculate damages for either lost profits or lost licensing opportunities.<sup>147</sup> Very briefly, lost profits are a primary method for the calculation of damages appropriate to the actual prejudice suffered by rightholders as a result of the infringement, constituting an example of the negative economic consequences of such acts.<sup>148</sup> However, the Enforcement Directive allows for an alternative possibility of calculating damages, namely by setting them as "as a lump sum on the basis of elements such as *at least the amount of royalties or fees* which would have been due if the infringer had requested authorisation to use the intellectual property right in question".<sup>149</sup> This latter possibility bears a strong resemblance to Mr Vitorino's definition of lost licensing opportunities. It is therefore *prima facie* difficult to understand his concept of lost profits as the basis of calculation of the PC harm.
- 63 Moreover, PC is an exception or limitation, meaning that relevant challenges arise when applying methods of calculation native to the infringement of exclusive rights. Chief among these is the fact that, contrary to the case of PC, it is possible in the context of exclusive rights to calculate lost licensing opportunities precisely with reference to information from previous licensing agreements (where these exist) that would encompass the uses in question. Such licensing agreements do not exist for PC purposes and one should be cautious in taking into consideration agreements for equivalent uses under exclusive rights, as their pricing does not reflect the infringer's unwillingness to license at this price. Consequently, levies set according to this method could lead to higher amounts paid by end-users.
- 64 Another issue relates to the definition of economic harm as reflecting lost licensing opportunities for subsequent copies of "lawfully acquired content".<sup>150</sup> This concept is not specified further by Mr Vitorino, and thus it is not possible to discern whether it is meant to apply to copies from content lawfully purchased, rented, streamed or downloaded (either subject to DRM, contractual conditions, payment or neither) or otherwise accessed. Assuming the concept is sufficiently broad to cover all the aforementioned variations, it implies that only PC acts from a lawful (or lawfully accessed) "source" are relevant for purposes of calculating fair compensation. Where national laws do not contain a qualification of this type, it is arguable that all PC acts fall within the scope of the exception or limitation, irrespective of the nature of the source or the access.<sup>151</sup> However, several European countries do contain provisions of this type.<sup>152</sup> In these countries, any copies from content unlawfully acquired, accessed or made available (e.g. in many cases, file sharing of torrent networks, newsgroups, social networks or cyber lockers) are deemed not covered by the exception and thus not exempted acts of PC. In that scenario, it seems to follow that no fair compensation is due, as the acts in question constitute instances of copyright infringement. That much results from Mr Vitorino's argumentation. Notwithstanding, such an interpretation, especially where restricted to instances of content lawfully *acquired strictu sensu*, if harmonized at the EU level brings with it the risk that a significant portion of current online uses – namely, acts of download not covered by licensed services – would be deemed infringing. This will not only raise enforcement costs, but also reduce the scope of the PC exception and potentially diminish the amount of revenues generated by levies. Those direct consequences will bring related concerns of privacy risks caused by additional enforcement, criminalization

of an increasing number of end-users and, in general, reduced scope for innovation that depends on the “breathing space” provided by private acts of online reproduction, mostly related to “dynamic” or “creative” PC.<sup>153</sup>

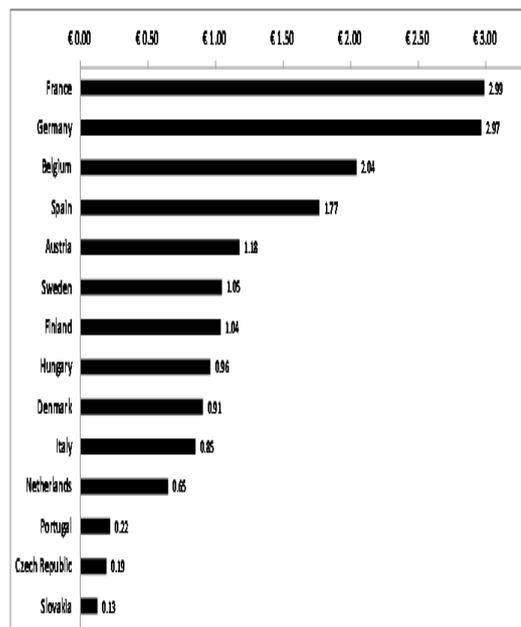
- 65 It is expected that this issue is dealt with in detail by the ECJ in the aforementioned ECJ references for preliminary rulings, which encompass many potential configurations of the unlawful source/access of/to the copies giving rise to subsequent private and non-commercial acts of reproduction.
- 66 A final criticism relates to Mr Vitorino’s understanding that “the ‘harm’ which is subject to fair compensation arises not from one single copy but from a number of a natural person’s activities which, taken together, amount to relevant ‘harm’ caused to right-holders”; as such, it cannot be qualified as *de minimis*.<sup>154</sup> By itself, this raises great legal uncertainty. No clarification is provided on multiple issues, such as where to draw the line for acts to be considered jointly. What are the relevant acts to be aggregated (those of a consumer regarding a specific work, by a specific rightholder, or all works of the same rightholder)? What is the relevant period of time for calculation of aggregate uses? Moreover, even if a broad interpretation on these points is professed so as to secure that a levy system is operational and effective, it then becomes nearly impossible to define the scope of *de minimis* uses.<sup>155</sup> Perhaps a reasonable way to address this uncertainty is to focus on each levied device or blank media, instead of each user. Consequently, calculation through aggregation of uses would be admissible for PC made in each such device of media over its lifetime. Where PC acts for each device or media (even when taken together) are minimal, no levy should be due. If Internet connections were to be levied instead of devices, the consequences of applying this logic would be different.

#### D. PC levies in practice in the EU

- 67 Following the Copyright Directive, 22 out of 27 EU Member States have introduced levy systems.<sup>156</sup> As technology used for consuming and storing music and audio-visual material changes rapidly, so do the devices and media levied. All 22 EU countries that introduced PC levies apply these to blank CDs and DVDs. A majority also have levies on memory cards, MP3 players and hard disc DVD recorders. In addition, a number of countries have levies on external hard drives, PCs, tablet computers and smartphones. Game consoles are generally exempted, as the Copyright Directive does not apply to software.<sup>157</sup>
- 68 There are also massive differences in the levels of PC levies. For example, for a blank CD, nominal levies range from € 0.009 in the Czech Republic to € 0.35 in France. Alternatively, several countries have levies

relative to the price of media, ranging from 1.25% in Bulgaria to 6% in Greece. For devices such as MP3 players, nominal levies often depend on the storage capacity. For a 32-GB player, levies range from € 1.42 in Latvia, to € 22.52 in Hungary. Levies for hard-disk DVD recorders range as high as € 50 in France.<sup>158</sup>

- 69 Figure 1 gives the revenues collected per capita in 2010 in several EU Member States. Revenues per capita range from less than € 0.01 in Bulgaria to nearly € 3 in France and Germany. For all EU Member States taken together, revenues totalled about € 648 million in 2010.<sup>159</sup> As a result of rapidly changing technology used for storing and copying content, in combination with a tradition of litigation over the incorporation of new media and devices in levy schemes, revenues tend to vary over time. An upward driver is the rapidly increasing storage capacity of most devices, which implies that revenues based on a fixed amount per MB or GB increase rapidly in time. A downward driver is the dynamic nature of the consumer electronics market. For instance, the use of blank CDs and DVDs has plummeted as they are substituted by USB sticks and memory cards. Likewise, the market for MP3 players is being cannibalized by smartphones.



**Figure 1: Private copying levies collected in 2010 (€ per capita)**

**Source:** Based on WIPO, *International Survey on Private Copying: Law & Practice 2012*. Geneva, Switzerland: World Intellectual Property Organization (2012), pp. 13-14. **Notes:** Within the EU, no PC levies exist (at the date of writing) in Cyprus, Ireland, Luxembourg, Malta and the UK; no data is available for Slovenia and Estonia.

## E. The economics of private copying levies

70 Having provided a detailed account of the legal background and ECJ interpretation of the PC exception or limitation, as well as a brief overview of the empirical data on PC levies in the EU, this part will now overlay on the previous legal and empirical blueprint an economic perspective on PC levies, which is often foreign to the legal debate in this field. The focus will be on the definition of types of PC, the articulation of the concept of harm with the economic notion of indirect appropriability and the application of TPMs.

### I. Types of private copying

71 Article 5(2)(b) of the Copyright Directive is phrased in a very generic way with respect to the *types* and *purpose* of private copies: as long as such copies are made by a natural person for private non-commercial use, they can fall under the exception, provided rightholders receive fair compensation. From an economic point of view, however, it is useful to distinguish various types of private copies, as they will have different values for consumers, and any harm for rightholders due to lost sales (or lost licensing opportunities) will also differ between these types. For these analytical purposes, the following typology is proposed:<sup>160</sup>

- a Making copies of broadcasted works for *time shifting*, such as storing radio or TV content on a recording device to watch it another time and if desired repeatedly;
- b Making “clone copies” of or “format shifting” CDs, DVDs and media files, or storing streaming audio and video for offline playback (also known as stream “ripping” or “capture”);
- c Making clone copies or format shifting to *share* works with members of your *household, family and friends*;<sup>161</sup>
- d Making clone copies or format shifting of works from media *rented* or *borrowed* from libraries or commercial renters;
- e Making *backup copies* of works;
- f *Downloading* and storing works from *unauthorised sources* on the Internet (and making subsequent copies thereof).

72 Typically, private copies of type (a)-(e) are allowed under the PC exception or limitation. However, types (b)-(e) may in practice be prohibited or restricted by TPMs and licence or rental agreements. According to a recent WIPO survey, downloading from unau-

thorised sources on the Internet (f) is prohibited in most EU Member States.<sup>162</sup>

73 There are relevant economic differences between all these types of copies. Copies of type (a) and (b) enhance the utility that consumers derive from their legitimate purchase or subscription. It enables them to consume this content at a more convenient time or place, on a more practical device or without carrying discs and devices around. For instance, they can keep a copy of their favourite CDs in their car or vacation home or play them on their computer, smartphone or MP3 player. Time-shifting also enables them to skip advertisements in TV programmes, either manually or by using built-in features in digital video recorders (DVRs) or software. Copies of type (c) and (d) are different from the former in that they extend the circle of consumers who derive utility from an original unit of content.<sup>163</sup> Unauthorised downloading (f) resembles the former types, with the notable difference that the extended circle of consumers is anonymous and potentially unlimited. Backup copies (e) do not provide utility directly but act as an insurance against mishaps.

### II. Harm and indirect appropriability

74 These differences are relevant in light of the *harm* that PC may cause to copyright holders and the concept of *indirect appropriability*. This term refers to the economic mechanism according to which, under certain conditions, the demand for originals will reflect the value that consumers place on both the originals and subsequent copies they may make. Hence, the value of PC can be priced into the initial purchase and by doing so, this value is *indirectly appropriated*. If copyright levies should be understood as a compensation for harm caused by PC, as is the case at least according to EU law, it is important to analyse the economics behind this harm more closely.

75 A seminal contribution to this issue is provided by Stan Liebowitz, who studied the effect of photocopying on the demand for journals.<sup>164</sup> He found that “publishers can indirectly appropriate revenues from users who do not directly purchase journals and that photocopying has not harmed journal publishers”.<sup>165</sup> The value consumers (or scholars) derive from copies contributes to the willingness of libraries to pay. Hence, publishers end up selling fewer originals at a higher price, which may even raise profits. If the number of copies per original differs substantially, such *indirect appropriability* depends on the ability to price-discriminate: charging a higher price for users who are likely to enable extensive copying while preventing arbitrage through a secondary market or other ways to circumvent price discrimination. In practice, this is done by a higher price for libraries and a lower price for individuals.

- 76 In general, selling fewer originals at a higher price introduces two opposing effects which may lead to both higher and lower profits. This issue was further studied by Besen and Kirby, who model PC while distinguishing (i) the extent to which originals and copies are perfect substitutes, and (ii) whether PC has constant or increasing marginal costs.<sup>166</sup> Increasing marginal costs may not only stem from the technology itself, but also from the “costs” of organizing the copying process within sharing groups. Besen and Kirby conclude that the effect of PC on consumer and producer surplus and total welfare depend strongly on the assumptions about substitutability and the costs of copying. When the marginal costs of copying are *constant*, copies will be distributed at marginal costs and the value of copies cannot be appropriated. The introduction of (relatively cheap) copying technology will then lower the price of originals and profits will decline subsequently. Consumer surplus will increase, while the effect on total welfare is ambiguous. If the marginal costs of copies are *increasing*, copying leads to fewer originals sold at a higher price: indirect appropriability. Besen and Kirby conclude that the effect on welfare will depend on whether or not copying is cheaper than producing originals: “in the case where the size of the sharing group is fixed, consumer and producer welfare generally increase when copying is efficient and decline when it is not. When the costs of both originals and copies are low, however, producers will generally lose and consumers will gain from the introduction of copying.”<sup>167</sup>
- 77 The scenario of *constant* (near-zero) marginal costs of copying resembles the situation of unauthorised file sharing over the Internet (type (f) above), even though such file sharing did not occur when Besen and Kirby wrote their paper. Their analysis implies that indirect appropriability is not feasible in the face of online file sharing. This also follows from the fact that the number of copies generated per original sold may differ immensely. Some CDs will not be copied at all, while others will be ripped and uploaded to torrent sites to be seeded to millions of users. This complicates price discrimination.
- 78 The scenario of *increasing* marginal costs will apply to all types of PC except for unauthorised file sharing and may or may not cause harm, depending on the costs and value of copies in comparison to that of originals and the size of sharing groups. Copying may cause no harm at all to copyright holders, but copies may also become competitors to the originals, constraining the price the copyright holder can charge and reducing profits substantially.<sup>168</sup>
- 79 Empirical testing of the net effect of PC on profits is lacking. Surveys carried out in the context of the levy-setting process in various countries typically focus on the number of private copies and the self-reported substitution rate<sup>169</sup> and ignore the effect of PC on the demand for the first original and the complex dynamics of indirect appropriability. The net effect can be expected to differ for the various types of PC discussed above. As mentioned there, private copies of types (a), (b) and (e) do not extend the circle of consumers that derive utility from an original unit of content. No “copying groups” are formed in which copies become competitors to the original. Some additional sales could be foregone as a result of such copying, for instance when a person would have bought his favourite CD twice to play it at home and in his car. But to the extent that consumers can roughly anticipate their copying behaviour, the option to copy can be *priced into the initial purchase* by rightholders. Put differently, the demand curve for originals will reflect the expected utility derived from such private copies. This is an important notion, as it means that in such a case a copyright levy that charges “the value that consumers attach to the additional copies”, as Mr Vitorino suggests, would lead to double payment.<sup>170</sup>
- 80 On the other hand, the demand curve will not reflect the utility of *unforeseen* copying possibilities: in the first decade after the introduction of the CD, consumers would not have expected the possibility that twenty years later, they would be able to make perfect copies of CDs within their home, let alone rip 500 CDs into a portable device the size of a matchbox. Hence, the utility they derive from copying and ripping these CDs will not have been reflected in their initial purchase at the time.<sup>171</sup>
- 81 Turning to copies shared within one’s household, and with family and friends (type (c)), the aforementioned models of Besen and Kirby and Varian are more likely to apply, and PC might be harmful to copyright holders even though some of the additional utility can be appropriated indirectly. This is partly due to the fact that the size of such copying groups is variable and price discrimination according to group size is not possible. The utility of copies of type (d) could in theory be appropriated indirectly by setting the appropriate rental prices, unless restrictions put on the rental price from a public service perspective prohibit doing so.
- 82 To summarize the economic perspective, the utility downloaders derive from *unauthorised file sharing* cannot be priced into the initial purchase. For other types of PC, these benefits can to a large extent be appropriated by using smart pricing, depending on the cost structures. For *time shifting*, *format shifting* and *clone copying* for personal use, this is likely to be the case almost entirely – after an initial shock wave caused by the introduction of cheap digital copying and ripping technology for consumers. Now that both consumers and producers are aware of this technology, indirect appropriability will apply and harm will be minimal. In such cases, levies aimed at compensating for this minimal harm

are ill-advised, given the administrative and transaction costs they incur and their potential effect to take away incentives for smart pricing.

- 83 For copies *made within the accepted circle of family and friends*, on the other hand, indirect appropriation may not be sufficiently possible (e.g. due to varying sharing group size) and harm from such private copies may well occur. However, the problems resulting from the latter for a PC perspective will greatly depend on the definition of the scope of what uses can be qualified as *private* under the exception (as all sharing acts outside that scope are deemed copyright infringement and, thus, not to be dealt with in the PC regime).

### III. The application of DRM

- 84 As a preliminary point, it should be noted that the term DRM encompasses both TPMs – e.g. access and copy control measures (Art. 6 of the Copyright Directive) – and electronic rights management information – such as fingerprinting or watermarking, also known as “social DRM” (Art. 7 of the same Directive). Furthermore, most economics literature applicable to PC levies either does not make the distinction and uses the term interchangeably or uses it solely to mean TPMs.<sup>172</sup> The distinction is relevant insofar as legal rules regulating the effect of these measures on the scope of PC and the calculation of levies mention solely TPMs.<sup>173</sup> Consequently, all arguments on the impact of other types of DRM on the amount of levies must be construed as economic (and normative) by nature. The following paragraphs adopt the broad use of the term DRM, making the distinction with TPMs where relevant.
- 85 Koelman points out that DRM increases the opportunities copyright holders have to appropriate the additional utility derived from PC.<sup>174</sup> This is in line with remarks in the Copyright Directive on the “application or non-application” of TPMs and Mr Vitorino’s recommendation that licenced copies do not require additional remuneration by a levy. However, the distinction between the “application or non-application of technological measures” is not as binary as it may seem at first glance. Due to its rich variety, DRM can be applied with the aim of making any kind of copy impossible, even clone copies or format shifts (type (b)) and backups (type (e)). Or it can be applied in a slightly more lenient way, allowing consumers to make a certain number of copies to other devices and carriers. In the case of *social DRM*, the aim of which is to discourage the distribution of private copies outside a circle of family and friends, copies found on file-sharing sites can be traced back to the original purchaser against whom action could be taken. In practice, several flavours of DRM coexist, sometimes even for the same title: consumers
- can choose the kind of DRM they are willing to accept and pay the corresponding price.
- 86 Many believe that DRM did not and will likely not eradicate all unlicensed copying. As Steve Jobs stated in 2007: “DRM (systems) haven’t worked, and may never work to halt music piracy.”<sup>175</sup> The technical and privacy issues that make strict enforcement problematic and give rise to copyright levies in the first place have not disappeared with the introduction of DRM. Nevertheless, various kinds of DRM are now available to give copyright holders at least a firmer grip on copying and more opportunities for price discrimination and indirect appropriation. Against this background, the decision *not* to apply DRM should also be considered. When consumers started copying and sharing CDs on a large scale, for instance, record labels introduced DRM on CDs, and until 2007, all digital music files bought from Apple’s iTunes store also contained DRM technology to prevent copying.<sup>176</sup> However, consumers did not appreciate the way in which DRM got in the way of supposedly legitimate uses. For instance, DRM sometimes caused computers to crash, which was a nuisance to people trying to play an audio CD with their computer, even without trying to copy it. Also, the use of DRM prevented consumers from format shifting, such as ripping their own CD collection onto their MP3 player. Thus, DRM “impose[s] costs on legal users who have no intentions of doing anything illegal”.<sup>177</sup>
- 87 Therefore, the use of DRM (and in particular TPMs) may create a disutility for consumers and have a negative effect on the demand for originals. For example, consumers who only play music from a hard drive or on their phone may stop buying CDs if TPMs prohibit them to rip these. DRM may even cause consumers to revert to TPM-free content from illegal sources.<sup>178</sup> Over the last few years, the music industry moved away from using DRM.<sup>179</sup> From an economic point of view, this should be a rational choice. Indeed Sinha et al. find that “the music industry can benefit from removing DRM” and that “a DRM-free environment enhances both consumer and producer welfare by increasing the demand for legitimate products as well as consumers’ willingness to pay for these products”.<sup>180</sup> Therefore, the choice *not* to use TPMs should be perceived as a rational choice in the spectrum ranging from more to less restrictive DRM technologies that are currently available.
- 88 Now that rightholders have these options, it makes no longer sense for copyright levies to draw a sharp line between the application and non-application of TPMs as the Copyright Directive seems to suggest. The choice *not* to use TPMs or any other kind of DRM (where they are available) should no more entitle copyright holders to compensation than the choice to use restrictive TPMs. There seems to be legal room to accommodate this economic argument.

For example, Hugenholtz *et al.* propose that “levies are to be phased out not in function of actual use, but of availability of technical measures on the market place.”<sup>181</sup> The point is that the decision not to apply TPMs but less restrictive DRM or no measures at all will enhance the value of the original to the initial consumer. This will increase consumers’ average willingness to pay, which implies the enhanced value of the original can (at least partially) be appropriated indirectly. Therefore, while TPM technology is widely available, its non-application or the application of less restrictive DRM is in many instances in the best interest of both consumers and rightholders.

- 89 The Court’s decision in *VG Wort v. Kyocera* seems oblivious to these considerations by preventing that the availability of TPMs is considered by itself as reason sufficient to eliminate any fair compensation to rightholders.<sup>182</sup> Notwithstanding, Member States retain a wide discretionary margin in defining the extent of fair compensation where TPMs are available but not applied. From a legal standpoint, such discretion must be exercised and, one might argue, on the basis of solid economic reasoning and evidence. Consequently, consideration should be given to the multiple types of TPMs available to rightholders that allow price discrimination and enable indirect appropriability, under the terms described above. Furthermore, nothing seems to *prevent* (although there is no legal imposition to do so) Member States from extending such consideration to other types of DRM that fulfil similar functions, thus allowing for a more holistic approach to the calculation of the applicable levies.
- 90 Finally, harm from PC cannot be equated to harm caused by the possible introduction of a PC exception or limitation to copyright. As pointed out above, consumers’ PC behaviour is to a large extent independent of its legal status, since enforcement is problematic. These acts occur with or without an enabling legal exception or limitation. Much of any harm from PC would thus not be the *result* of the introduction of such an exception. This implies that the suggestion, both in *Padawan* and in Mr Vitorino’s Recommendations, to base compensation on the harm caused by the *introduction* of the PC exception, could leave copyright holders empty-handed. Consequently, it would make more sense for rightholders to more closely follow the letter of Recital 35 of the Copyright Directive and have fair compensation be calculated on the basis of the “use made of their protected works or other subject matter”. If the above arguments on indirect appropriability and the economic analysis of the concept of harm are adopted by national legislators, rightholders would have economic logic on their side in doing so.

## F. Conclusions

- 91 Copyright levies have been introduced to compensate rightholders for the harm caused by PC. However, economic analysis has shown that the utility consumers derive from offline private copies can to a large extent be appropriated indirectly. Hence, the harm caused by these acts will be substantially smaller than the utility consumers derive from private copies or even the sales forgone by such copying. For private copies that do not lead to a proliferation of content – for example, time shifting, format shifting and backup copies – there may be no harm at all, provided consumers are aware of these copying possibilities at the time of their initial purchase.
- 92 TPMs, less restrictive DRM and innovative pricing schemes have improved the possibilities for copyright holders to appropriate the value of private copies. Therefore, charging levies for copies that are licenced by rightholders would lead to double payment. The Court of Justice’s decision in *VG Wort v. Kyocera* ignores this economic reasoning and the inherent link between contractual arrangements and DRM availability. By denying legal effects to acts of authorisation within the scope of PC, the Court opens the door for levying related goods *in addition to license fees*; to be sure, this is detrimental to consumers, who will ultimately bear the burden of payment of both. Moreover, the choice *not* to apply TPMs is nowadays a rational choice that, from an economic perspective, should not be treated differently from the choice to apply TPMs (or any other sort of DRM for that matter). Altogether, the case for levies to compensate for harm caused by “classical” private copies is gradually diminishing.
- 93 The argument of indirect appropriability does not apply to private reproductions made in the context of unauthorised online file sharing, as there is no relation between the uploader (including any unlawful content provider) and the downloader and the number of copies made from an original will vary dramatically. It is an open question in references for preliminary rulings pending at the Court of Justice (in *Constantin Filmverleih v. UPC Telekabel*, *Copydan Båndkopi v. Nokia* and *ACI Adam and Others v. Stichting de Thuis kopie*) whether EU legislation allows levies to account for the harm caused by copies from content unlawfully accessed or from an unlawful source. If the question is answered in the affirmative, copyright levies will continue to have a sound economic basis within the EU. If not, as already happens to different extents in various Member States, the resulting narrow scope of the PC exception or limitation will provide an increasingly weaker economic case for levies in the digital age.

1 Parts of this article are based on: Poort, “Chapter 21: Copyright levies”, in: *Handbook of the Digital Creative Economy*, Towse, & Handke (eds.), Edward Elgar (forthcoming 2013). The authors

thank the editors for useful comments on an earlier draft of that chapter.

- 2 Grundig Reporter, German Federal Supreme Court (Bundesgerichtshof), 18 May 1955, Case I ZR 8/54, GRUR 492; and German Federal Supreme Court (Bundesgerichtshof), Case I ZR 10/54. While the first case focuses on copyrights managed by the German CMO GEMA, the second addresses related or neighbouring rights in sound recordings held by record companies. See also the follow-on case GEMA-Hinweis, German Federal Supreme Court (Bundesgerichtshof), 22 January 1960, Case I ZR 41/58, GRUR 1960, 340.
- 3 Personalausweise, German Federal Supreme Court (Bundesgerichtshof), 29 May 1964, Case Ib ZR 4/63, GRUR 1965, 104.
- 4 For a detailed analysis of these cases and a legal-historical account of the genesis of PC levies in Europe, see Hugenholtz, “The Story of the Tape Recorder and the History of Copyright Levies”, in *Copyright and the Challenge of the New*, B Sherman & L Wiseman (eds.), Information Law Series, vol. 25 (Alphen aan den Rijn: Kluwer International 2012), pp. 179-196.
- 5 WIPO, “*International Survey on Private Copying: Law & Practice 2012*”, World Intellectual Property Organization (2012), p. 3.
- 6 Green Paper on Copyright and the Challenge of Technology 1988, pp. 99-142.
- 7 The documents resulting from the mentioned stakeholder consultations in 2006 and 2008 can be accessed at European Commission, The EU Single Market, Copyright and Neighbouring Rights, Ongoing Initiatives: Private copying levies, [http://ec.europa.eu/internal\\_market/copyright/levy\\_reform/index\\_en.htm](http://ec.europa.eu/internal_market/copyright/levy_reform/index_en.htm).
- 8 See Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, on a Single Market for Intellectual Property Rights boosting creativity and innovation to provide economic growth, high quality jobs and first class products and services in Europe, COM (2011) 287 final (May 24, 2011) [hereinafter IPR Strategy].
- 9 See European Commission, The EU Single Market..., supra note 7.
- 10 Vitorino, A, *Recommendations resulting from the Mediation on Private Copying and Reprography Levies* (Brussels, Belgium, Jan. 31, 2013), [http://ec.europa.eu/internal\\_market/copyright/docs/levy\\_reform/130131\\_levies-vitorino-recommendations\\_en.pdf](http://ec.europa.eu/internal_market/copyright/docs/levy_reform/130131_levies-vitorino-recommendations_en.pdf). See also *Mediation on private copying and reprography levies: António Vitorino presents his Recommendations to Commissioner Barnier* (IP/13/80), Jan. 31, 2013, [http://europa.eu/rapid/press-release\\_IP-13-80\\_en.htm?locale=en](http://europa.eu/rapid/press-release_IP-13-80_en.htm?locale=en).
- 11 See Competitiveness Council – 29-30 May 2013, MEMO/13/465, Brussels, 28 May 2013, [http://europa.eu/rapid/press-release\\_MEMO-13-465\\_en.htm](http://europa.eu/rapid/press-release_MEMO-13-465_en.htm).
- 12 See COUNCIL OF THE EUROPEAN UNION, Press Release, 3242nd Council meeting Competitiveness (Internal Market, Industry, Research and Space), Brussels, 29-30 May 2013, 10142/13, pp. 2, 8, [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/intm/137340.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/intm/137340.pdf).
- 13 See Art. 5(2)(b) of Directive 2001/29, 2001 OJ L167/10 [Copyright Directive].
- 14 See Part B.
- 15 The copyright *acquis* in the meaning ascribed to it herein includes the European Parliament and Council Directive 2009/24/EC (codified version), 2009 OJ (L 111/16) [Software Directive], European Parliament and Council Directive 2006/115/EC (codified version), 2006 OJ (L 376/28) [Rental Right Directive], European Parliament and Council Directive 2011/77/EU, 2011 OJ (L 265/1) [Term Directive], Council Directive 93/83/EEC, 1993 OJ (L 248/16) [Sat-Cab. Directive], European Parliament and Council Directive 96/9/EC, 1996 OJ (L 77/20) [Database Directive], the Copyright Directive, European Parliament and Council Directive 2001/84/EC, 2001 OJ (L 272/32) [Resale Right Directive], Directive 2004/48/EC, 2004 O.J. (L 195/16) [Enforcement Directive], and European Parliament and Council Directive 2012/28/EU, 2012 O.J. (L 299/5) [Orphan Works Directive].
- 16 For an in-depth analysis of this topic, see, inter alia, Karapapa, *Private Copying: The Scope of User Freedom In EU Digital Copyright* (Routledge 2012); Senfleben, *Copyright, Limitations and the Three-Step Test. An Analysis of the Three-Step Test in International and EC Copyright Law*, (The Hague, Kluwer Law International, 2004), pp. 246-281; Guibault, “Why Cherry-Picking Never Leads to Harmonization. The Case of the Limitations on Copyright under Directive 2001/29/EC”, JIPITEC (2010), 1 (2), pp. 55-66.; Bechtold, “Comment on Directive 2001/29/EC”, in Dreier & Hugenholtz (eds.), *Concise on European Copyright Law* (Alphen aan den Rijn, Kluwer Law International, 2006); and Walter & von Lewinski (eds.), *European Copyright Law: A Commentary* (Oxford, Oxford University Press, 2010), pp. 921-1141.
- 17 “WIPO Internet Treaties” is meant here as an umbrella term for the WIPO Copyright Treaty, opened for signature 20 December 1996, 2186 U.N.T.S. 121 (entered into force 6 March 2002) [WCT] and the WIPO Performances and Phonograms Treaty, opened for signature 20 December 1996, 2186 U.N.T.S. 203 (entered into force 20 May 2002) [WPPT].
- 18 See Ohly, “Economic rights”, in, *Research Handbook on The Future Of EU Copyright*, (E Derclaye [ed.], Edward Elgar 2009), pp. 212-241, p. 214, noting that “vertical harmonization” of the reproduction right had occurred for specific subject matter in the context of the Software Directive (Art. 4(a)), Database Directive (Art. 5(a)), and the repealed 1992 version of the Rental Right Directive (previous Art. 7, in respect of related rights). On the implementation of the WIPO Internet Treaties, see Recital 15 of the Copyright Directive.
- 19 Under Art. 7 of the Rental Right Directive (“fixation right”), which reads: “1. Member States shall provide for performers the exclusive right to authorise or prohibit the fixation of their performances. 2. Member States shall provide for broadcasting organisations the exclusive right to authorise or prohibit the fixation of their broadcasts, whether these broadcasts are transmitted by wire or over the air, including by cable or satellite. 3. A cable distributor shall not have the right provided for in paragraph 2 where it merely retransmits by cable the broadcasts of broadcasting organisations.”
- 20 See Ohly, supra note 18, pp. 214-215, raising formal and substantive objections to this legislative technique.
- 21 See Art. 9(1) of the Berne Convention for the Protection of Literary and Artistic Works of Sep. 9, 1886, completed at Paris on May 4, 1896, as revised at Paris on Jul. 24, 1971 and amended on Sep. 28, 1979 [Berne Convention], Arts. 7, 10 and 13 of the International Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organisations of Oct. 26, 1961 [Rome Convention], and 1(4) of the WCT. See also Agreed Statements to Arts. 7 and 11 WPPT.
- 22 See von Lewinsky, *Certain legal problems related to the making available of literary and artistic works and other protected subject matter through digital networks*, UNESCO ECOPYRIGHT BULL. 1, January-March 2005 issue, p. 5.
- 23 See ECJ, Case 5/08, Infopaq, [2009] ECR I-06569 [Infopaq], *passim* (applying such a broad interpretation), ECJ, Case 302/10, Infopaq II [2012] ECR I-00000 (narrowly interpreting exemptions for temporary acts of reproduction) and even ECJ, Joined Cases C-403/08 and C-429/08, Football Association Premier League and Others, [2011] ECR I-00000 [Premier League] (interpreting the reproduction right in Art. 2(a) Copyright Directive as extending to transient fragments of the works within the memory of a satellite decoder and on a television screen, although exempting such acts under Art. 5(1)).
- 24 See ECJ, Infopaq, Case 393/09 *Bezpečnostní Softwarová Asociace* [2010] ECR I-13971, Joined Cases Premier League, Case

- 145/10 Painer [2011] ECR I-00000 [Painer], Case C-604/10 Football Dataco [2012] ECR I-00000, and Case C-406/10 SAS [2012] ECR I-00000.
- 25 As examples of remuneration rights, see e.g. the right for an unwaivable and equitable remuneration for rental (Art. 5 Rental Right Directive) and the rights for single and equitable remuneration for broadcasting and communication to the public (Art. 8(2) Rental Right Directive). Rights of fair compensation for reprographic reproductions, private copying/use, reproductions of broadcasts by non-commercial social institutions and for use of orphan works by specific organizations can be found, respectively, in Arts. 5(2)(a), (b) and (e) of the Copyright Directive, and 6(5) of the Orphan Works Directive.
  - 26 Note also that Recitals 9 and 11 seem to favour an “in dubio pro autore” interpretation of this right. See Ohly, *supra* note 18, p. 217.
  - 27 Art. 5(1) of the Copyright Directive reads: “Temporary acts of reproduction referred to in Article 2, which are transient or incidental [and] an integral and essential part of a technological process and whose sole purpose is to enable: (a) a transmission in a network between third parties by an intermediary, or (b) a lawful use of a work or other subject-matter to be made, and which have no independent economic significance, shall be exempted from the reproduction right provided for in Article 2.”
  - 28 See Hugenholtz, et al.; *The Recasting Of Copyright And Related Rights For The Knowledge Economy*, Final Report, (2006), [http://ec.europa.eu/internal\\_market/copyright/docs/studies/et-d2005imnd195recast\\_report\\_2006.pdf](http://ec.europa.eu/internal_market/copyright/docs/studies/et-d2005imnd195recast_report_2006.pdf), pp. 68-69, arguing that this is a technical and not a normative approach.
  - 29 On the exhaustive nature of the catalogue of exceptions or limitations in Art. 5, see Recital 32 of the Copyright Directive.
  - 30 See Art. 5 (1)-(3) and (5) of the Copyright Directive.
  - 31 *Id.*
  - 32 See Art. 5 (3) and (5) of the Copyright Directive.
  - 33 Cf. Recital 36 of the Copyright Directive.
  - 34 The three-step test, which originally applied to the reproduction right, as stated in Art. 9(2) of the Berne Convention, currently extends to all economic rights, by virtue of Arts. 13 TRIPS, 10 WCT (and its Agreed Statements) and 16 WPPT. The Copyright Directive’s broad version of the same states that “[t]he exceptions and limitations provided for in paragraphs 1, 2, 3 and 4 shall only be applied in certain special cases which do not conflict with a normal exploitation of the work or other subject-matter and do not unreasonably prejudice the legitimate interests of the rightholder”. It should be noted that this test also applies to the Software Directive – Art. 6(3) – Database Directive – Art. 6(3) – and Rental Right Directive (by virtue of Art. 11(1)(b) of the Copyright Directive). A comprehensive analysis of the three-step test as implemented by the Copyright Directive is beyond the scope of this article, especially in what concerns the articulation of an open-ended interpretation of the test with an exhaustive catalogue of exceptions or limitations. On this topic, see Senftleben, “*The International Three-Step Test. A Model Provision for EC Fair Use Legislation*”, JIPITEC, Vol. 1 (2010).
  - 35 For in-depth analysis, see Walter & Von Lewinski, *supra* note 16, pp. 1013ff., Karapapa *supra* note 16, *passim*.
  - 36 See Bechtold, *supra* note 16, p. 375, and Walter & Von Lewinski, *supra* note 16, pp.1031-1032.
  - 37 See Art. 1(2)(a) and (e) of the Copyright Directive. See also van Eechoud, Hugenholtz, et al.: *Harmonizing European Copyright Law: The Challenges of Better Lawmaking*, Information Law Series 19 (Alphen aan den Rijn: Kluwer Law International 2009), p. 117. For an explanation of the historical background of this provision and the articulation of the recital with lit. (b), see Walter & Von Lewinski, *supra* note 16, p. 1031.
  - 38 See Walter & Von Lewinski, *supra* note 16, p. 1032, noting also that the term “private use” is present elsewhere in the *acquis* and international copyright law, namely Art. 15(1)(a) of the Rental Right Directive and Arts. 6(2)(a) and 9(a) of the Database Directive.
  - 39 *Id.* pp. 1032-1033.
  - 40 *Id.* p. 1033.
  - 41 *Id.* p. 1033.
  - 42 See Bechtold, *supra* note 16, p. 375.
  - 43 For an overview of the same, see Karapapa, *supra* note 16, pp.53-59.
  - 44 For a detailed analysis, see *id.* pp.49-78, proposing a test for the determination of the private character of the copyright use, which aims at assessing the relationship between the copier and the audience, the perception of the latter by the right-holder vis-à-vis the commercial exploitation of the work, and the (private) nature of the place where the use is made. For the concept of “public” in the *acquis*, see the most recent ECJ rulings dealing with the interpretation of the right of communication to the public, namely Case 306/05SGAE, [2006] ECR I-11519, Premier League, Joined Cases 431/09 and 432/09 Airfield, [2011] ECR I-00000, Case 135/10, Società Consortile Fonografici, [2012] ECR I-00000, and Case 162/10, Phonographic Performance (Ireland) Ltd, [2012] ECR I-00000.
  - 45 For a detailed analysis of this requirement, see Karapapa, *supra* note 16, pp. 79-98,
  - 46 *Id.* p. 80. See also Bernault, & Lebois (under the supervision of Lucas), *Peer-to-peer file-sharing and literary and artistic property: A feasibility study regarding a system of compensation for the exchange of works via the Internet*, trans. Smith & Palatezzi (Nantes: Institute for Research on private law, University of Nantes, 2006), [https://privatkopie.net/files/Feasibility-Study-p2p-acs\\_Nantes.pdf](https://privatkopie.net/files/Feasibility-Study-p2p-acs_Nantes.pdf), p.30.
  - 47 See Karapapa, *supra* note 16, p. 82.
  - 48 *Id.* p. 91, noting that the examination of the copier’s intent of commercial exploitation means that the judicial test for non-commerciality is not the exact counterpart of the definition of commerciality.
  - 49 For an attempt, see *id.* p. 98.
  - 50 See B.II.
  - 51 See Bechtold, *supra* note 16, p. 374, noting that both time and space-shifting might be covered by such *de minimis* cases.
  - 52 See, to this effect, *id.* p. 373 (“This link to the notion of harm, which is part of the concept of ‘fair compensation’ is alien to the concept of equitable remuneration”).
  - 53 See, concerning Art. 8(2) of the Rental and Lending Directive, ECJ, Case 245/00, Sena v. Nos, [2003] ECR I-1251, [2005] 3 CMLR 36 [Sena], paras 36-37, and ECJ, Case 192/04, Lagardère, [2005] ECR I-7199, [2005] 3 CMLR 48, p. 50.
  - 54 Art. 6(3) of the Copyright Directive.
  - 55 *Id.*
  - 56 Art. 6(1) and (2) of the Copyright Directive.
  - 57 In this sense, see Walter & Von Lewinski, *supra* note 16, p.1073.
  - 58 See Art. 6(4), first and second subparagraphs, of the Copyright Directive.
  - 59 Art. 6(4), third subparagraph, of the Copyright Directive.
  - 60 In this respect, Recital 39 of the Copyright Directive addresses the articulation of TPMs and digital private copying and remuneration schemes, urging Member States to take into consideration “technological and economic developments” when applying this exception and limitation, noting that the latter “should not inhibit the use of technological measures or their enforcement against circumvention”.
  - 61 Art. 6(4), fourth subparagraph, and Recital 53 of the Copyright Directive. It is the authors’ view that the term “interac-

- tive” makes reference to uses covered by the making available right under Art. 3 of the Copyright Directive.
- 62 “Agreed contractual terms” in this context seems to have a broad construction and likely applies also to standard form contracts such as typical online end-user license agreements. See Walter & Von Lewinski, *supra* note 16, p. 1074, (n. 482). For a more restrictive view, arguing for the application of the provision solely to negotiated and agreed terms, see Guibault, Westkamp, et al.; *Study on the Implementation and Effect in Member States’ laws of Directive 2001/29/EC on the Harmonisation of Certain Aspects of Copyright and Related Rights in the Information Society, report to the European Commission, DG Internal Market* (February 2007), p.112 (“the exception to the main rule of article 6(4) of the Directive could be interpreted as applying only in respect of the supply of online services for which the contracting parties have negotiated the terms of use...”).
- 63 See van Eechoud, Hugenholtz, et al.; *supra* note 37, p. 118, raising the possibility that, for cases where the application of TPMs makes PC activities impossible or near impossible (e.g. copy controls on DVDs), no compensation should be claimed as it would be unjustified.
- 64 See Hugenholtz, Guibault, & Van Geffen, “*The Future of Levies in a Digital Environment*”, Institute for Information Law (March 2003), *passim*, and Van Eechoud, Hugenholtz, et al.; *supra* note 37, p. 118. *Contra* the argument that the Directive provides for automatic phasing out of levies, see Walter & Von Lewinski, *supra* note 16, p.1034.
- 65 See ECJ, Case 467/08, *Padawan SL v. SGAE*, [2011] ECDR 1 [Padawan],
- 66 See ECJ, Case 462/09, *Stichting de ThuisKopie v. Opus Supplies Deutschland GmbH*, [2011] 3 C.M.L.R. [Stichting de ThuisKopie], *passim*.
- 67 Joined ECJ, Cases C-457/11, C-458/11, C-459/11, C-460/11, *Verwertungsgesellschaft Wort (VG Wort) v. KYOCERA Document Solutions Deutschland GmbH and Others, Canon Deutschland GmbH and Fujitsu Technology Solutions GmbH, and Hewlett-Packard GmbH v. Verwertungsgesellschaft Wort (VG Wort)*, [2013] I-00000 [VG Wort v. Kyocera]. This judgement results from references for a preliminary ruling from the Bundesgerichtshof (Germany) made in the context of proceedings between a German collecting society (VG Wort) and several intermediary suppliers (Kyocera, Epson, Xerox, Fujitsu and Hewlett Packard) concerning the compensation to be paid to the first by the latter as a consequence of the placement on the market of devices capable of copying, such as printers, plotters and personal computers
- 68 Opinion of Advocate General Sharpston delivered on 24 January 2013, *Joined Cases C-457/11, C-458/11, C-459/11 and C-460/11* [A.G. Sharpston Opinion].
- 69 See ECJ, Case C-521/11, *Amazon.com International Sales Inc. and Others v. Austro-Mechana Gesellschaft zur Wahrnehmung mechanisch-musikalischer Urheberrechte Gesellschaft m.b.H.*, [2013] I-00000 [Amazon.com v. Austro-Mechana]. This judgement deals with the interpretation of “fair compensation” in the context of a national levy scheme that targets all recording media, irrespective of their purposive use, but provides debtors with an (enforceable) right of ex post reimbursement against the CMOs collecting where the levied media is exported before it is sold to consumers. See also Opinion of Advocate General Paolo Mengozzi delivered on 7 March 2013, *Case C-521/11*.
- 70 See Padawan, paras. 44-45.
- 71 *Id.* para. 46.
- 72 *Id.* noting that the referred intermediaries are responsible for discharging the private copying levy.
- 73 *Id.* para. 57, referring that the incompatibility with the Copyright Directive occurs when the levy is applied to equipment/devices/media “clearly reserved for uses other than private copying” (emphasis added). Stichting de ThuisKopie tested this rule in the context of cross-border sales within the EU of equipment/devices/media through distance-selling arrangements, elucidating that the relevant harm occurs in the territory of residence of the end-user. See Stichting de ThuisKopie, para. 35. *Amazon.com v. Austro-Mechana* clarified *inter alia* that indiscriminate application of the levy is only admissible subject to a specific set of cumulative conditions, including the provision of an enforceable right of reimbursement of the intermediary first placing a recorded media on the market. See *Amazon.com v. Austro-Mechana*, paras. 16-37.
- 74 See Padawan, para. 31.
- 75 *Id.* para. 32. See also: ECJ, *Case 327/82, Ekro* [1984] ECR 107, para. 11; ECJ, *Case 287/98, Linster*, [2000] ECR I-6917, para. 43; and ECJ, *Case 523/07 A*, [2009] ECR I-2805, para. 34.
- 76 See Padawan, paras. 32 and 37, applying by analogy to the concept of “equitable remuneration” in Art. 8(2) of the Rental Right Directive. See also Sena, para. 24.
- 77 See Padawan, paras. 34-35. See also Premier League, para. 186, identifying the principal objective of the Copyright Directive as the establishment of a “high level of protection of authors, allowing them to obtain an appropriate reward for the use of their works”. See also ECJ, *Case 510/10, DR and TV2 Danmark*, [2012] ECR I-00000, para. 35.
- 78 See Recital 31 of the Copyright Directive. For the use of the fair balance criteria in Recital 31 within the context of the Court’s systematic interpretation of provisions in the directive, see Painer, para. 132.
- 79 See ECJ, *Case 277/10, Luksan*, [2012] ECR I-00000 [Luksan], para. 100.
- 80 *Id.* para. 102.
- 81 *Id.* paras. 104-105.
- 82 See Stichting de ThuisKopie, para. 34.
- 83 See Luksan, para. 106.
- 84 See Padawan, para. 7.
- 85 *Id.* paras. 39-41. Recital 38 allows Member States, in the context of analogue PC, to keep in place or introduce “remuneration schemes to compensate for the prejudice to right-holders”, as these would only have a negligible impact on the functioning of the internal market. Conversely, digital PC, due to its likelihood “to be more widespread and have a greater economic impact”, requires fair compensation to be assessed differently.
- 86 See Padawan, para. 40, and Stichting de ThuisKopie, para. 24.
- 87 See Padawan, para. 42.
- 88 See B.II.
- 89 See discussion at C.II, E.II and E.III.
- 90 See VG Wort v. Kyocera, para. 40
- 91 *Id.* paras. 34-35
- 92 *Id.* para. 36.
- 93 *Id.* paras 37-39.
- 94 *Id.* paras 37-39.
- 95 A.G. Sharpston Opinion, para. 119.
- 96 *Id.* paras 119-121 and 137, fourth indent.
- 97 See Part C. This is namely the case of the recommendation that copies made by “end users for private purposes in the context of a service that has been licensed by rightholders do not cause any harm that would require additional remuneration in the form of private copying levies”.
- 98 See VG Wort v. Kyocera, paras. 48-52.
- 99 *Id.* paras. 48-57.
- 100 *Id.* para 58.
- 101 A.G. Sharpston Opinion, para. 104.

- 102 Reference for a preliminary ruling from the Oberster Gerichtshof (Austria) lodged on 29 June 2012, Case C-314/12, UPC Telekabel Wien GmbH v. Constantin Film Verleih GmbH, Munich (Germany), Wega Filmproduktionsgesellschaft mbH [UPC Telekabel v. Constantin Film].
- 103 Reference for a preliminary ruling from the Østre Landsret (Denmark) lodged on 16 October 2012, Case C-463/12, Copydan Båndkopi v. Nokia Danmark A/S [Copydan Båndkopi v. Nokia].
- 104 Reference for a preliminary ruling from the Hoge Raad der Nederlanden (Netherlands) lodged on 26 September 2012, Case C-435/12, ACI Adam BV and Others v. Stichting de ThuisKopie and Others [ACI Adam and Others v. Stichting de ThuisKopie].
- 105 See Copydan Båndkopi v. Nokia.
- 106 See *id.*, respectively, questions one through six and variations thereof.
- 107 See ACI Adam and Others v. Stichting de ThuisKopie.
- 108 See UPC Telekabel v. Constantin Film, second question: “... Are reproduction for private use (Article 5(2)(b) of the Information Directive) and transient and incidental reproduction (Article 5(1) of the Information Directive) permissible only if the original of the reproduction was lawfully reproduced, distributed or made available to the public?”
- 109 An issue dealt with in detail in ACI Adam and Others v. Stichting de ThuisKopie, UPC Telekabel v. Constantin Film, Copydan Båndkopi v. Nokia, and only indirectly mentioned in the Recommendations.
- 110 See VG Wort v. Kyocera, paras 48-59. See also A.G. Sharpston’s Opinion, paras. 94-104.
- 111 See *supra* note 11.
- 112 See Vitorino, *supra* note 10, pp. 2-4.
- 113 *Id.* p. 3.
- 114 *Id.* p. 3.
- 115 *Id.* p. 3.
- 116 *Id.* pp. 3-4.
- 117 *Id.* pp. 6-9.
- 118 *Id.* pp. 10-23.
- 119 *Id.* p. 9.
- 120 *Id.* p. 6.
- 121 *Id.* pp. 7-8.
- 122 *Id.* pp. 8-9.
- 123 See A.G. Sharpston Opinion, paras. 105-121.
- 124 *Id.* paras. 120-121, and 137, fourth indent.
- 125 VG Wort v. Kyocera, paras. 37-40. See above B.II.3.
- 126 See Vitorino, *supra* note 10, p. 8.
- 127 See Communication from the Commission on content in the Digital Single Market, COM(2012) 789 final, Brussels, 18.12.2012. See also Licenses for Europe, [http://ec.europa.eu/internal\\_market/copyright/licensing-europe/index\\_en.htm](http://ec.europa.eu/internal_market/copyright/licensing-europe/index_en.htm).
- 128 See Vitorino, *supra* note 10, pp. 10-11.
- 129 *Id.* p.11.
- 130 *Id.* p.11.
- 131 Because this article does not focus on the exception/limitation of reprography, Mr Vitorino’s recommendations that “more emphasis should be placed on operator levies than on hardware based levies” shall not be addressed. See Vitorino, *supra* note 10, p. 16-17.
- 132 *Id.* p. 12.
- 133 *Id.* pp. 15-18.
- 134 *Id.* pp. 18-19.
- 135 *Id.* p. 19.
- 136 *Id.* pp. 21-23.
- 137 *Id.* p. 22. In this context, Mr Vitorino set forth the following minimum standards for the tariff-setting process: (i) decisions on the application of a levy to a product are to be taken within one month post-market introduction; (ii) provisional/transitional tariff levels should be set within three months post-market introduction; (iii) the definitive tariff level is to be set within six months post-market introduction; (iv) in principle, the definitive level should be equal or inferior to the provisional level; if superior, the payment of the difference should be gradual.
- 138 *Id.* pp. 21 and 23.
- 139 *Id.* p. 20.
- 140 *Id.* p. 20.
- 141 *Id.* p. 20.
- 142 *Id.* p. 20.
- 143 *Id.* pp. 20-21.
- 144 *Id.* p. 21.
- 145 See Karapapa, *supra* note 16, pp. 15-27, and Hugenholtz, *supra* note 4, *passim*.
- 146 At the time of writing, the UK is in the process of implementing into law a narrow and uncompensated private copying exception. See Technical review of draft legislation on copyright exceptions, Private Copying (7 June 2013), UK Intellectual Property Office, <http://www.ipo.gov.uk/techreview-private-copying.pdf>.
- 147 See Art. 13 of the Enforcement Directive.
- 148 Art. 13(1)(a) of the Enforcement Directive.
- 149 See Art. 13(1)(b) of the Enforcement Directive; emphasis added.
- 150 See Vitorino, *supra* note 10, p. 20.
- 151 See WIPO, International Survey..., *supra* note 5, p. 4. The WIPO survey explicitly identifies a number of countries – The Netherlands, Russia, Switzerland and Canada – as not having a specific rule on the lawful nature of the source of PC acts. However, it should be noted that other countries not expressly identified, such as Portugal, also lack such a provision, which raises concerns as to accuracy of the survey. In such cases where the source or access are deemed irrelevant, rightholders are still entitled to pursue parties responsible for the unlawful making available (and in certain cases access) of their works.
- 152 See, e.g. §53(1) of the German Copyright Act (UrhG) and Art. L 122-5 (2) of the French Intellectual Property Code (Code de la Propriété Intellectuelle).
- 153 These terms are usually used in the broader discussion of private uses. See Senftleben, *supra* note 16, pp. 204-206, *presciently* discussing private uses which, although primarily consumptive in nature, form the basis of future creations. For the author, these uses (which cover many modalities of PC) must remain within the scope of exceptions or limitations, for reasons of intergenerational equity. On the concept of dynamic PC, see Karapapa, *supra* note 16, pp. 40-48, which distinguishes between “passive” private use (giving rise to “permitted” uses) and “dynamic” private use, affective both the reproduction right and other exclusive rights, which gives rise to “permissible” uses.
- 154 See Vitorino, *supra* note 10, p. 21.
- 155 Importantly, guidance on the *de minimis* qualification of the prejudice is forthcoming in Copydan Båndkopi v. Nokia.
- 156 Exceptions include the UK and Ireland, which so far have not introduced a private copying exception other than for time-shifting TV content; and Malta, Cyprus and Luxembourg, which treated private copying as *de minimis*. See M. Kretschmer, Private Copying and Fair Compensation. An empirical study of copyright levies in Europe, UK Intellectual Property Office (2011), p. 10. On the narrow uncompensated private

copying exception to be introduced into UK law, see Technical review of draft legislation on copyright exceptions, *Private Copying*, supra note 146.

- 157 See Art. 1(2)(a) of the Copyright Directive.
- 158 See WIPO, *International Survey...*, supra note 5, pp. 13-14.
- 159 Id.
- 160 A somewhat different typology can be found in Kretschmer, supra note 156, pp. 9, 70, which sums up activities that users may consider private. Kretschmer also mentions user-generated content, uploading and online publication, performance and distribution within networks of friends as separate categories. These are ignored here as they are not considered to fall under the PC exception. The reason is that they partially or wholly involve acts that can be legally qualified as communication/making available to the public under Art. 3 of the Copyright Directive.
- 161 Insofar as these activities are covered by the PC exception due to an extended definition of the requirement “private” (which may include, e.g., the circle of people mentioned). See B.I.2.
- 162 See WIPO, *International Survey...*, supra note 5, p. 4.
- 163 One could also argue that making copies of legally borrowed or rented content – type (d) – is a form of time shifting (beyond the rental period) rather than an extension of the circle of consumers.
- 164 See Liebowitz, “*Copying and Indirect Appropriability: Photocopying of Journals*”, *Journal of Political Economy*, 93 (5), 945-957 (1985).
- 165 Id. p. 945.
- 166 Besen & Kirby, “*Private Copying, Appropriability, and Optimal Copying Royalties*”, *J. Law Econ.* 32 (2), 255-280 (1989). Like other models discussed in this article, the models Besen and Kirby develop ignore possible positive dynamic effects of the consumption of copies on future sales (the so-called “sampling effect”) and negative effects of lost sales on the future production of content.
- 167 Id. p. 280.
- 168 Varian, “*Copying and Copyright*”, *Journal of Economic Perspectives*, 19 (2), 121-138 (2005).
- 169 In relation to the Dutch PC levies, see e.g. Verhue & Hillhorst, *Gebruik van opslagmedia: twintigste meting* (Amsterdam: Veldkamp) (2012) and PwC, *Thuiskopie: Onderzoek naar gedeelde inkomsten door huiskopie thuiskopieën* (2012).
- 170 Time shifting of TV content is a somewhat different issue: advertisers will be aware that some of their ads will be skipped when consumer watch programmes they recorded. This will lower advertising revenues for channels, while increasing consumers’ willingness to pay for TV channels and recorders.
- 171 Not everyone would agree that RHs have a natural claim to any benefits from these unforeseen uses.
- 172 For an example of the first, see Koelman, “*The Levitation of Copyright: An Economic View of Digital Home Copying, Levies and DRM*”, *Entertainment Law Review*, 4, 75-76-81 (2005). For an example of the second, see Elkin-Koren & Salzberger, *The Law and economics of intellectual property in the Digital Age – The limits of analysis* (Routledge, 2013), pp. 184-185.
- 173 See explanation of the extant legal framework above at B.I.2.
- 174 See Koelman, supra note 172, pp. 75-76 and 81.
- 175 Quoted in Sinha, Machado & Sellman, “*Don’t Think Twice, It’s All Right: Music Piracy and Pricing in a DRM-Free Environment*”, *Journal of Marketing*, 74 (2), 40-54 (2010).
- 176 See id.
- 177 See Vernik, Purohit & Desai, “*Music Downloads and the Flip Side of Digital Rights Management*”, *Marketing Science*, 30 (6), 1011-1027 (2011).
- 178 See Sinha et al., supra note 175, passim, and Vernik et al., supra note 177, passim.
- 179 See Sinha et al., supra note 175, passim.
- 180 Id. p. 40.
- 181 Hugenholtz, Guibault et al., supra note 64, p. 4.
- 182 See B.II.4.

# Not for Designers

## On the Inadequacies of EU Design Law and How to Fix It

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**Abstract:** Design rights represent an interesting example of how the EU legislature has successfully regulated an otherwise heterogeneous field of law. Yet this type of protection is not for all. The tools created by EU intervention have been drafted paying much more attention to the industry sector rather than to designers themselves. In particular, modern, digitally based, individual or small-sized, 3D printing, open designers and their needs are largely neglected by such legislation. There is obviously nothing wrong in drafting legal tools around the needs of an industrial sector with an important role in the EU economy, on the contrary, this is a legitimate and good decision of industrial policy. However, good legislation should be fair, balanced, and (technologically) neutral in order to offer suitable solutions to all the players in the market, and all the citizens in the society, without discriminating the smallest or the newest: the cost would be to stifle innovation. The use of printing machinery to manufacture physical objects created digitally thanks to computer programs such as Computer-Aided Design (CAD) software has been in place for quite a few years, and it is actually the standard in many industrial fields, from aeronautics

to home furniture. The change in recent years that has the potential to be a paradigm-shifting factor is a combination between the opularization of such technologies (price, size, usability, quality) and the diffusion of a culture based on access to and reuse of knowledge. We will call this blend Open Design. It is probably still too early, however, to say whether 3D printing will be used in the future to refer to a major event in human history, or instead will be relegated to a lonely Wikipedia entry similarly to <sup>3</sup>Betamax<sup>2</sup> (copyright scholars are familiar with it for other reasons). It is not too early, however, to develop a legal analysis that will hopefully contribute to clarifying the major issues found in current EU design law structure, why many modern open designers will probably find better protection in copyright, and whether they can successfully rely on open licenses to achieve their goals. With regard to the latter point, we will use Creative Commons (CC) licenses to test our hypothesis due to their unique characteristic to be modular, i.e. to have different license elements (clauses) that licensors can choose in order to adapt the license to their own needs."

**Keywords:** Design Rights, Novelty, CDR, OHIM, Creative Commons, CCO, Open Design

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### A. Introduction

1 Design rights represent an interesting example of how the EU legislature has successfully regulated

an otherwise heterogeneous field of law. Yet this type of protection is not for all. The tools created by EU intervention have been drafted paying much more attention to the industry sector rather than to designers themselves. In particular, modern,

digitally based, individual or small-sized, 3D printing, open designers and their needs are largely neglected by such legislation. The absence in the whole legal framework of a clear definition of the word “designer” is a first warning. Another can be taken in the amount of Recitals making reference to the needs of the industrial sector in the Community Design Regulation, including 7, 8, 13, 14, 15, 16 and 25.<sup>1</sup> Individual designers find some recognition only in Recitals 7 and 24. This is certainly not a conclusive argument by itself, but it is quite symptomatic of the level of the debate during the drafting phase.

- 2 The historical moment when this legislation was drafted (the Green Paper is from 1991<sup>2</sup>) offers only a partial justification. It is true that this was a time when products of industrial design meant industrially based enterprises, and where the state of the technology, its costs, and dissemination did not allow individual designers, or even small enterprises, to play a relevant role. However, the equation seems inversely proportional: the technology evolved from 1998 (the year of the Design Directive) to 2002 (the year of the Design Regulation), giving wider access to individual designers, but their relevance in the statutes did not evolve accordingly. On the contrary, the needs of the industrial sector found a sounder recognition in the most recent legislation.
- 3 There is obviously nothing wrong in drafting legal tools around the needs of an industrial sector with an important role in the EU economy; on the contrary, this is a legitimate and good decision of industrial policy. However, good legislation should be fair, general, and (technologically) neutral in order to offer suitable solutions to all the players in the market and all the citizens in the society, without discriminating against the smallest or the newest. Failure to fulfil this commonly accepted public policy goal would represent an obstacle for innovation.
- 4 Thanks to technological evolution, the role of small and individual players in the game of design has grown exponentially without the law apparently being able to catch the shift or the consequences it entails.
- 5 Nowadays, the situation in technological terms is diametrically different from the time when EU design law was enacted, as witnessed by “personal” 3D printing solutions and the number of projects implementing them.<sup>3</sup> The proportions of the relationship recall IBM’s 1970 data processing units that occupied entire rooms contrasted with today’s tablets.
- 6 The use of printing machinery to manufacture physical objects created digitally thanks to computer programs such as Computer-Aided Design (CAD) software has been in place for quite a few years, and it is actually the standard in many industrial fields, from aeronautics to home furniture. The change in recent years that has the potential to be a paradigm-shifting factor is a combination between the popularization of such technologies (price, size, usability, quality) and the diffusion of a culture based on access to and reuse of knowledge.<sup>4</sup> We will call this blend Open Design.<sup>5</sup>
- 7 Many Open Design supporters argue that 3D printing technology and mass customization can be seen as the cornerstone of a third industrial revolution,<sup>6</sup> much like the steam engine and the spinning mule were for the first, and mass production and standardization for the second.<sup>7</sup> 3D printing has an endless number of possible applications, from food to aerospace, from biotech to jewellery. In particular, Open Source 3D printing – i.e. the use of 3D printers created and licensed following the FLOSS model – promise the achievement of economically efficient *distributed manufacturing models* that will reduce shipping and storage costs, improve efficiency of the affected economic sectors, create new markets and new forms of social interaction, and reduce pollution (such as that connected with shipment).<sup>8</sup>
- 8 As it has already happened in the past, when legislative interventions fail to recognize new technological, economic, and business needs, social change happens and new forms creation and dissemination flourish beyond, or in spite of the law. It is fundamental, from a policy point of view, not to turn this social change form *beyond* to *against* the law. From a legal point of view, a careful balancing of the different rights and interests at stake can lead to shared solutions that empower institutions, stake holders, citizens and global welfare. From an economic point of view, turning thousands or millions of potential customers into transgressors can hardly be seen as a good business plan.
- 9 It is probably still too early, however, to say whether 3D printing will be used in the future to refer to a major event in human history, or instead will be relegated to a lonely Wikipedia entry similarly to “Betamax” (copyright scholars are familiar with it for other reasons). It is not too early, however, to develop a legal analysis that will hopefully contribute to clarifying the major issues found in current EU design law structure, why many modern open designers will probably find better protection in copyright, and whether they can successfully rely on open licenses to achieve their goals. With regard to the latter point, we will use Creative Commons (CC) licenses to test our hypothesis due to their unique characteristic to be modular, i.e. to have different license elements (clauses) that licensors can choose in order to adapt the license to their own needs.<sup>9</sup> CC licenses are already employed in a number of 3D projects.<sup>10</sup>
- 10 It must be borne in mind, however, that other legal tools may play an important role in the protec-

tion of products of design, such as patents, models and trademarks (especially three-dimensional trademarks). Nonetheless, a thorough analysis of such aspects would exceed the scope of this work, and therefore they are not addressed here.<sup>11</sup> This analysis is from a EU perspective: Copyright and maybe even more design rights may operate quite differently in extra EU jurisdictions<sup>12</sup>.

- 11 The structure of the paper is as follows: Part I deals with legislative-based protection and its interpretation by courts. In this part, after this short introduction (section 1), we will analyse the relevant EU design law provisions (section 2) and copyright (section 3), with some brief but interesting national examples. Part II of the paper is dedicated to what we can do to fix the EU legal framework available to products of design. We start by outlining the most relevant aspects of CC licenses in section 4. In section 5 we try to understand how these licenses apply, if at all, to products of design, and whether the resulting structure can lead to a working legal framework for Open Design. In our conclusions (section 6), we indicate that a first superficial answer is negative. CC licenses are copyright licenses and it is not possible to expand their scope to include design rights. However, a more detailed answer is not that straightforward, and even if CC licenses and design rights remain two different and incompatible legal instruments, given the specific features of each one, it is arguably possible to combine them in order to create a legal framework for the development of Open Design under the name of CC-Plus-Design.

## B. Design rights in the EU

- 12 The attention that the EU legislator has directed to the field of design led to the enactment of two important pieces of legislation: the Design Directive (DD)<sup>13</sup> and the Community Design Regulation (CDR).<sup>14</sup>
- 13 The DD of 1998, the oldest of the two, was enacted with the goal of harmonizing the – sometimes significantly heterogeneous – national legislations of Member States in the field of registered design products. The CDR, in force since 2002, possesses the different objective of creating a unified system of protection for design products at the EU level, and along with the registered option (Registered Community Design, RCD) offers an unregistered form of protection (Unregistered Community Design, UCD). The DD harmonizes only in the field of registered design (and within this field only substantive and not procedural rules), and does not create (but does not preclude the survival at the national level of) any form of unregistered design scheme.<sup>15</sup>
- 14 In light of such double-tier protection, the options available to a hypothetical European-based designer are twofold. First, a national registered form of pro-

tection based on common substantive law principles throughout the EU – procedural rules regarding registration and maintenance can in fact vary from country to country. National registration offers protection only for the national territory where registration is filed,<sup>16</sup> in addition to the usual terms of priority offered on the basis of the Paris Convention.<sup>17</sup>

- 15 Second, the designer can opt for a community design protection, register her design through the OHIP<sup>18</sup> registrar office and obtain an EU-wide legal title that protects her design in the whole EU. A key aspect of the CDR is the unitary character of protection, which mandates that a community design shall have equal effect throughout the Community and cannot be registered, transferred or surrendered or be the subject of a decision declaring it invalid, nor can its use be prohibited, save in respect of the whole Community.<sup>19</sup>
- 16 If the designer does not register her design at any level, she can still enjoy a three-year unregistered (UCD) protection which can operate regardless of any other form of national unregistered design protection. Such an eventuality is observed in the UK, for example, where an unregistered form of protection was available long before the CDR; it still survives and offers some limited advantages over the UCD.<sup>20</sup>
- 17 Regarding the substantive law aspects, it can be observed that the DD and the CDR create an almost identical set of provisions, and therefore, unless otherwise noted, the analysis, albeit focusing on the CDR, reflects this identity.<sup>21</sup>

## I. Definitions and requirements for protection

- 18 Article 3 CDR defines two major concepts in design law: *design* and *product*. Combining the two definitions and removing the list of examples therein contained, it emerges that the protection offered to products of design covers “the appearance of the whole or a part of ... any industrial or handicraft item resulting from the features of the product itself ... and/or its ornamentation”.
- 19 The types of features Article 3 enumerates include *lines, contours, colours, shape, texture and/or materials*.<sup>22</sup> The definition of *products* includes *parts intended to be assembled into a complex product, packaging, get-up, graphic symbols and typographic typefaces, but excluding computer programs*.<sup>23</sup> Pivotal to the definition of what is protected is indeed the concept of “appearance”, which has to be construed broadly as confirmed by the non-exhaustive list of elements that qualifies it. This definition, has been said, should be

broad enough to “encapsulate any economic value that is attached to the appearance of the product”.<sup>24</sup>

- 20 Given such a generous definition, it is possible to include in the scope of protection of the CDR both 2D[i-mensional] (e.g. ornaments) and 3D[imensional] (e.g. shapes) products in a huge variety of conformations. As has been expressed, it is a much easier exercise to focus on the aspects that are explicitly excluded from the definition than on those that could be potentially included.<sup>25</sup> Of particular relevance among the items explicitly excluded from registration: blueprints for houses or other architectural plans directed to a house (though they can be registered as “other printed matters” following the Locarno classification<sup>26</sup>), a single colour as such, mere verbal elements (words *per se*), music and sounds (but not their graphical representation registrable as “other printed matters”) and living plants.<sup>27</sup>
- 21 Fragrances and smells were listed as another exclusion item by Musker, but in the consulted Manual there is no sign of them anymore.<sup>28</sup> Suthersanen suggests that given the definition of design – which is strongly linked to the concept of appearance of a product, and therefore to a visual dimension – it would be unlikely that a court would expand the definition to protect characteristics such as sound or smell.<sup>29</sup> This interpretation is supported by many commentators, although some point out that even though the CDR<sup>30</sup> and the Green Paper<sup>31</sup> strongly focus on the visual dimension of the concept of appearance, therefore excluding sounds and smell from this notion, references in Article 3 to *texture* and *material* imply that touch may be an important attribute of a design.<sup>32</sup> Process design and service design seems to fall squarely outside the protection afforded by CDR as there is no industrial or handicraft product identifiable.<sup>33</sup> Interior and exterior design do not seem to be directed to a product either, though it is considered protectable by some scholars.<sup>34</sup> Web design appears to be a borderline category. On the one side, the appearance of a website (eliminating sounds, and reducing it down to what can be filed as supporting documentation at the OHIM office, therefore excluding also dynamic elements) seems not to differ significantly from the appearance of, say, a book’s front cover. However, “product” is strictly defined as an industrial or handicraft item, and under this point of view it should be impossible for web design to meet such a definition. It seems, therefore, that web design in general should be excluded from protection, with the exception of computer icons and graphic user interfaces (GUI), for which there is a specific, though only indirect, provision. GUI and computer icons usually do not form part of the underlying computer program, an aspect that disqualifies them from the exclusion granted to software.<sup>35</sup> This is, however, an extremely contentious issue (see *infra*).<sup>36</sup>

- 22 Nonetheless, not all the designs that conform with the – overly broad – definition outlined above can be protected. Two key requirements need to be met: *novelty* and *individual character*.<sup>37</sup>

## II. Novelty and individual character

- 23 Novelty is defined by Article 5 CDR, which mandates that no other “identical design” must have been made available to the public before the date on which the design for which protection is claimed was first made available to the public (for UCD); or before the date of filing of the application for registration of the design for which protection is claimed; or if priority is claimed, the date of priority (for RCD). The body of designs constituting the prior art, i.e. the threshold against which novelty needs to be tested, is defined in detailed by Article 7 in a way that significantly reduces the broadness of Article 5 (and of Article 6, see below). Such details include territorial, business sectors, confidentiality- and intentionality-related issues to an extent that “the broad, objective novelty notion [is transformed] into a peculiar and complex form of local novelty”.<sup>38</sup>
- 24 Section 2 of the same article briefly describes the concept of *being identical* and stipulates that identity has to be found when the features of two designs differ only in immaterial details.<sup>39</sup> Therefore, in order to be considered new, a design has to look different in material details from everything that has been produced before, regardless of whether the designer has copied from any prior art.<sup>40</sup>
- 25 The second requirement to be met in order to enjoy CDR protection is the individual character. Article 6 explains that in order to possess individual character, the design must produce an overall impression on the informed user that is different from the overall impression produced on such a user by any design which has been made available to the public before the relevant date (i.e. before the date it was first made available to the public for UCD or before the date of filing or priority for RCD).
- 26 Section 2 of the Article indicates that the degree of freedom of the designer in developing the design shall be taken into consideration in assessing the requirement. In order to establish the individual character, the standard reference is the “informed user”. This informed user has been defined “as particularly observant and [with] some awareness of the state of the prior art, that is to say the previous designs relating to the product in question”.<sup>41</sup> The informed user is a concept that lies somewhere in between that of the average consumer – applicable in trade mark matters – who needs not have any specific knowledge and who makes no direct comparison between the trade marks in conflict, and the sectorial expert, who is an expert with detailed tech-

nical expertise (somehow closer to the person skilled in the art found in patent law<sup>42</sup>). Therefore, the concept of the informed user refers not to a user of average attention – this is a particularly observant one, either because of his personal experience or his extensive knowledge of the sector in question – but it is still a user, not an expert in the sector.<sup>43</sup>

- 27 In light of this connotation of the threshold for the informed user, it is necessary to clarify the connected standard of *overall impression*. As the expression suggests, all the features of the design should be taken into account to perform this comparison, although the comparison is based exclusively on what is visible to the informed users during normal use, therefore excluding features that are not visible or are only under special circumstances.<sup>44</sup>
- 28 Excluded from the overall impression test shall also be those features that are entirely dictated by technical function, in accordance with the same Article 8. An important parameter to determine the individual character is the freedom of the designer. The more a design is pre-determined by technical conditions, the smaller the possibility for its design to diverge from a given pattern. In light of this, a design which could seem as not creating a different overall impression on the informed user (a given design is too similar to existing prior art) could after all be protected since it should create a different overall impression on the informed user who is aware of the technical constraint.<sup>45</sup> The other face of the coin of such limited designer freedom is the limited protection that applies in this specific case in light of Article 10(2) CDR, which states that in assessing the scope of protection, the degree of freedom of the designer in developing his design shall be taken into consideration.<sup>46</sup>
- 29 Once established that in order to possess individual character a design should produce an *overall impression* on an *informed user* which is different from that produced on her by the existing design corpus, we should enquire *how different* this overall impression should be. As a hermeneutic tool, we are helped by Recital 14 CDR, which establishes that the difference needs to be *clear*.<sup>47</sup> Therefore, only if a design's overall impression on an informed user *clearly differs* from that produced on him by the existing design corpus, will the design possess an individual character and be protected, although this qualification (clearly) is only present in the mentioned *Recital* and not carried over into the wording of Article 6.<sup>48</sup> This view, expressed in detail by the UK Court of Appeal, has been only partially successful among commentators (for a detailed discussion, see *infra*).<sup>49</sup>
- 30 As for the type of prior art contemplated by the CDR, Article 7 indicates that we are in the presence of an absolute novelty requirement. In fact, any form of disclosure is accepted in order to create prior art and destroy novelty. The Article states that for the purpose of Articles 5 (novelty) and 6 (individual character), a design shall be deemed to have been made available to the public if it has been legitimately (i.e. in the absence of any abuse or breach of confidence) published following registration or otherwise, or exhibited, used in trade or otherwise disclosed before the relevant date (which is indicated respectively at Articles 5(1)(a)&(b) and 6(1)(a)&(b)). However, this absolute prior art test is considerably reduced in significance by a list of exceptions.
- 31 Previous disclosures, in fact, do not destroy novelty when the aforementioned events (publication, exhibition, use in trade, etc.) could not reasonably have become known in the normal course of business to the circles specialized in the sector concerned, operating within the Community.<sup>50</sup> Another major exception is represented by the 12-month grace period set forth by Article 7(2), during which the disclosure is excused. In the present case, the making available to the public needs to be occasioned by the designer, her successor in title, or even a third party, but as the result of information or actions of the designer. As said, under these conditions, and only during a period of 12 months, is such making available to the public deemed irrelevant towards both novelty and individual character tests, with the consequence that the designer is still entitled to file an application for registration. During this 12-month period (and for the following 24), the design will most likely be protected by UCD, which offers protection to the designer against acts of copying. Accordingly, a third-party independent application for an identical design to the one subject to the 12-month grace period would be rejected for lack of novelty, while a corresponding use (i.e. the use of a UCD that has not been copied but independently developed, see *infra*) would not represent an act of infringement. In the case where a third party legitimately uses (not copying) a design protected only by UCD during the 12-month grace period, and before the expiration of that period the UCD holder registers an RCD, the third party can continue in her activity within the limits of pre-use as long as she acts in good faith, she has not copied the design,<sup>51</sup> and most importantly, her use does not constitute a disclosure. In fact, it must be borne in mind that this grace period is not a right of priority,<sup>52</sup> nor does it have similar consequences: any third-party independent (i.e. not occasioned by information or actions of the designer) disclosure operates along the normal rules, meaning that it would prevent the designer who finds herself in the 12-month grace period from the possibility of successfully filing a registration for lack of novelty.<sup>53</sup>
- 32 An important limit contained in the CDR is that of Article 8, which excludes from protection those features (not the entire design) that are dictated entirely by technical considerations (as a logical corollary of what was established by Article 6 above).

Article 8 embraces two different cases: the first case of exclusion is mandated when the form of a product is dictated by a technical function, while the second is observable where the form is dictated by the need to mechanically combine or connect with other products. The rationale of this exclusion is explained in Recital 10 CDR, according to which technological innovation should not be hampered by granting design protection to features dictated solely by a technical function. In particular, the purpose of such provisions is to prevent design rights from being used to obtain monopolies over technical solutions without meeting the relatively more stringent conditions laid down in patent law.<sup>54</sup>

### III. Scope of protection and infringement

- 33 Article 10 deals with the key aspect of the scope of protection. The scope of protection is based on the parameters contained in Articles 5 and 6, and states that the protection conferred by a community design (CD) includes any design which does not produce on the informed user a different overall impression assessed in consideration of the degree of freedom of the designer in developing his design. Remarkably, the scope of protection of a CD as such is not affected by the products and classifications to which the design is applied or incorporated.<sup>55</sup> This means that a design protected as applied to a lamp could be infringed by a completely different product, such as a personal bag. However, it seems that the correct reading of the provisions of Articles 10 and 36(6) is that the fact that the design is incorporated in two different products should not *per se* exclude an infringement. In fact, the ultimate test remains that of a different overall impression on the informed user, who can obtain or not obtain such similar or different impression also in light of whether the design is incorporated in different and unrelated products.<sup>56</sup>
- 34 Therefore, in a hypothetical infringement test, an informed user should compare the two designs as they are applied to the respective specific products.<sup>57</sup> If the same design is applied to a fork and to a spoon, there is a higher likelihood that the informed user gets a similar overall impression. However, if the same spoon shape is applied to an 80-meter-long, 2000-ton space shuttle, the informed user's overall impression might be quite different. This reading of the test contributes to a more balanced view of the protection offered by CD, and helps to justify the requirement to indicate the class of products for which protection is claimed during the registration phase. It also contributes to limiting possible unjustified monopolies of forms on products not even identified.
- 35 The relevance of the product to which a design is applied or incorporated is confirmed by the OHIM, where it establishes that a certain design can only be registered for some class of products and not for others (for example, blueprints for houses can only be registered as "other printed subject matter", and not as "building"; see above). The rule seems to follow logics: if the goal of CD is to protect the appearance of a product, protection is given, and infringement can take place only in the presence of those products' appearance (the protected one and the infringing one). The fact that the product is defined broadly implies that protection and infringement will occur more often than if the definition had been narrower, but the presence of a product is still necessary. The fact that Article 36(6) establishes that protection is not limited to the class of products for which registration is filed represents a – questionable – policy decision that can only be interpreted systematically as excluding the fact that a different class of products would automatically determine a non-infringement finding. Still, as the OHIM practice recognizes, the fact that a design is applied or incorporated to different products does have consequences, sometimes as serious as to cause the rejection of the application.
- 36 Another aspect that should be considered in the infringement test is the *type* of overall impression in light of what we observed when analysing Article 6 (see *supra*). In other words, should the infringement test employ the "clearly different" standard as found in Recital 14? This consideration has direct practical consequences, since it will determine whether a product (its overall impression on the informed user) needs to be just different, or *clearly* different from a protected one, in order to discard infringement. In the silence of the CDR, it seems to this author that should be followed the theory sustaining that "clearly" operates only in the case of Article 6 (prior art test) and not in the case of Article 10 (infringement test).<sup>58</sup> The main reasons are based on policy considerations:
- 37 It is one thing to restrict the grant of a monopoly right to designs which are shown "clearly" to differ from the existing design corpus. That makes sense – you need clear blue water between the registered design and the "prior art", otherwise there is a real risk that design monopolies will or may interfere with routine, ordinary, minor, every-day design modifications – what patent lawyers call "mere workshop modifications." But no such policy applies to the scope of protection. It is sufficient to avoid infringement if the accused product is of a design which produces a "different overall impression." There is no policy requirement that the difference be "clear." If a design differs, that is enough – an informed user can discriminate.<sup>59</sup>

38 This view, though offering a justification to the specific difference in the wording of Recital 14 and in that of Article 10, seems to be only partially accepted by commentators.<sup>60</sup> A better drafting technique would have helped to avoid such an interpretative loophole.

#### IV. Registered and unregistered

39 In order to benefit from the protection offered by CDR, it is not necessary to file an application and obtain the consequent registration of the design. Registration is a requirement only for RCD, which offers a stronger protection to its holder (it offers protection also against design independently developed). However, if the designer decides not to register her design (or during the 12-month grace period), she will enjoy UCD protection, which offers the same extent of protection as the RCD, but only against acts of direct copying. Albeit different in nature, the broader right granted by registration and the anti-copying right granted by UCD – once validly registered or validly substantiated during a court proceeding<sup>61</sup> – offer to their proprietor the same type of rights: the right to use the corresponding product of design and to prevent any third party not having her consent from using it.<sup>62</sup> The difference between CDR and UCD in terms of the type of protection offered resides in the nature of the alleged infringing design: any infringing design in the case of RCD, or only infringing design resulting from copying of the protected design.<sup>63</sup> In particular, the contested design shall not be deemed based on an act of copying if it results from an independent activity by a designer who may be reasonably thought not to be familiar with the design made available to the public by the holder.<sup>64</sup> This means that the CDR creates a sort of simple presumption in favour of the UCD holder, given the fact that it is the alleged infringer who has to prove that she is not familiar with the “original” design (which needs to be disclosed in the public in the first place in order to trigger UCD protection).<sup>65</sup>

#### V. Rights granted by community design

40 Article 19 specifies that a CD confers on its holder the exclusive right to use it and to prevent any third party from doing the same. The Article further offers a non-exhaustive but detailed list of what “use” shall mean: the making, offering, putting on the market, importing, exporting or using of a product in which the design is incorporated or to which it is applied.<sup>66</sup> Once more we can observe how the CDR is far from clear in its use of legal terms. With regard to the present Article, it is not clear whether an infringement is caused by an unauthorized use of the design or of a product to which the design is applied or in-

corporated. Article 19’s literal structure is not conclusive in this regard, as in the first sentence it only employs the word “design” (*a community design shall confer ... the right to use it*, i.e. the right to use the community design), while in the second sentence’s list of possible acts of infringement, all the given examples make reference to the presence of a product in which the design is incorporated or applied.

- 41 It must be noted that the concept of *product* is central to the entire CD structure: only if a product exists can there be a design right applying to it, and consequently also an infringement can only be occasioned by a product incorporating the design.<sup>67</sup> After all, the same Article 3, defining a CD, clearly states that the essence of a design is the *appearance of a product*. This means that infringement can only occur where a person deals with or uses another product with the same appearance.
- 42 Although reduced in importance by the broad definition of product, the determination of whether a product is necessary to cause infringement is not without relevant consequences. Bently asks whether a cartoon character registered as a design is used when the cartoon is broadcast on TV or otherwise communicated online. In such cases of on-air or online uses, can we still speak of an *industrial or handicraft* product? In that author’s opinion, the answer should be in the negative, rooting this view not only in the literal and systematic analysis of Article 19, and more in general in the whole structure of CD, which, as mentioned, is construed around the concept of product, but also on Recital 21, which specifies that a CD right should extend to trade in products embodying infringing designs.<sup>68</sup>
- 43 The same author, however, notes that the definition of design clearly indicates that the appearance of graphic symbols is to be protected. In this respect, confining use to material products – excluding immaterial media such as the web – seems unduly limiting. The effect of this narrow construction, the author explains, is also to exclude web design from the field of designs law.<sup>69</sup>
- 44 Focusing on the semantic meaning of the concept, it seems that the “use” of an “industrial” or “handicraft” product is linked to its physical dimension, where it can carry out the function for which it is manufactured. However, in light of the current technological development that allows uses of physical products on immaterial medias, it does not seem possible to conclude that the CDR explicitly excludes such acts from the definition of use, a definition that is general and open ended.
- 45 A possible help to untangle this complex problem could perhaps be found by looking once again at the test for infringement. A community design of a screwdriver is infringed, for example, when other

identical screwdrivers are manufactured without the rightholder's consent. But the use of the screwdriver's appearance on a monitor (such as when reading an eBook) seems not to be tantamount to an act of infringement: First, one could argue that there is no use of the product; there is only the appearance without the product (after all, there is no screwdriver). Second, and maybe more importantly, even assuming that a product is present (if an eBook can be considered a product, after all, although a quite different one for this purpose), the overall impression on the informed user is different, as few would confuse the product screwdriver with the product eBook that at page xy has a 2D representation of a screwdriver (assuming that a normal use of an eBook makes its pages visible). If this difference is able to cause a different overall impression on an informed user, no infringement occurs.

## VI. Computer icons and other computer-based designs

- 46 The practice of OHIM specifically allows registrations for computer icons and graphic user interfaces (GUI) produced by computer programs, usually in Locarno class 14.<sup>70</sup> In light of the OHIM manual, it seems that a protectable immaterial product could certainly be the graphical user interface of a computer screen layout with the exclusion of sounds. Whether moving images and dynamic user interfaces can be held protectable is not clear. However, the concept of appearance of a product seems to exclude that dynamic elements, many times governed by the final user, can be included under the scope of protection. Further, it would be difficult to document such unpredictable dynamic aspects in the registration process.
- 47 It must be noted that, while protection of computer icons and GUI would probably be considered highly debatable, in the absence of a specific provision, an industrial or handicraft product represented in digital form is probably enough to trigger protection. There is a clear conceptual difference between the digital item "computer icon" – which is neither an industrial or handicraft product nor possesses the characteristic to be made, manufactured or printed into one, and that unfolds its function exclusively on the computer screen as a digital immaterial item – and a spoon represented digitally as a CAD file. A design that is computer created using a computer-assisted design program (CAD) and that represents perfectly the appearance of the product (therefore in the correct number of dimensions, sizes, colours, indications of materials, and more generally all the information that is required to define its appearance), can most likely be deemed protectable, and its actual manufacture is probably not necessary in order to activate the CD.
- 48 Once more the legal framework is not absolutely clear in this specific case, which is quite common to many modern designers, as we will see. We know, though, that the OHIM is not interested in such aspects in its determination of whether to grant a registered community design: "Whether the product indicated is actually made or used, or can be made or used, in an industrial or handicraft manner, shall not be examined".<sup>71</sup>
- 49 The very same process of registration does not require a specimen of the claimed CD, save for the limited case of Article 36(1)(c).<sup>72</sup> And Article 11, defining the commencement of protection of the UCD, includes among the acts that constitute a communication to the public the publication of the design (incorporated or applied to a product). It is not clear if the term publication is limited to the case of 2D designs such as ornaments, but it seems plausible that as long as the outer appearance of a product is communicated to the public, this is sufficient to trigger the legal effects of CD. It has been argued that as long as the appearance of the product is made available to the public, even an oral disclosure could achieve the purpose.<sup>73</sup>
- 50 The same Examination Guidelines seem to require – *a contrario* – that a design exists only in relation to an industrial or handicraft item, which has to exist or be passible/subject to coming into existence.

## VII. Exceptions and limitations

- 51 Article 20 provides for certain limitations of the rights conferred by a CD. The rights conferred by a CD shall not be exercised in respect of: (i) acts done privately and for non-commercial purposes, (ii) acts done for experimental purposes, and (iii) acts of reproduction for the purpose of making citations or of teaching.<sup>74</sup> Article 20 also provides for another set of exception (sec. 2) that are specific to the repair of aircrafts and ships, but these are not of interest here.
- 52 In the first of the listed exceptions, Article 20 specifies that it is not sufficient that an act be done for non-commercial purposes, but it must also be "private".<sup>75</sup> Therefore, a non-commercial public use will fall outside the present exception. This double restriction (private and non-commercial) is not required by international sources, and it should be ascertained whether under a policy perspective it is desirable.<sup>76</sup> It is not required, however, that the use be personal; therefore, all uses that are not public – including a private number of individuals and those that are done for non-commercial purposes – will be deemed covered by the provision.<sup>77</sup>
- 53 The exception for experimental purposes is drafted following a similar provision in the Topography Directive.<sup>78</sup> In particular, it seems that acts done for ex-

perimental commercial purposes should be included within the scope of this exemption.<sup>79</sup> It is unclear whether experiments have to be concerned with the design itself, or whether any type of experiment employing a protected product of design are exempted, therefore including those cases where the experimentation is directed to something different than the design, but where the latter is used.<sup>80</sup>

- 54 The third exception should look quite familiar to copyright scholars. It provides that acts of reproduction for the purpose of making citations or of teaching are exempted from protection, provided that mention of the source is made, and that such acts do not unduly prejudice the normal exploitation of the design. Citation is not further defined, and it seems that any act is allowed that reproduces a design as long as this is in accordance with fair trade practice and does not prejudice the normal exploitation of the design. Bently brings the example of a book about design, where designs of shapes (3D) are reproduced in the book. He argues that in such a case, there should be no need to resort to such an exception in the first place (the design is not applied to a product). However, should it not be the case, the present exception will be a helpful demonstration.<sup>81</sup> The teaching limitation is broadly defined and should not be limited to educational institutions (public or private) but extend to any act connected with teaching.<sup>82</sup> This will, of course, be limited to acts of reproduction for teaching, and will clearly not extend to dealing in products involving such reproductions.<sup>83</sup> A third and final condition is required: mention of the source. Once again, this is a provision with an obscure meaning – not only do we lack a definition of *source* but also of designer. Bently observes that it is unclear who – among the manufacturer, the designer and the design proprietor – should be taken as the source, and cautiously suggests mentioning those three.<sup>84</sup> Musker, on the other side, believes that the designer/author does not need any recognition, limiting the mention to the manufacturer or the supplier, at least in the case of UCD, since in the case of a registered design, a mention of the CD Bulletin number will suffice.<sup>85</sup>

## VIII. Ownership

- 55 Entitlement to a right in community design is dealt by Article 14, which identifies the (not better defined) designer or his successor in title as the owner of the right to the community design. In the next section, the same Article recognizes the possibility of joint development by different designers, in which case this right shall vest in them jointly. Section 3 clarifies that in the case of an employee developing the design in execution of his duties or following the instructions given by his employer, the right to CD shall vest in the employer, unless otherwise agreed
- or specified under national law. This last provision is not deemed applicable in cases of commissioned designs, where in the absence of a specific agreement the right to CD will vest in the designer.<sup>86</sup>
- 56 Article 14 is silent on who qualifies as a designer. It has been noted how CD has been created and implemented with industry and market interests in mind, not designers, and this pillar of CD is observable, for example, in the attention given to the concept of design as an industrial product, rather than in the figure of the designers as individuals undertaking productive and innovative activities.
- 57 The chosen wording – a designer does not *create* a design, but *develops* it – suggests further that there is a weak link between the designer and the design, and a much stronger one between the product and its industrial or handicraft background. To determine who is the designer, especially in the case (not central to the entire CD framework) of individual designers, is not an easy task. Musker notes that since “design” is the appearance of the whole or a part of a product (Art. 3(a)), designers are those who define that appearance.<sup>87</sup> However, this consideration will not have a conclusive result with many instances of collaborative development, since “a given design may involve contributions at many levels, from setting the specification or brief (which is probably at too high a level to specify the appearance of a product sufficiently to qualify the setter as a designer in most cases) down to making the production drawings or CAD file (which is probably at too low a level to do so in most cases)”.<sup>88</sup> In some instances, where rights other than CD are protecting the product of a design (such as copyright, or trade-marks, or other forms of national protection), it might well happen that these rights follow different ownership rules, and consequently lead to a product that can be defined as “complex” from the subjective point of view, or in other words, where different property rights are allocated to different owners: a clear case of economic inefficiency also known as “tragedy of the anti-commons”.<sup>89</sup>

## C. Copyright

- 58 Copyright plays a key role in the protection of applied art and industrial design. It also represents a difficult element to analyse from an EU perspective. The EU legal framework in the field of design protection establishes the principle of cumulation with copyright, but leaves the determination of the extent and the conditions of this protection (and especially the levels of originality required) to be determined by each member state.<sup>90</sup>
- 59 This provision, which arguably represents the attempt to reconcile the many different national approaches, is unfortunate for the consequences it cre-

ates under a common market (and society) point of view. It partially misses the objective to create a more consistent European framework for the protection of designs, since it mandates cumulation with a legal tool that is all but harmonized within the EU. The explicit provision that every Member State can determine the extent and the conditions under which copyright protection for works of industrial design is granted, pushes towards an even wider plethora of possible solutions, furthering diversity of approaches at the national level.

- 60 It can be observed that in different countries the level of originality required for products of design differs greatly, ranging from the standard level required for any other work (perfect cumulation approach<sup>91</sup>), to much higher levels, such as the requirement of artistic value (partial cumulation approach<sup>92</sup>). An effect of the EU legislative policy in design protection has certainly been to get rid of those approaches that did not allow cumulation or only under certain strict conditions (such as in the case of “separability” in place in Italy before the entry into force of the DD).
- 61 This small step forward under the light of standardization cannot make up for a solution that fosters differences rather than similarities, and it is hard to understand how this can produce positive effects in the European market and society.
- 62 The InfoSoc Directive makes little to no reference to the issue of cumulability with design rights. A reference to them can be found in the final section of the Directive dealing with common provisions. Article 9, titled “Continued application of other legal provisions”, states that “this directive shall be without prejudice to provisions concerning in particular ... design rights”.<sup>93</sup> As we will see in more detail below, other major international copyright instruments, such as the Berne Convention or the TRIPs Agreements, tend to leave broad directionality to Members in terms of cumulation.<sup>94</sup>

## I. EU directives: Scope of protection and protected rights

- 63 Policy criticisms aside, a brief analysis of the relevant aspects of EU copyright law will help to understand the relationship between the latter, design rights and CC. As mentioned, EU copyright law has witnessed different attempts of harmonization; nonetheless, this plurality has not led to a unique harmonized EU framework. Partly due to the limited scope of some of the directives,<sup>95</sup> partly because, even when the directives had a more horizontal scope, they only harmonized “certain aspects”,<sup>96</sup> we are still nowadays in the presence of an only partially harmonized EU copyright framework.

- 64 The most relevant – for our purposes – of the copyright directives is certainly the Directive 2001/29/EC on the harmonization of certain aspects of copyright and related rights in the information society (InfoSoc)<sup>97</sup>. The scope of the InfoSoc Directive is to harmonize the legal protection (some aspects thereof) of copyright and related rights in the framework of the internal market, with particular emphasis on the information society.<sup>98</sup> It harmonizes in the first instance the type of rights that right-holders should be granted in the digital environment. Member States shall provide for the exclusive right of reproduction for authors and for rightholders of related rights,<sup>99</sup> of communication and making available to the public by wire or wireless and “on-demand” for authors and other rightholders,<sup>100</sup> and of the right of distribution of works.<sup>101</sup> Article 5 of the Directive provides for a list of possible exceptions and limitations to copyright (ELC) to the aforementioned rights. This Article encompasses a closed list of non-mandatory ELC (save for the case of temporary acts of reproductions<sup>102</sup>) whose harmonization effects – in light of such an extremely modest legislative technique – have already been criticized in a number of publications, and with good reason.<sup>103</sup> Suffice it here to restate that if the objective is to harmonize EU copyright law, the act of creating a closed list of non-mandatory ELC, whose implementation is left to each Member State to be decided upon, simply misses the goal of the Directive as a tool of EU legal harmonization.
- 65 That being said – and with the limits of a set of rights subject to 27 different possible combinations of ELC – the aforementioned rights do form a core of protected activities that are harmonized at the Member State level and that can therefore be considered reserved to their copyright-holder across the EU territory in a more or less consistent way.

## II. Protected works and elaborations

- 66 Crucial to our analysis is to note how the InfoSoc Directive does not define two concepts. The first is the fundamental concept of protected work, i.e. a definition of the protected subject matter by EU copyright law. The second is the concept of derivative work or adaptation (we will fully discover the importance of this concept *infra*). These two aspects are left untouched by the InfoSoc or any other EU Directive, and Member States are left free to offer protection to the subject matter (and derivatives) of their choice – at least from an EU perspective. It is true, in fact, that beyond the EU Directives – and CJEU decisions<sup>104</sup> – another major source for copyright harmonization, or at least coordination, is represented by the international agreements concluded in the area of copyright and intellectual property more generally.

- 67 In our field there are at least three major international instruments that cannot be forgotten in this analysis: the Berne Convention (BC),<sup>105</sup> the WIPO Copyright Treaty (WCT)<sup>106</sup> and the TRIPs agreements.<sup>107</sup> For our limited goal (definition of protected works and of derivative works), it would suffice to analyse the relevant provisions of the BC given the intertwined system created by the aforementioned three instruments for what concerns some basic rules.<sup>108</sup> The BC, in Article 2, offers a non-exhaustive but quite detailed list of protected works, which (selected on the basis of their relevance for this study) includes “every production in the literary, scientific and artistic domain ... such as works of drawing, painting, architecture, sculpture, works of applied art, ... plans, sketches, ... and three dimensional works relative to ... architecture or science”.<sup>109</sup> Section 3 of Article 2 indicates that “[t]ranslations, adaptations, arrangements of music and other alterations of a literary or artistic work shall be protected as original works without prejudice to the copyright in the original work”.<sup>110</sup> It is interesting to note that section 7 of the same Article establishes a specific provision for the case of applied art, industrial design and models, leaving it as a matter for legislation at the national level “... to determine the extent of the application of their laws to works of applied art and industrial designs and models, as well as the conditions under which such works, designs and models shall be protected”.
- 68 This specific provision has played an important role at the EU level towards the adoption of the principle of cumulation, in order to overcome the possible discriminations of protection on the basis of the country of origin and reciprocity rule.<sup>111</sup>

### III. Some national examples

- 69 Accordingly, it is possible to find at the national level of EU Member States the presence of provisions in copyright law regarding the protectability of works of industrial design and applied art, though significant differences survive, especially in the pre-DD era.

#### 1. Netherlands

- 70 Illustratively, the Dutch Copyright Act clarifies in Article 10 that “literary, scientific or artistic works includes ... works of applied art and industrial designs and models”<sup>112</sup> and that “reproductions of a literary, scientific or artistic work in a modified form, such as translations, arrangements of music ... and other adaptations ... shall be protected as separate works, without prejudice to the copyright in the original work”. No special requirements are present in the Dutch Copyright Act regarding the protection of design, nor does the Dutch design law prescribe any particular requisite.
- 71 As mentioned earlier, the Benelux (the union of states formed by Belgium, the Netherlands and Luxembourg) is governed by uniform design law provisions in virtue of the Benelux Convention on Intellectual Property (Trade-marks and Designs).<sup>113</sup> Under the Convention, Benelux offers a good example of a perfect cumulation approach.<sup>114</sup> Under the old Benelux Design Law, however, the situation was different, as that act required a “clear artistic” character in order for designs to be able to attract copyright protection.<sup>115</sup> The Court of Justice of Benelux, however, clarified that the threshold for copyright protection for works of applied art should be reached when the work has an original character showing the author’s personality, not much differently from any other copyrightable subject matter, and accordingly Article 21 of the old design act, requiring this extra condition, was repealed.<sup>116</sup>

#### 2. Italy

- 72 The Italian Copyright Act<sup>117</sup> protects works of ingenuity possessing creative character in the field of literature, figurative arts and architecture regardless of the form of expression. In particular, the protection includes “works of industrial design that present by themselves creative character and artistic value”.<sup>118</sup> It is therefore not easy to reach copyright protection for designs in Italy. Designs need to possess not only creative character but also the new and arguably difficult-to-reach parameter of artistic value. Artistic value can be reached when “wide acknowledgement is expressed by different cultural institutions, in favour of the belonging of the work to an ambit of expression which is rooted and expresses tendencies and influences of artistic movements, beyond the intentions and the very same awareness of its author, as the work of artistic content acquires value in itself thanks to its expressive and communicative characteristics”.<sup>119</sup>
- 73 This high requirement creates a system where very few designs and works of applied art are able to enjoy copyright protection. It also seems quite clear that, even if it is not possible to speak of separability (*scindibilità*) anymore, a requisite as high as “artistic value” is as close to the pre-Design Directive standard as legitimately possible after the entry into force of said Directive.
- 74 Italian-based designers should also consider the separate issue of the repeatedly reformed transitory provision contained in Article 239 of the Industrial Property Code, which in its current wording grants a 13-year period of time during which products of design that were in the public domain before 19 April 2001 (the date that sanctioned the cumulation of

protections in the Italian system) can still be produced without infringing the relative copyright by those third parties who by that date were already – legitimately because in the public domain – producing such items, but only within the limits (including quantitative limits) of the pre-use. Said period of time (13 years) has been introduced very recently by a law of 2012<sup>120</sup> amending the previous period of time of five years. The five-year period was in place between the reported reform of the law of 2012 and 2010.<sup>121</sup> Before 2010 the transitory provision was of 10 years.<sup>122</sup> Note that the 10-year period was the object of the preliminary ruling of the ECJ, which declared it in contrast to EU law.<sup>123</sup> How a reform that brings the period of 10 years (judged excessive by the Court) to 13 years can be held legitimate remains obscure. Courts in Italy have already taken the stand that this 13-year period is clearly in contradiction to EU law and therefore should not be applied.<sup>124</sup>

### 3. UK

- 75 In the UK, copyright law<sup>125</sup> confers protection to designs by protecting the form and decoration of articles as artistic works (sculptures, engravings, or works of artistic craftsmanship<sup>126</sup>). Copyright provides protection also to preliminary documents on which a design has been based, usually as a graphic work.<sup>127</sup>
- 76 Of special interest in the UK legal landscape are the specific rules that apply to the interface between copyright and design rights. In particular, section 51 of the CDPA states that copyright is not infringed by making an article from a design document or a model which records or embodies a design where the design is for anything other than an artistic work or a typeface.<sup>128</sup> This is a fundamental aspect for our analysis: “copyright in a blueprint for a three-dimensional industrial design will not be infringed where a person makes articles that embody the drawing”.<sup>129</sup> Note that for section 51, design means the design of any aspect of the shape or configuration (whether internal or external) of the whole or part of an article, other than surface decoration. This includes non-visible parts (which are excluded from CD), but excludes surface decorations (which are included in CD). Also, the existence of an unregistered form of protection peculiar to the UK legal system has to be accounted for: making an article from a 3D blueprint may represent an infringement of unregistered design rights.<sup>130</sup>
- 77 Section 51 operates only in the case of a design document, which must be for something other than an artistic work, and applies only to the creation of a 3D article copied from the design document. Section 51 will not apply in the case of decorations or other 2D designs. Section 4(1) CDPA defines artistic work as “a graphic work, photograph, sculpture or collage, irrespective of artistic quality, a work of architecture being a building or a model for a building, or a work of artistic craftsmanship”. Given such a broad meaning of artistic work, the real extent of section 51’s relevance is probably quite limited.<sup>131</sup>
- 78 The CDPA is also interesting as in section 52 it contains a limitation of the term of protection for copyright: when an artistic work has been exploited by an industrial process by making more than 50 articles, all of which are copies, copyright will last only 25 years from when the article was first marketed (counting from the end of the calendar year).<sup>132</sup> However, articles such as works of sculpture, printed matter, maps, plans and the like are explicitly excluded from the exception.<sup>133</sup> Section 52 operates as a defence, and only with regards to acts that apply the design to a product. The mere reproduction of the copyright disconnected from any design does not benefit from the defence (meaning that copyright will regain its natural term). The future survival of section 52 is uncertain as proposals for its repeal have been discussed.<sup>134</sup>

## IV. Final observations to part I

- 79 As a conclusion to the part dedicated to designs protection, we can observe that in the EU products of design can be protected by a quite conspicuous and overlapping number of rights. Even limiting our analysis to only two of them (the most relevant anyway: design rights and copyright), the possible different rules that apply in function of the relevant jurisdiction are many. For example, a product of design, protected by a registered community design, is likely protected also by copyright, unless the applicable law has provisions similar to the Italian one, in which case it should be ascertained whether the product is not only creative but also possesses an artistic value, or any other threshold that domestic law has established.
- 80 As a matter of fact, the same product can be protected by copyright in one country (Germany) and not in another one (Italy) as some case law has demonstrated.<sup>135</sup> This possesses a clear negative impact on the free circulation of goods in the internal market.
- 81 However, the failure to implement a consistent cumulation scheme in the internal market is only one, although quite serious, reason for criticisms. From what we have seen thus far, design law, though having achieved some remarkable harmonizing effects, has nonetheless failed to regulate the field of design rights in a consistent and technologically neutral way. In particular it lacks the flexibility to offer a suitable form of protection to modern, small-sized, 3D printing, EU-based, open designers. Aspects such as the lack of prior art search during registration

and the consequent bad quality titles that this produces, the threshold of “difference” in prior art and infringement tests, the fact that registration requires the indication of the class of products without limiting the scope of protection, the absence of a clear definition of designer, the extremely limited ambit of operation of exceptions and limitations, and the confusing terminology employed when it comes to identifying an industrial or handicraft item and when it is used, are but the major identified flaws. Their reform would contribute to bringing the entire EU design law framework closer not just to the needs of Open Designers, but more generally to the needs of a more efficient EU legal and economic system.

- 82 Copyright, on the other side, while suffering from some of the same flaws, seems a more flexible tool. However, it is poorly harmonized throughout Europe, a situation exacerbated in the specific case of works of industrial design and applied art by the fact that it is left to Member States to establish the levels of originality for protection. In the next section we will see whether contracts (a peculiar typology thereof) can be successfully employed to overcome such shortcomings.

## D. Creative Commons

- 83 Creative Commons (CC) is a non-profit organization that endorses a modern view of copyright – the famous *some rights reserved* principle – and offers licenses and other legal tools for free public use. There are different licenses that CC offers, but the most relevant in terms of use is the CC Public License (CCPL), which comes with different license elements (clauses) depending on the selection that users can make on the online license chooser.<sup>136</sup> Another interesting license is CC0 (CC zero), which comes in just one “flavour” and is better seen as a waiver of different rights that the affirmer has on the work or other material. There is a fair amount of available information, mostly online, on CC operations and the licenses.<sup>137</sup> Here we will specifically focus on a few features that are relevant in cases of products of design and applied art.<sup>138</sup> We will make reference to the CCPL in its current version 3 (CCPLv3). In the second half of 2012, a deep revision of CCPLv3 was initiated with the objective to develop a new version 4 (CCPLv4) by 2013. When this paper was written, CCPLv4 had not yet reached final public release; nonetheless, we will make specific reference to the changes in the new version that could have an impact on the aspects hereby studied.<sup>139</sup>

## I. The Creative Commons Public License (CCPL)

- 84 The CCPL offers a core of rights that are always licensed regardless of the options that licensors choose. These rights include the right to reproduce, redistribute, communicate to the public, make available to the public and perform the work. Licensors can further choose among the following optional conditions:

BY – Attribution: Attribution must be given to the licensor in the modalities indicated in the license. Attribution is not actually an option anymore since it applies per default since version 2.0.

NC – Non Commercial: Licensor offers the rights identified above only for purposes that are not primarily intended for or directed towards commercial advantage or private monetary compensation.<sup>140</sup>

ND – Non Derivatives: Licensor reserves the right to create derivative works.

SA – Share Alike: Licensor allows the creation of derivative works only under the condition that those are licensed under the same – or an equivalent – license.

- 85 The main question that this paper attempts to answer is whether a CCPL can be applied to design products and if yes, whether this can represent the basis to develop a legal theoretical framework fit for an Open Design model. In order to answer this question, we need to analyse CCPL’s scope and licensed rights.

## II. CCPL’s scope and licensed rights

- 86 The license grant is contained in section 3 of the CCPL<sup>141</sup> and provides that by using such license a licensor grants a worldwide, royalty-free, non-exclusive, perpetual (for the duration of the applicable copyright) license to exercise the rights in the Work as stated below:

- to Reproduce the Work, to incorporate the Work into one or more Collections, and to Reproduce the Work as incorporated in the Collections;
- to create and Reproduce Adaptations provided that any such Adaptation, including any translation in any medium, takes reasonable steps to clearly label, demarcate or otherwise identify that changes were made to the original Work. For example, a translation could be marked “The original work was translated from English to Spanish,” or a modification could indicate “The original work has been modified.”;

- to Distribute and Publicly Perform the Work including as incorporated in Collections; and,
  - to Distribute and Publicly Perform Adaptations
- 87 In the 4th draft of version 4 (CCPL 4.0d4), the structure of the licenses has received major restructuring, and content-wise the license grant has been expanded substantially. Not only neighbouring rights, such as the *database sui generis right*, are explicitly included in the scope of the license, but the reservation clause typical of CCPL3.0 has been removed.<sup>142</sup> As we will see, however, the now open-ended list of rights included in the scope of the license is not still capable, nor is it arguably intended, to capture design rights.
- 88 In the new version 4.0 there is a new definition in section 1.1, that of “Share”, which includes most of the activities listed in section 3 of the previous version.<sup>143</sup> The grant is contained now in section 2 and reads along the lines of the previous version 3 definition, save for employing the term *share* as defined in section 1.
- 89 In the CCPL version 3, “Work” is defined by section 1 as:
- the literary and/or artistic work ... including without limitation any production in the literary, scientific and artistic domain, whatever may be the mode or form of its expression including digital form ... such as ... a work of drawing, painting, architecture, sculpture, engraving or lithography; ...a work of applied art; an illustration, map, plan, sketch or three-dimensional work relative to geography, topography, architecture or science.*
- 90 Version 4.0d4 has substituted the definition of work with that of “licensed material”, which is defined as “the artistic or literary work, database, or other material to which the Licensor has applied this Public License”. Copyright and neighbouring rights, on the other hand, are defined as “copyright and/or similar rights closely related to copyright including, without limitation, performance, broadcast, sound recording, and Sui Generis Database Rights, without regard to how the rights are labelled or categorized....”
- 91 Note the similarity in the terminology between version 3 and the BC terminology, and the fact that works of applied art are expressly included in the definition of “work”. Version 4.0d4 is much more succinct in its definition of licensed material and copyright, though it employs a formula which clearly comprehends any subject matter included in the protection offered by copyright. It seems unquestionable that both version 3 and the forthcoming version 4 cover in their scope works of applied art and design, as long as these are protected by copyright.
- 92 At the same time, however, it seems irrefutable from the license grant that the CCPL (both version 3 and 4) is a copyright license that additionally includes other rights closely related to copyright, but not rights that are different in nature, scope and structure. Design rights, as defined by the DD and CDR, are not only absent from the license’s enumeration, but their nature, scope and structure make them a completely different type of rights from copyright and from copyright-related rights – as confirmed, *inter alia*, by the fact that no sign of them is present in the Rome Convention nor in any EU copyright (and related rights) Directives.<sup>144</sup> Design rights, under a number of aspects (registration, subject matter, requirements, duration, competent offices, tests) are much closer to trademarks and patents, a set of rights that are unanimously outside the scope of the CCPL.<sup>145</sup>
- 93 Accordingly, a CCPL applied to a design will only govern the copyright in the work, and not the design rights in the product. This may lead to the paradoxical consequence that a user of a CCPL work of applied art which is also protected by design rights is allowed to perform some given acts on the basis of the copyright regime, but prohibited to perform very similar activities on the basis of the – non-licensed – design rights.<sup>146</sup> We will analyse in detail the possible situation emerging from this duality of protection in section 5.

### III. CCO

- 94 Another CC license that deserves a brief mention is the CCO, a waiver more than a license, particularly popular in the field of data and databases. CCO is interesting in our analysis for two main reasons: a) its scope; and b) how it deals with the rights included in its scope.
- 95 Regarding the first point, we can observe that CCO’s scope is much broader than that of the CCPL. It includes the right to reproduce, adapt, distribute, perform, display, communicate and translate a Work; *publicity and privacy* rights; rights protecting *against unfair competition* with regard to a work; rights protecting the extraction, dissemination, use and reuse of data in a Work; database rights; and other similar, equivalent or corresponding rights throughout the world based on applicable law or treaty. In particular, the specific indication of privacy rights and unfair competition rights, and the general clause including equivalent or corresponding rights throughout the world, might trigger a doubt as to whether there is space for inclusion of design rights in such a broad and open-ended scope of protection.
- 96 The answer will most likely be in the negative for the case of registered design rights (as the specific exclusion of patents and trademarks may suggest<sup>147</sup>),

but a positive answer might be plausible in the case of UCD or other national unregistered design forms of protections, given the nature of such unregistered rights, which can be found close to copyright under more than one aspect (absence of registration, scope, nature of protection and infringement). Unregistered community design also recalls some provisions of unfair competition (a defence against acts of deliberate and slavish copying), which is specifically listed in the CC0 scope.

- 97 The second aspect of interest is the waiver: To the greatest extent permitted by, but not in contravention of, applicable law, the affirmer fully and permanently waives, abandons and surrenders all of its copyright and related rights and associated claims and causes of action, whether now known or not. Therefore, although this seems to be a case of very limited practical relevance, it could be possible to apply a CC0 to a product of design, and by this act the designer would surrender any copyright in it, as well as any UCD-based claim against acts of copying of the design. Of course, the designer would still be entitled to file a registration for an RCD within a period of 12 months from the date of the first disclosure of the product, but after this grace period, anybody should feel free to reproduce the design.<sup>148</sup> In light of the fact that a CC0 by itself would probably not solve issues connected with the relinquishment of the right to file for a registered community design, coupled with the fact that the applicability to unregistered design rights is based more on interpretation than on actual wording or known case law, this solution remains highly hypothetical and should not attract the attention of those interested in anything more than purely academic speculation. If it did – and we repeat that it shouldn't – it must be borne in mind that CC0 is a waiver; therefore, it would not be possible to employ CCPL license elements (BY, ND, NC, SA).

## E. Open Design

- 98 In the dynamics of what we call an Open Design workflow,<sup>149</sup> we have observed that a common practice among “open designers” is that of sharing their blueprints online in order to allow everybody to benefit from their creations.<sup>150</sup> Designers who do that are inspired by different sentiments, though. For some, the sharing of the knowledge is the major reward and incentive, and accordingly those designers tend to employ licenses with few restrictions, among which are usually “copyleft” clauses.<sup>151</sup> Others contrast such a libertarian stand with a much more pragmatic one. In their intentions the sharing should contribute to spread their work and their name in ways (or at costs) that common marketing tools could not reach, and accordingly they release their blueprints under terms that restrict

the creation of derivative works or the commercial exploitation.

- 99 In light of this observation, our analysis requires a slight shift in angle: given the centrality of the blueprint, it is precisely from this element that we should start. Blueprints, when reaching the required level of originality or creativity, can be considered a work of authorship in their own right. Alternatively, when purely technical and lacking any originality, it is arguable that blueprints are not protected by copyright, though in some countries we have found a specific neighbouring right on the reproduction of the plan and on the realization of a project of engineering in absence of the project drafter's consent.<sup>152</sup> Blueprints, however, when disclosing the outer appearance of the product, could also be considered part of the product, or even as the product of design themselves, and accordingly attract the protection offered by design law (see above section 2.6).
- 100 Given the plurality of roles played by a blueprint, it can help to resort to a simple example. Let us imagine that a designer creates a blueprint and makes it available online under a CC license that allows derivative works under a Share Alike (SA) provision (therefore employing a CCPL BY-SA). For the sake of clarity, we will analyse separately what can be done with the blueprint as a work of authorship and what can be done with the resulting product.

## I. The blueprint

- 101 The first aspect at issue (the blueprint and the possibility to modify it) represents an easier case which follows usual copyright rules, if any. The blueprint can be of a purely technical nature and lack any possible form of copyright protection. This is an unlikely scenario considering how low the required level of originality usually is; however, especially in the most technical environments, this remains a possibility that cannot be excluded *a priori*. A technical drawing reporting the calculation of the acceleration of a particle released from a given height and lacking any original or creative addition, can indeed be considered too technical for copyright protection, at least in those jurisdictions with higher standards.<sup>153</sup>
- 102 In such a case, the blueprint is not protected by copyright or usually by any other neighbouring right.<sup>154</sup> The blueprint is said to be in the public domain, a legal status that allows everybody, for copyright purposes, to use and reuse the material. The application of a CC license to this public domain blueprint should be harmless (and pointless), since CC licenses base their operation on the copyright protecting the work. In the absence of any copyright, no term of the CC license should be considered enforceable.<sup>155</sup>

- 103** In the opposite case, where the blueprint meets copyright standards, the license is triggered and the creation of any other work covered by its scope should conform to the conditions established in the license. Therefore, if a licensee decides to modify the blueprint in an original way, for example adding a new creative element to it, this will be possible, in our case (use of a CCPL BY-SA), under the condition that the licensee correctly report the attribution, and applies the same, or an equivalent, license to the resulting blueprint.<sup>156</sup>
- 104** But what about the possibility to manufacture a product based on the blueprint?

## II. The product

- 105** A more complex analysis regards this second issue, i.e. the manufacture of a product from the blueprint. Let us imagine that a second designer finds the same blueprint online. She downloads the blueprint's file and sends it to her 3D printer in order to obtain the corresponding object. At this point we need to determine what is the legal status of the object under: a) copyright, and b) design rights.

### 1. Copyright

- 106** A first case is given by the possibility of identity between the copyrighted blueprint and the realized product. This means that the blueprint is not only the authors' own intellectual creation but is also complete and final: it determines the appearance of the product, to use design law wording. In this case the blueprint leaves no discretion to the manufacturer as to how to manufacture the product, and the manufacturer, on his side, adheres completely with no creative changes to the blueprint. In such a case, the digital blueprint (for example the CAD file<sup>157</sup>) is "ready", in the sense that in order to print the product it will be sufficient to "send" the file to the 3D printer. Any intermediate act before printing takes place is limited to predetermined and technical interventions, such as "clean-up" of the CAD file from programming errors, the conversion of the CAD file in an executable code to be sent to the printer, and the specific regulations and parameters of the printing machinery.<sup>158</sup>
- 107** Accordingly, the realization of the product (the 3D item) will very likely represent a *reproduction* of the blueprint to a different media or format not much different from what the printing of a digital journal article on a regular 2D printer would be. Also in this latter case, sometimes it is necessary to clean up the file from comments or typos, to convert the file into a format readable by the printer (usually done automatically by the software in a way that the user is

completely unaware of), or configure some parameter of the printer, such as the type of paper, the order of collation, whether comments should be printed and the like. All these activities have a direct influence on the final print-out; however, they are marginal and not creative and will not be deemed sufficient to constitute a derivative work under copyright law. In a case of identity between the digital blueprint and the material product, where the blueprint embraces all the creative elements of the material product itself, the act of printing the article is covered by the right of reproduction, not by the right of creation of a derivative work.<sup>159</sup> Accordingly, the author of the copyrighted item is the author of the copyrighted blueprint, as there is only one copyright at stake here, one that is likely infringed – save for the presence of exceptions or authorizations – by the act of printing<sup>160</sup>.

- 108** In our example (CCPL BY-SA blueprint), the license allows printing (reproducing) as many products as desired, copying them further, distributing them, showing them in public or communicating them to the public, with the only limitation to apply the same license in case of acts of redistribution of verbatim or derivative works and to mention the original author in the form she indicated. As long as the printing corresponds to an act of reproduction, blueprints distributed under a CCPL with the Non Derivative clause can also be legitimately printed.<sup>161</sup> It should also be borne in mind that any possible ELC as present in the applicable copyright law is explicitly affirmed by the license.<sup>162</sup>
- 109** A second different case is given when the printed item results in a substantially different work from the blueprint, either because the blueprint is not detailed enough to be printed right away (imagine that it consists of a drawing or image, maybe just in 2D, rather than in the complete final CAD file<sup>163</sup>), or because the second designer decides to modify, enhance or in any way creatively adapt the blueprint, or in any other case in which the final printed item is substantially different from the blueprint. Under these circumstances (that can be analogized to the realization of a cinematographic adaptation from a novel), it must be established whether the intellectual creation as present in the original blueprint is identifiable in the final product in a way that may constitute a copyright infringement, or whether, on the contrary, we are in the presence of a product merely inspired by the blueprint but that does not reproduce the original creation in a way prohibited by copyright law.
- 110** In the former situation, the manufacturer (who creatively modifies the blueprint) will be the copyright holder of the derivative work (if her modifications amount to the level of originality required). Of course, this is without prejudice to the copyright in the original work. In our example, the creation

of a derivative work (the modified printed product) does not amount to an infringement, as it is allowed by the Share-Alike clause of the Creative Commons license under which the blueprint is distributed. Therefore, the second creative designer will be the author of the copyrighted item, but obliged to apply to its work the same – or an equivalent – license in order to comply with the requirements of the CC-BY-SA governing the use of the original work. Failing to do so (or in all cases where the original blueprint does not allow the creation of derivative works, such as the use of a CC with the Non Derivative clause) would trigger liability for copyright infringement, save for the eventual operation of any ELC.

**111** In a different situation, where the product is merely inspired but not copied from the blueprint, it is arguable that the product does not infringe the copyright in the blueprint, in the same way that a story-line regarding a doctor who creates a monster named after him does not infringe Mary Shelley's novel, as long as the former represents an independent intellectual creation of the author. In order to find precise application in a real case, however, the reported general principle needs to face the idiosyncrasies of the legal system where protection is sought, since, as reported above, the concept of derivative work has received very little attention at the EU as well as at the international level. Accordingly, the degree of creative autonomy that the new work needs to possess in order to qualify as independent and non-infringing can vary substantially. In order to find an answer to this issue, an analysis of the outer limits of the concept of derivative work should be undertaken for any relevant country, and with particular attention to the transition from two to three dimensions and the technical or creative elaborations this implies.

## 2. Design rights

**112** Once the designer makes the blueprint publicly available online, as happens in our example, she most likely *discloses* it. This will happen when the blueprint reveals the outer appearance of the product, such as where there is an identification between the blueprint and the product of design. Accordingly, novelty (if present at all) becomes an impediment for any third party trying to claim design right protection for products that do not cause a (clearly) different impression.<sup>164</sup>

**113** This mechanism will represent an interesting option for those designers interested in sharing but who want to make sure that no one else can use their blueprints to obtain design protection. In those cases, designers need to consider that such a disclosure operates only if it reaches the normal circles of business in the relevant sector. The online publication (regardless of the type of license) seems to facilitate this possibility, though attention should be paid

to the specific circumstances of the case. The manufacture and exhibit of at least a few samples is advisable, in order to silence the possible objection (not shared here) that the design is disclosed only when applied or incorporated to the *material* product.<sup>165</sup>

**114** On the contrary, when the blueprint does not correspond to the appearance of a product of design, the act of making available the copyrighted blueprint does not correspond to the design law concepts of disclosure. A second designer could find inspiration from this publicly available documentation and manufacture an independent design with the intention to obtain registered or unregistered protection. This is a possible scenario that does not depend on the type of license under which the blueprint is distributed. It must be noted, however, that in such a case the difference between the blueprint (or any other design, documentation or information available) and the final design needs to be considerable, since the latter will have to be (clearly) different from the already available body of designs in order to pass novelty and individual character tests. Unfortunately, however, such tests will only come into play during eventual litigations, and not during the registration process, a mechanism that has already been criticized in this paper.<sup>166</sup>

**115** Another aspect to keep in consideration in such cases is that no parts of a copyrighted blueprint (or any other protected work) can be present in the claimed design in forms that would constitute a copyright infringement: Article 25 CDR lists among the reasons for invalidity of a CD the fact that the design constitutes an unauthorized use of a work protected under copyright law.<sup>167</sup>

**116** An interesting case is given by the eventuality in which the work of art applied to the product is licensed under a CCPL with a non-commercial clause. In this case, no commercial activity that involves the work under CCPL can be legitimately carried out; therefore, most likely the entire product will have to be dealt with in a non-commercial way.

**117** As we have seen, however, the CCPL scope does not cover design rights. Therefore, while the inner structure of design law, and chiefly the effects of disclosure, can represent a satisfactory scheme for licensors, licensees will still find themselves in a situation of uncertainty since they might be infringing the unlicensed design rights.

## 3. The licensee's perspective

**118** So far we have focused our analysis on the licensor in order to secure that she can rely on the expected legal effects that the application of a CCPL to the product of design should entail. Given the likely double layer of protection of products of design in

the EU and the application of a CCPL to the work of applied art, it seems that the licensor can reasonably achieve the prospected goals, at least on the basis of the copyright provisions. In fact, the use of a CCPL has no consequences on the rights stemming from community design protection. Therefore, our licensor will always have in her hands the power to enforce her rights on the product of design even in contradiction with her own determinations when licensing the copyright in the same product (with the obvious limitations regarding acts *contra factum proprium*). This can indeed be seen as irrational behaviour on the part of the licensor, but it is still technically possible. Further, licensors can change over time, transfer rights, change ideas, or simply be or become different persons depending on the rights at stake.<sup>168</sup>

**119** Accordingly, the last issue that needs to be addressed for a complete analysis concerns the conditions under which the licensee can reasonably trust that the acts undertaken on the basis of the CCPL will not infringe the licensor's design rights. In fact, in all those circumstances where the blueprint of a product of design discloses the appearance of the product and triggers protection, it can well happen that the blueprint's author is entitled to file registration for CDR or enjoy UCD anyway. As repeatedly pointed out in this study, we are not concerned with legal or procedural defences that may offer a resort against an act first permitted and then prohibited on the basis of a different right by the same person (acts *contra factum proprium*, and relative national epiphanies such as *bona fide* doctrines, estoppel, and other legal presumptions). Such defences and theories can actually prove extremely effective in preventing abuses; however, they will vary on a case-by-case basis, and here we are concerned in developing a consistent framework based on substantive law provisions.

**120** Upon disclosure of the product of design, the designer enjoys the protection granted by UCD for a period of three years, together with a 12-month grace period to register the design. In these cases, potential licensees could feel extremely frustrated by the lack of legal certainty around their use of the product. Their use, in fact, is based on the CCPL and will only grant them the possibility to perform a number of acts on the basis of a copyright authorization, with the design rights still reserved to the designer. This would represent a major bias, especially for users beyond the amateur circle, such as in professional and commercial environments, where the eventual exceptions of private and non-commercial uses seen above would not find application.

### III. A proposal

**121** In order to overcome the situation of legal uncertainty caused by the use of a CCPL for products of design – that is to say, of an agreement that licenses the copyright but not design rights in a way that could lead many licensees in error – we propose to combine the CCPL with other CC tools.

**122** As briefly mentioned, in addition to the CCPL, Creative Commons offers additional legal tools that can prove quite effective in cases such as the present. CC+ (CCPlus) is one of those. Strictly speaking, CC+ is not a license but a “protocol” composed by a standard CCPL license *plus* an additional agreement that allows licensors to offer additional permissions and more rights above and beyond those granted by the standard CCPL.<sup>169</sup>

**123** In our proposal, the “+” would be represented by a waiver whereby the affirmer relinquishes every possible right or interest stemming from EU community design, or from national design rights law. The specific wording should mirror, *mutatis mutandis*, the one found in the CC0, with the substitutions and adaptations of the case. The affirmer, in particular, should declare not to have filed any application for a CDR, and to relinquish the relative right (which would exist for a 12-month period from disclosure) to file for a registration. In a case in which a CDR has been filed and/or obtained, the waiver should contain specific wording declaring that the rights granted by the CDR are waived, abandoned or relinquished and will never be enforced. The affirmer should also explicitly abandon, waive and promise not to assert the UCD which will endure for a period of three years from disclosure regardless of any affirmative step taken by the designer. A specific reference in the waiver should be addressed to national unregistered design rights (such as in the UK case).

**124** In order to ensure the maximum level of compliance with national laws, where and to the extent that such waivers are deemed invalid, the affirmer should grant a worldwide, non-exclusive license allowing the performance of all the acts that the waiver would have covered. The waiver should be preceded by a preamble clarifying the intentions and motives of the licensor in order to guide courts called upon to interpret this novel contractual structure in case of litigation. Again, the specific wording of the CC0 would represent a perfect *blueprint*.

**125** With the combination of a standard CCPL and the type of waiver proposed, designers will finally have at their disposal an easy and practical way to share their works with the community under the conditions that so far have proven to be the most popular in Internet and digital based initiatives: attribution of paternity (in a way that community design

rights are not able to offer), permission/prohibition of creation of derivative works and eventual *share alike*, and the possibility to reserve the rights of commercial exploitation, an aspect particularly popular among those interested in experimenting with new business models.

**126** However, this solution has a potential flaw. Or better, its application in jurisdictions featuring a partial cumulation approach could lead to unexpected results. Partial cumulation jurisdictions, as seen, establish different, usually higher, levels of originality for works of applied art and industrial design. Where this level is particularly high, e.g. in Italy where an artistic value is required, works of applied art and industrial design do not usually reach that threshold, and are thus only protected by design rights, not by copyright. This legislative solution makes perfect logical sense. It excludes cumulation in the majority of cases (and de facto circumvents the prohibition of “*scindibilitá*”), offering design rights protection to products, copyright protection to works, and both only in those exceptional cases when a product is also a work of art. However, in the EU only a minority of countries follow this solution, which leads to cross-border issues and consequent legal uncertainty.

**127** The solution we just proposed, i.e. to waive design rights and rely on copyright, cannot obviously work when copyright does not exist. If applied, it would lead to some sort of “contractual public domain” status, as copyright is absent and design rights have been relinquished.

**128** To solve the problem, an alternative approach is possible. It largely resembles the CC+Design solution seen above, but the “+” is in this case is not represented by a waiver, but by an additional grant that extends the scope of the license to include (registered and unregistered) design rights. In this way, design rights will not be waived, but licensed together with copyright and other related rights, and will therefore follow the conditions established by the CCPL. This solution allows licensors also in countries with a partial cumulation approach to allow the use and reuse of their designs under conditions such as attribution of paternity, use of the same or equivalent license for derivatives, and non-commercial uses.

## F. Conclusions and future work

**129** Throughout an analysis of the most relevant legal tools that affect the activities of designers dealing with new personal, digital, often open-source, 3D printing technologies, we tried to demonstrate a rather simple point. Design law, at least in the EU, does not offer a suitable system of protection and exploitation of rights to individual designers and small-

sized enterprises that use 3D printing technologies in novel ways, creating innovation and added value in technological, economic and social terms.

**130** We proposed two possible solutions that similarly combine a contractual tool based on copyright, copyright law itself and design rights. It is undeniable that the proposed solutions exploit copyright law’s ability to control derivative works and try to annul as much as possible design law. In fact, in the CC+Design model, design rights will have to be waived to the greatest extent possible, or, if not possible, included in the scope of the license. Another solution would certainly be to employ licenses that specifically include design rights in their scope of protection. We think we have demonstrated that as long as our model proves effective in practice, such licenses will add very little. At the same time, they would suffer from the problems connected with possible registered IP rights, i.e. a process of registration and the correlated costs. More importantly, CC licenses have the unique capacity of being modular, i.e. to offer a set of license elements (BY, SA, ND, NC) that can be chosen by the licensor, an aspect particularly important to designers and not found in other open licenses.

**131** As seen, designers based in partial cumulation legal systems – especially where the required level of originality is particularly high – should opt for the CC+Design expanding the scope of the license, not on the waiver, unless they pursue a public domain-like result. A possible obstacle could be present in the UK, where the creation of an article from a design plan enjoys a specific copyright defence. In such a case, the application of a CCPL to the relative blueprint will not be very effective, as a potential licensee could have a defence for not applying a specific license element (e.g. SA condition) to the resulting article. However, as seen, this scenario will only operate for quite limited number of subject matter.

**132** Our preference for a waiver of design rights is based in our critical view of the current EU design law framework, which we already summarized in the final remarks to part I. It is however important to restate once more at least one aspect that could be, and to some extent has been already, fixed by courts. Registered community design rights offer protection against any type of infringing products, including independently developed ones. In this regard, it is extremely important that the tests for protection and for infringement operate on a different basis: Only products that cause a *clearly* different overall impression can be considered novel, but it is sufficient for a product to be *just* different from a protected one to avoid infringement. If courts were to interpret the two tests along these lines (set forth by the UK Court of Appeal), by way of interpretation one of the major flaws of EU design law would be partially corrected.

**133** However, generally speaking, this would represent a rather modest improvement. It is quite clear that the EU design legal framework does not favour the creation of property rights around innovation. On the contrary, it stimulates the creation of a high number of bad quality monopoly rights around something that has not been tested for novelty or individual character. The very same idea that this process has low costs is simply wrong. The costs for innovation and competition are significant when the barrier to enter the relative markets is so high: property rights protecting something that may or may not be new since no check has been made. Especially for those with small or non-existent design portfolios, such a market is simply not attractive or accessible in the majority of situations.

**134** In our opinion, modern, 21st-century, 3D printing, Fablab-based, individual or small-sized open designers will find a much better tool of protection in copyright. And this is bad news, as it is a clear demonstration that design law has failed, at least for this category, and that copyright is used for items that are closer to products than to works.

**135** This brings us to a final consideration that will also represent our future work: How far does the concept of derivative work reach? This question – *i.e.* what are the boundaries of copyright protection in the case of modified works and products (2D to 3D and vice-versa) – is arguably the key point and the limit of the analysis we have proposed. In the case of use of the CCPL, this problem is tempered as the omission of the ND will generally grant the possibility to create derivative works. However, a clear indication of where to draw the line between an act of infringement (like a derivative work) and an act of inspiration is crucial. Copyright law, especially in the field of derivative works, is absolutely not harmonized at the EU or at the international level, and a comparative study in this field will complement the analysis developed in this article.

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**1** A considerable improvement from the Design Directive where such needs are explicit only in Recitals 13 and 19. See Directive 98/71/EC of the European Parliament and of the Council of 13 October 1998 on the legal protection of designs, and Council Regulation (EC) n° 6/2002 of 12 December 2001 on Community Designs.

**2** See *Green Paper on the legal protection of industrial design, of the Commission of the European Communities*, III/F/5131/91-EN, “Superior design is an important instrument for European industries in their competition with industries from third countries with lower production costs. It is the design, which in many cases, is decisive for the commercial success of products thus allowing European enterprises, investing heavily in development of designs to prosper”.

**3** A particularly interesting example is represented by FabLabs, a project started by the Media Lab at the Massachusetts Institute of Technology, that has rapidly spread around the world, [https://en.wikipedia.org/wiki/Fab\\_lab](https://en.wikipedia.org/wiki/Fab_lab).

**4** Well-known examples of this culture are Free Libre Open Source Software (FLOSS) and Open Content/Access. From a legal point of view, these examples are based on legal documents such as the GNU General Public License (GPL) or Creative Commons licenses.

**5** For Wikipedia, Open Design is the development of physical products, machines and systems through use of publicly shared design information. Open design involves the making of both free and open-source software (FOSS) as well as open-source hardware. The process is generally facilitated by the Internet and often performed without monetary compensation. The goals and philosophy are identical to that of the open-source movement, but are implemented for the development of physical products rather than software. A real definition of Open Design was developed in 2000 at [www.opendesign.org](http://www.opendesign.org), although the project seems to no longer be under development. Currently the most active initiative in the Open Design field seems to be the Open Design project hosted by the Open Knowledge Foundation, which states, “We aim to use existing definitions for inspiration in this process, including the first Open Design definition drafted in 2000, the Open Design Manifesto, the Open Design page on Wikipedia and the Open Hardware definition”; see <http://design.okfn.org/current-projects/>. See Van Abel, Evers, Klaassen, Troxler, *Open Design Now – Why design cannot remain exclusive*, Amsterdam, 2011.

**6** Among others, see Rifkin J, “The Third Industrial Revolution: How the Internet, Green Electricity, and 3-D Printing are Ushering in a Sustainable Era of Distributed Capitalism”, available at: <http://www.worldfinancialreview.com/?p=1547>; See also “A third industrial revolution”, *The Economist*, 21 April 2012, available at: <http://www.economist.com/node/21552901>.

**7** From a lawyer’s point of view, a better categorization could be represented by the concept of limited liability that has favoured the first industrial revolution as much as technological inventions. Similarly, the second industrial revolution witnesses the development of the basic concepts of labour law, and paves the way for what will become consumer protection law. It is arguable that for the third industrial revolution, design rights, copyright and the ability to combine the relative subject matter are among the legal driving factors. Interesting in this regard is an article that appeared in a 1926 issue of *The Economist*, suggesting that “the nameless inventor of [limited liability] might earn a place of honour with Watt, Stephenson and other pioneers of the industrial revolution”; see *The Economist* 23 December 1999, available at: <http://www.economist.com/node/347323>.

**8** See e.g. Wittbrodt et al., “*Life-cycle economic analysis of distributed manufacturing with open-source 3-D printers*”, in *Mechatronics*, Volume 23, Issue 6, September 2013, pp. 713–726.

**9** See below, sec. 4.

**10** See e.g. <<http://thingiverse.com>>, a project where designers can share their blueprints and where the suggested licenses are CCs.

**11** Studies in this sector are blossoming; see e.g. for a US account on the relationship with patents: Weinberg, *It will be awesome if they don’t screw it up: 3D printing, intellectual property, and the fight over the next great disruptive technology*, Public Knowledge, 2010. For a UK perspective see: Mendis, *The Clone Wars - Episode 1: The Rise of 3D Printing and its Implications for Intellectual Property Law - Learning Lessons from the Past?*, in *European Intellectual Property Review*, 35 (3), 155-169. See also Desai & Magliocca, *Patents, Meet Napster: 3D Printing and the Digitization of Things*, in George-

- town Law Journal, 2013, forthcoming, available at: <<http://ssrn.com/abstract=2338067>>.
- 12 See Weinberg, *What's the deal with copyright and 3D printing?*, Public Knowledge 2013.
  - 13 See Directive 98/71/EC of the European Parliament and of the Council of 13 October 1998 on the legal protection of designs.
  - 14 See Council Regulation (EC) n° 6/2002 of 12 December 2001 on Community Designs. Another good document demonstrating EU attention and useful for understanding the historical underpinnings of such legislation is the Green Paper, cit. fn 2 above.
  - 15 Art. 96(1) CDR establishes that its provisions should be without prejudice to a number of Community or Member States' law, including unregistered designs. For the UK case, see Cornish, Llewelyn & Aplin, *Intellectual Property: Patents, Copyright, Trade Marks and Allied Rights* (7th ed., London, 2010), at 623 and ss; Bently, Sherman, *Intellectual Property Law* (Oxford, 3rd ed., 2009), at 667 and ss.
  - 16 With the exception of the Netherlands, Belgium and Luxembourg (the Benelux), where a centralized system of registration is in force in virtue of the Benelux Convention on Intellectual Property (trademarks and designs), signed in The Hague in 2005, as modified.
  - 17 See the Paris Convention for the Protection of Industrial Property, signed in Paris, France, on 20 March 1883.
  - 18 Art. 2 CDR identifies in the Office for Harmonization in the Internal Market (Trade Marks and Designs, OHIM), instituted by the Council Regulation (EC) No. 40/94 of 20 December 1993 on the Community trade mark, the office which shall carry out the tasks entrusted to it by the Regulation itself.
  - 19 See Art. 1(3) CDR.
  - 20 See Bently, at 686.
  - 21 Recital 9 CDR reads: "The substantive provisions of this Regulation on design law should be aligned with the respective provisions in Directive 98/71/EC".
  - 22 See Art. 3(a) CDR.
  - 23 See Art. 3(b) CDR.
  - 24 See Suthersanen, *Design Law: European Union and United States of America* (2nd ed., London, 2012), at 95.
  - 25 See Musker, "Community design regulation art. 3", in Gielen/Von Bomhard, *Concise trade mark and design law* (Karlsruhe - Amsterdam - London, 2011), at 364; from the same author, *Community design law - Principles and practice* (London, 2002), 10 - 15; for an illustrative, non-exhaustive list of OHIM practices, see also "The manual concerning proceedings before the office for harmonization in the internal market (trade marks and designs) - Examination of applications for registered community designs" [Manual], at 23 - 24, available at: <http://oami.europa.eu/ows/rw/pages/RCD/legalReferences/OHIMDesignManual.en.do>
  - 26 See Locarno Agreement Establishing an International Classification for Industrial Designs, signed at Locarno on 8 October 1968 as amended on 28 September 1979, available at: <http://www.wipo.int/classifications/nivilo/locarno/#>; see also Suthersanen, at 97-100, pointing out, inter alia, that the design of a portable house has been held protectable in *Mobile Home*, Hamburg DC, October 20, 2006.
  - 27 See Musker 2011, at 364; see also Manual, at 23 - 24.
  - 28 Id.
  - 29 See Suthersanen, *Design Law*, at 95.
  - 30 See, for example, Recitals 12 and 14 CDR.
  - 31 See EC Green Paper, at 8.9.
  - 32 See Bently, at 629.
  - 33 But of course, if the process or service leads to the creation of a product, this would be protectable.
  - 34 See Massa & Strowel, "Community Design: Cinderella Revamped", *EIPR*, 2003, 25(2), 68 - 78, at 72.
  - 35 See case C-393/09 [EUCJ] *BeSoft v. Softwarova*.
  - 36 Regarding the protection of GUI and computer icons, see in general Kurr, "Protection of graphical user interfaces under European design legislation", *IIC* 2003, 34(1), 50-62.
  - 37 No reference to any industrial character is present in the CDR, confirming that CDR is meant to protect products belonging to fine arts, applied arts and industrial design, with no differentiation; see Suthersanen, *Design Law*, at 96.
  - 38 See Bently, at 645.
  - 39 See Art. 5(2) CDR.
  - 40 This requirement is clearly closer to the novelty requirement in patent law, rather than to the originality requirement found in copyright law.
  - 41 See *Grupo Promer Mon Graphic SA v. OHIM - PepsiCO Inc.*, T-9/07 (General Court, GC) of 18 March 2010, at 62, as upheld (denying appeal on this point) by the European Union Court of Justice (EUCJ).
  - 42 See Art. 56 of the Convention on the Grant of European Patents (EPC) of 5 October 1973, as revised; see *Procter & Gamble Co v. Reckitt Benckiser (UK) Ltd* [2007] *EWCA Civ 936*, at 16.
  - 43 See *PepsiCo, Inc. - Grupo Promer Mon Graphic SA*, C-281/10 P (EUCJ), of 20 October 2011, at 53 and 54.
  - 44 See Art. 4 (2) and (3).
  - 45 In this sense, see also Musker, cit., at 368.
  - 46 See Art. 10(2) CDR, corresponding to Art. 9(2) DD.
  - 47 Recital 14 CDR: "The assessment as to whether a design has individual character should be based on whether the overall impression produced on an informed user viewing the design clearly differs from that produced on him by the existing design corpus, taking into consideration the nature of the product to which the design is applied or in which it is incorporated, and in particular the industrial sector to which it belongs and the degree of freedom of the designer in developing the design."
  - 48 In this sense, see *Procter & Gamble Co v. Reckitt Benckiser (UK) Ltd* [2007] *EWCA Civ 936*, at 16 - 18.
  - 49 See *Procter and Gamble Co v. Reckitt Benckiser (UK) Ltd* [2007] *EWCA Civ 936*, at 16 - 18.
  - 50 See Art. 7(1) CDR.
  - 51 See Art. 22 CDR; Musker at 394.
  - 52 See Art. 43 CDR.
  - 53 See Bently, at 630 - 631; Musker at 372.
  - 54 See *Lindner Recyclingtech GmbH v. Franssons Verkstäder*, Board of Appeal of 22 October 2009, R 690/2007-3 - *Chaff cutters*, at 28; and Bently at 634.
  - 55 See Art. 36(6) CDR; see also Musker, cit., 376.
  - 56 In this sense, see *Case C-281/10 P, Pepsi Co. v. Grupo Promer & OHIM*, of 20 October 2011.
  - 57 See Suthersanen, at 133.
  - 58 In this sense, see *Procter & Gamble Co v. Reckitt Benckiser (UK) Ltd* [2007] *EWCA Civ 936*, at 19.
  - 59 Id.
  - 60 Sceptical in this regard is Suthersanen at 131; Bently seems to leave a door open to a higher standard for individual character than for infringement, but notes that the Official Commentary on the Regulation suggests that the difference need not be significant; see Bently, at 649. Cornish, however, seems to accept that "clearly different" is the test to be employed; see Cornish, at 610.
  - 61 See Art. 85(2) CDR.
  - 62 See Art. 19(1).

- 63 See Art. 19(2).
- 64 Id.
- 65 See Musker, 389.
- 66 The type of rights conferred by CD is very close to those conferred by Community Patent.
- 67 In this sense, see Bently, at 665. Musker, however, is doubtful: “It is unclear whether use of a design must mean use as a design; in other words, in application to the appearance of a product of some kind or its ornamentation”; see Musker 2011, at 388.
- 68 See Bently, at 667.
- 69 See Bently, 667, at fn 65.
- 70 See The Manual at 3.1.3; see also Musker at 364. See the Locarno Agreement Establishing an International Classification for Industrial Design, signed at Locarno on 8 October 1968, as amended on 28 September 1979. Note that Art. 2(1) of the Locarno Agreement states that the system of classification it establishes has a purely administrative character.
- 71 See Examination Guidelines Community Design, at 5.1; available at: <http://oami.europa.eu/ows/rw/pages/RCD/legalReferences/guidelines.en.do>.
- 72 Art. 36(1) reads: “1. An application for a registered Community design shall contain: (c) a representation of the design suitable for reproduction. However, if the object of the application is a two-dimensional design and the application contains a request for deferment of publication in accordance with Article 50, the representation of the design may be replaced by a specimen.”
- 73 See Musker, 371, 378.
- 74 See Art. 20(1) CDR.
- 75 A similar wording is found in Directive Council Directive 87/54/EEC of 16 December 1986 on the legal protection of topographies of semiconductor products, Art. 5(2).
- 76 TRIPs agreements only require protection against acts of commercial purposes; see Art. 26.
- 77 On the meaning of communication to the public, see Case C-135/10, *Società Consortile Fonografici (SCF) v. Marco Del Corso*, 81 – 90, available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62010CJ0135:EN:HTML>.
- 78 See Directive Council Directive 87/54/EEC of 16 December 1986 on the legal protection of topographies of semiconductor products, Art. 5(3).
- 79 See Bently, at 672. Musker seems to arrive at a different conclusion, though he recognizes that the issue is not clear; see Musker 2009, at 391.
- 80 See Bently, at 672.
- 81 See Bently, at 672 – 673.
- 82 See Bently, 673.
- 83 Id.
- 84 Id.
- 85 See Musker, 390.
- 86 See Musker 2011, at 383.
- 87 See Musker 2011, at 382.
- 88 Id.
- 89 See Heller, “*The Tragedy of the Anticommons*”, in 111 *Harvard Law Review* 621 (1998), and *The Gridlock Economy: How Too Much Ownership Wrecks Markets, Stops Innovation, and Costs Lives*, New York, 2008.
- 90 See Recital 32 and Art. 96(2) CDR. For an explanation of the reasons, see Explanatory Memorandum to the Regulation, COM(93) 342 final-COD 463 Brussels, 3 December 1993, and in particular: “The smooth functioning of the internal market for products embodying design is going to be fully achieved only if the Community Design system is supplemented by harmonized national rules of copyright law relating to the protection of design. This is, however, a formidable task which needs intense preparation, further comparative studies and contacts with national authorities and interested or academic circles. If the introduction of the Community Design should be subordinated to the achievement of such a harmonization, the urgent need of giving to design industry an efficient tool for the internal market could not be satisfied within a reasonably short period. It is, however, important that the Member States be aware of the Commission’s intention to proceed in the direction indicated: acceptance of the principle of ‘cumulation’ of protection, as defined in this paragraph would constitute their first contribution in this direction. It should also be stressed that it would be difficult to require Member States which traditionally attach the utmost importance to protection of design by copyright, like France or the Benelux States, to accept the “market oriented approach” of this Regulation, if they were not sufficiently satisfied that harmonized rules of copyright law will be laid down at Community level in order to protect the creativity aspect of the activity of design. Accepting the principle of ‘cumulation’ should not, however, prevent the Member States who already apply such a principle under restrictive conditions (Germany, Spain, Portugal, Denmark, Ireland) from continuing to do so. For the time being, the extent and the conditions of protection, including the level of originality required, would continue to be autonomously determined by each Member State. The introduction in the Regulation of the principle of ‘cumulation’ would, on the contrary, have an immediate impact for Italy, where the principle of ‘cumulation’ is excluded by the existing legislation”.
- 91 An example of perfect cumulation is traditionally represented by France, where on the basis of the principle of unity of art, every work of the mind is protected regardless of the form of expression, merit or purpose. As Goldstein & Hugenholtz observe, however, if the design is strictly functional, copyright protection might be denied; see Goldstein & Hugenholtz, *International Copyright – Principles, Law, and Practice* (3rd ed., 2013), at 214 – 216.
- 92 This is the approach Italy chose after the DD, which obliged an abandonment of the previous approach based on the principle of “scindibilità”. The current Italian Copyright Act requires artistic value in order to offer protection to products of industrial design and applied art. The precise meaning of artistic value is not clear, however; see Franzosi, *Design italiano e diritto italiano del design: una lezione per l’Europa?*, in *Rivista di Diritto Industriale – 2009 – Parte I – 71 – 82*; *Montantari, L’Industrial Design tra modelli, marchi di forma e diritto d’autore*, in *Rivista di Diritto Industriale*, 2010, Parte I, 7 – 25. Another example of partial cumulation, with an originality requirement that is higher than the standard for other copyright works but does not achieve the extreme of artistic value, is Germany; see Goldstein & Hugenholtz, 215.
- 93 Art. 9 reads “This Directive shall be without prejudice to provisions concerning in particular patent rights, trade marks, design rights, utility models, topographies of semiconductor products, type faces, conditional access, access to cable of broadcasting services, protection of national treasures, legal deposit requirements, laws on restrictive practices and unfair competition, trade secrets, security, confidentiality, data protection and privacy, access to public documents, the law of contract”. See also Recital 60.
- 94 See Art. 2(7) Berne Convention and Art. 25 TRIPs Agreements.
- 95 Such as the Software or Database Directives for an example of limited subject matter, or the Rental Directive for an example where the directive concentrated on specific rights.
- 96 Such as the InfoSoc Directive.
- 97 See Directive 2001/29/EC of the European Parliament and of the Council of 22 May 2001 on the harmonisation of certain

aspects of copyright and related rights in the information society.

- 98 See Art. 1 InfoSoc.
- 99 See Art. 2 InfoSoc.
- 100 See Art. 3 InfoSoc.
- 101 See Art. 4 InfoSoc.
- 102 Art. 5(1) reads: “Temporary acts of reproduction referred to in Article 2, which are transient or incidental [and] an integral and essential part of a technological process and whose sole purpose is to enable: (a) a transmission in a network between third parties by an intermediary, or (b) a lawful use of a work or other subject-matter to be made, and which have no independent economic significance, shall be exempted from the reproduction right provided for in Article 2”.
- 103 See Hugenholtz, “*Why the Copyright Directive is unimportant, and possibly invalid*”, EIPR, 2000-11, 499 – 505; Guibault, “*Why Cherry Picking Never Leads to Harmonisation: The Case of the Limitations on Copyright under Directive 2001/29/EC*”, JIPITEC, 2010-2, 55-66.
- 104 The Court of Justice of the European Union has expanded the originality requirement of “intellectual creation of its author” beyond the field of software and databases, where it was confined by the relevant directives. It can be said that nowadays the originality requirement in EU copyright law is the author’s own intellectual creation; see, inter alia, Case C-5/08, *Infopaq International A/S v. Danske Dagblades Forening*, of 16 July 2009.
- 105 See the Berne Convention for the protection of literary and artistic works of 9 September 1886, as amended.
- 106 See the World Intellectual Property Organization (WIPO) Copyright Treaty adopted in Geneva on 20 December 1996.
- 107 See Agreements on Trade-Related aspects of Intellectual Property rights (TRIPs), WTO Agreement, Annex 1C, adopted in Marrakesh, 15 April 1994.
- 108 Art. 2 WCT identifies itself as a Special Agreement within the meaning of Art. 20 BC, and specifically indicates that contracting parties are bound by Arts. 1 – 21 BC. A similar provision is found in Art. 9 TRIPs.
- 109 See Art. 2(1) BC.
- 110 See Art. 2(3) BC.
- 111 See Explanatory Memorandum; see also Case C-28/04 *Tod’s SpA and Tod’s France SARL v. Heyraud SA* establishing that “Article 12 EC, which lays down the general principle of non-discrimination on grounds of nationality, must be interpreted as meaning that the right of an author to claim in a Member State the copyright protection afforded by the law of that State may not be subject to a distinguishing criterion based on the country of origin of the work”.
- 112 See Art. 10 Copyright Act (Auteurswet) 1912.
- 113 See the Benelux Convention on Intellectual Property (Trademarks and Designs) of 25 February 2005. The convention creates a uniform body of laws for the Benelux territory in the field of Trade-marks and Designs.
- 114 See fn 86 above.
- 115 See Art. 21 of the Benelux Uniform Law on designs and models Act of 1975.
- 116 See Benelux Court of Justice, case A 85/3, *Screenoprints Limited v. Citroen Nedelrland*.
- 117 See Law 22 of April 1941, n. 633 “Protezione del diritto d’autore e altri diritti connessi al suo esercizio”, as amended.
- 118 See Art. 2(10) Italian Copyright Act. Sec. 10 was introduced by Legislative Decree 2 February 2001, n. 95, implementing the Design Directive. The decree also repealed part of sec. 4, which still protects works of sculpture, painting, drawing, engraving, figurative arts, and similar, including scenography, “even if applied to industry, as long as their artistic value is distinguishable from the industrial character of the product to which they are associated”.
- 119 See Tribunale di Milano (Court of first instance of Milan) ordinanza 29 Dicembre 2006, n. R.G.74660-1/06.
- 120 See Legge 24.02.2012 n° 14, Conversione in legge, con modificazioni, del DL 29 dicembre 2011, n. 216.
- 121 See Art. 123 Decreto legislativo 13.08.2010 n° 131, Modifiche al decreto legislativo 10 febbraio 2005, n. 30, recante il codice della proprietà industriale, ai sensi dell’articolo 19 della legge 23 luglio 2009, n. 99.
- 122 This was the original excused period contained in the first version of Decreto legislativo 10.02.2005 n° 30, Codice della proprietà industriale.
- 123 The Design Directive should be interpreted as “precluding legislation of a Member State which – either for a substantial period of 10 years or completely – excludes from copyright protection designs which, although they meet all the requirements to be eligible for copyright protection, entered the public domain before the date of entry into force of that legislation, that being the case with regard to any third party who has manufactured or marketed products based on such designs in that State – irrespective of the date on which those acts were performed”; see Case C-168/09 *Flos SpA v. Semeraro Casa e Famiglia SpA*, at 65.
- 124 See for example *Flos S.p.a. contro Semeraro Casa e Famiglia S.p.a.*, n. 9906/12 of 12 settembre 2012; and *Vitra Patente AG contro High Tech s.r.l.*, n. 09173/2012, of 3 May 2012.
- 125 See Copyright, Designs and Patents Act 1988 [CDPA].
- 126 See Id. Chapter 48. It must be recalled that the list of subject matter in the UK copyright Act is exhaustive and mandatory and that a work has to conform to listed subject matter to be eligible for protection.
- 127 See sec. 51 CDPA; see Bently, 679.
- 128 A “design document” is defined as any record of a design, whether in the form of a drawing, a written description, a photograph, data stored in a computer or otherwise; see CDPA, sec. 51(3).
- 129 Bently at 681.
- 130 Section 236 CDPA reads: “Where copyright subsists in a work which consists of or includes a design in which design right subsists, it is not an infringement of design right in the design to do anything which is an infringement of the copyright in that work”. See *Mark Wilkinson Furniture v. Woodcraft Design* [1998] FSR 63, 65; see also Bently at 682 and footnotes 19 and 20.
- 131 In this sense, Bently, 683.
- 132 See section 52 UK Copyright Act and sec. 2 and 3 of the Copyright (Industrial Process and Excluded Articles) (No. 2) Order 1989; Bently 684.
- 133 See sec. 3 of the Copyright (Industrial Process and Excluded Articles) (No. 2) Order 1989.
- 134 For a detailed and critical account, see Bently L, “The Return of Industrial Copyright?”, in *European Intellectual Property Review*, Vol. 10, September 2012.
- 135 See for example the facts of the *Donner* case, Case C-5/11, 21 June 2012.
- 136 See <http://creativecommons.org/choose/>.
- 137 A good starting point is [www.creativecommons.org](http://www.creativecommons.org). The top-level domain name can be changed to the desired country code in order to find specific localized information.
- 138 See Jasserand C., “Creative Commons licences and design: Are the two compatible?”, JIPITEC, 2011-2, pp. 131-142.
- 139 We will make reference to the last CCPLv4 drafts available online for public consultation. The draft version used for this pa-

- per is 4, available for public consultation at <[http://wiki.creativecommons.org/4.0/Drafts#Draft\\_4\\_Details](http://wiki.creativecommons.org/4.0/Drafts#Draft_4_Details)>.
- 140 The requirement that the compensation be private has been removed from version 4.
- 141 In this article we use CCPL BY-SA version 3 unported as a reference model unless otherwise noted.
- 142 Sec. 3 last paragraph, last sentence CCPL3.0 BY-SA reads: “Subject to Section 8(f), all rights not expressly granted by Licensor are hereby reserved”.
- 143 Currently, the definition of “Share” reads: “Share means to distribute material to the public by any means or process such as public display, performance, dissemination or communication, and to make material available to the public including in such a way that members of the public may access the material from a place and at a time individually chosen by them”.
- 144 See Rome international convention for the protection of performers, producer of phonograms, and broadcasting organizations, done at Rome on 26 October 1961, which is commonly regarded as the international source for neighbouring rights.
- 145 “CC licenses do not directly affect rights other than copyright, such as the trademark or patent rights or the publicity and privacy rights of third parties; however, our licenses do not expressly reserve those rights and as between licensor and the public implied licenses may exist. These and other rights may require clearance (i.e. permission) in order to use the work as you would like”; available at <<http://wiki.creativecommons.org/FAQ>>.
- 146 Again, we will not consider here aspects such as bona fide obligations, estoppel, or other legal defences, actions or theories preventing to dispose of a right *contra factum proprium*. Such aspects are not covered by the type of analysis conducted here (copyright, design rights, CC), and will certainly represent a suitable resort in some situations. The objective of this study, however, is to find a possible synthesis on the substantive legal level, which will offer a solution in the generality of situations.
- 147 See sec. 4 Limitations and Disclaimers: No trademark or patent rights held by Affirmer are waived, abandoned, surrendered, licensed or otherwise affected by this document.
- 148 Also in this case we are not looking into the area of bona fide, estoppel, and acts *contra factum proprium*.
- 149 We intentionally avoid offering a precise definition of Open Design. There are a number of Open Design definitions that partially catch the complexities of the phenomenon, and a debate is ongoing regarding a more generalized and bottom-up definition able to represent all the different aspects involved. That is probably the best place for a definition to emerge.
- 150 For examples, see in this regard the operations of the FabLabs, see *supra* fn 3, or websites such as <<http://thingiverse.com>>.
- 151 From a legal perspective, “copyleft” means the condition that allows the creation and further distribution of derivatives under the obligation to use the same – or sometimes an equivalent – license. Given this definition, clauses such as the Share Alike (SA) of CC are a copyleft clause.
- 152 See Art. 99 Italian Copyright Act. It must be noted that it consists of a right to compensation limited to a maximum amount; see M. Fabiani, *La protezione dei lavori di ingegneria, in Il diritto d'autore*, 2007/4, 560 – 566.
- 153 If it is still possible to speak of a standard different than that of intellectual creation of the author, as repeatedly established by the EUCJ; see Infopaq cited.
- 154 See, however, Art. 99 of Italian Copyright Act cited.
- 155 See sec. 2 CCPL version 3 unported. It is debatable whether those provisions not connected to copyright or a related right could survive, such as warranties and limitations liabilities, for example.
- 156 As established by section 4.b CCPL 3.0 BY-SA
- 157 The file format created by the software used for computer-aided design; see [http://en.wikipedia.org/wiki/Computer-aided\\_design](http://en.wikipedia.org/wiki/Computer-aided_design) .
- 158 Usually CAD files are automatically converted into STL files; see <[http://en.wikipedia.org/wiki/STL\\_\(file\\_format\)](http://en.wikipedia.org/wiki/STL_(file_format))>.
- 159 To the extent and in the jurisdictions where these two rights are conceptually separate.
- 160 We have already pointed out the problems connected with the fact that the thresholds of copyright protection for applied art and industrial design can vary significantly from jurisdiction to jurisdiction in section 3.
- 161 See sec. 3 last sentence CCPL-BY-SA version 3, and the almost equivalent wording on version 4d3: “The above rights may be exercised in all media and formats whether now known or hereafter devised. The above rights include the right to make such modifications as are technically necessary to exercise the rights in other media and formats” (emphasis added). Therefore, as long as the passage from the digital to the physical format does not amount to a derivative work, but is only a technical modification, the ND provision is also in line with the 3D printing of a work.
- 162 Therefore, no part of the license can be interpreted as limiting any exception or limitation to copyright under national law. Exceptions such as that of private copy can play an important role in cases of printing of objects for private uses.
- 163 In such a case it could be argued if we are in presence of a blueprint, or of a different copyright subject matter.
- 164 Such an act will simultaneously trigger a 12-month grace period, and a 36-month UCD protection for the benefit of the designer.
- 165 See above, sec. 2.
- 166 See above, sec. 2.
- 167 See Art. 25(1)(f) CDR.
- 168 We have seen that copyright and design rights first ownership might follow different rules.
- 169 “It is NOT a new or different license or any license at all, but a facilitation of more permissions beyond ANY standard CC licenses. Worth emphasizing is that CC+ (and use of that mark) requires that the work be licensed under a standard CC license that provides a baseline set of permissions that have not been modified or customized. The plus (+) signifies that all of those same permissions are granted, plus more!”; see <http://wiki.creativecommons.org/CCPlus>.

# Book Review: Jacques de Werra (ed.), *Research Handbook on Intellectual Property Licensing*

Edward Elgar 2013, 499 pages, ISBN 978-1-84980-440-0

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- 1 Licensing agreements are the motor behind the exploitation of any piece of intellectual property: without them only few creations and inventions would ever reach the market. Indeed initial makers are not always in a position to produce and distribute the fruit of their own intellectual labour; licenses are the solution to allow third parties to do so. Apart from exploitation licences, contractual arrangements play nowadays an increasing role in setting the conditions under which IP protected items can be used, primarily by the general public accessing material in the digital environment. Licenses are essentially a tool in the hands of rights owners to help them exercise their rights. This tool can be used to achieve multiple (at times, conflicting) goals, from encouraging further innovation by subsequent creators to strategically fending off competitors and everything in-between that is not contrary to public order.
- 2 In the laws of most jurisdictions in the world, IP licenses are an unnamed form of contract, most often of a hybride nature, for which no specific legal framework exists, save for rare exceptions. As a result, the formation, content and interpretation of IP licences call for the application of relevant norms from numerous other fields of the law, such as contract law, property law, commercial law, consumer law etc. Despite efforts of harmonisation at the international and regional levels, these related areas of the law remain to a large extent nationally determined, influenced by the legal tradition of each country, where significant differences appear between common law and civil law systems. A Research Handbook that highlights the main policy concerns and doctrinal debates on the subject of intellectual property licensing is therefore particularly timely.
- 3 The book, edited by *Jacques de Werra*, professor at the University of Genève, contains nineteen chapters written by world-renowned scholars in the area from Europe (Germany, Belgium, Spain, Switzerland, UK) and abroad (US, China, India and Japan). The book is divided into three parts addressing specific IP licensing policies (I), common IP licensing policies (II) and a selection of local IP licensing policies (III). Among the specific IP licenses analysed in the distinct chapters of Part I are copyrights, software (proprietary and open source), factual information and databases, patents, trade secrets and know-how, technology transfers and trademarks. Part II of the book deals with various aspects of intellectual property licensing law which do not depend on the type of intellectual assets at issue, including licensing issues related to public health, a model IP commercial law, IP and bankruptcy, IP licensing and conflict of laws, and arbitration. As explained in the Preface,

‘given the diversity of local solutions, the third part of the book (...) adopts a geographic approach and presents selected national and regional intellectual property licensing policies, by focusing on countries and regions which appear of key importance on the global intellectual property scene’. The four local IP licensing policies examined in Part III of the book focus on China, India, Japan and Europe.

- 4 The Preface further specifies that the Handbook ‘ultimately aims at offering a scientific contribution to the identification of what could constitute global features of intellectual property licensing agreements. From a broader perspective, it is designed to contribute to the discussion about the adoption of a global regulatory framework on intellectual property contract law (or intellectual property commercial law), which shall regulate the relationship between intellectual property rights and contracts’. Although the individual contributions are thought provoking and certainly deserve a reading on their own merit, the book as a whole could have better attained the ambitious objectives set out in the Preface. Below are five points that caught my attention.
- 5 One, where the aim of the book is to offer insight towards the adoption of a global regulatory framework on intellectual property contract law, the contributions in the book could have followed a more conceptual and normative approach around a well-articulated question. An initial section in the book could have set out and discussed the problem squarely: What are IP licences? What distinguishes an IP licence from another type of contract? What are the characteristic elements of an IP licence? Are there different types of IP licences – is an exploitation licence something conceptually different than a licence to use? Does the nature of a licence vary depending on the IP right concerned? Or on the laws of the jurisdiction where the rights are claimed or exercised? Devising a global regulatory framework on IP contract law demands a uniform understanding of all the key concepts involved. These questions are presumably at the root of the contributions in the book, but because they are mostly not made explicit, common elements in the analysis of IP licences relating to different IP rights can hardly be distilled. In fact, only few contributors to the book have expressly considered the nature of an IP licence, most notably *John Hull* on licensing of trade secrets and know-how, *Neil Wilkof*, on trademark licensing and *Mark Reutter* on IP licensing agreements and bankruptcy.
- 6 The two first chapters of the book offer a good example of a lack of clear common conceptual framework. Both chapters deal with the seemingly similar topic of copyright licensing. Chapter 1, written by *Jane Ginsburg*, examines authors’ transfer and license contracts from a US law perspective, while chapter 2, written by *Alain Strowel* and *Bernard Vanbrabant*, considers the broader issue of copyright licensing from a European perspective. Ginsburg clearly delineates the subject of her chapter by focusing on the rules relating to the scope of authors’ contractual grants, looking at the features of the 1976 U.S. Copyright Act and the state law contract rules. This analysis leads to the consideration of the policy issues concerning the ‘pros and cons for authors of entering into agreements that surrender control over and compensation for an infinite number of downstream acts in connection with their works, or that transfer rights as part of an agreement to host material on third party websites’.
- 7 Strowel and Vanbrabant, by contrast, choose to give a review of selected copyright licensing issues, through illustrations taken from various national regimes, without clarifying which types of licences are under examination. The chapter concludes by giving ‘prospective reflections on the need for drafting model provisions on copyright licensing’, ‘for having international or at least EU framework rules to facilitate cross-border licenses’, and for developing future rules to meet the challenges of the Internet. Chapter 2 does analyse questions like the material and formal requirements for the conclusion of copyright contracts, the scope of the licence and rules on interpretation. But the chapter goes on to discuss issues regarding the initial ownership of rights, extended collective agreements, the cross-border licensing and the online exploitation of works. All these issues are currently hot topics at the European level, but they do not directly concern the rules relating to the scope of authors’ contractual grants, as examined in Ginsburg’s chapter. Since the points of emphasis in both chapters differ, the conclusions drawn inevitably diverge, making it difficult to identify global features of copyright licensing agreements.

- 8 Two, given the mosaic of potentially applicable rules pertaining to different aspects of intellectual property licensing and given the strong positivistic approach followed in most chapters, the legal framework within which each topic is analysed should have been clearly and systematically presented to the reader. Most contributors have naturally tended to refer to the laws they know best – those of their own country, but without making this fact explicit. For instance, in his otherwise very interesting chapter on ‘Issues in modern licensing of factual information and databases’, *Raymond T. Nimmer* explains that the general licensing framework discussed in that chapter includes two main issues: ‘a) what technological and contractual limits or permissions to use or transfer the database or factual information exist, irrespective or in addition to intellectual property right limitations?; and b) what contractual commitments to or limitations on quality or accuracy are made and what extra-contractual qualitative obligations exist in law or are disclaimed by contracts?’ It is for the reader to understand that Nimmer’s framework of reference is U.S. law, more specifically, copyright law, the doctrine of misappropriation, contract and liability law. The same remark applies to the no less interesting chapter by *John Hull*, on the licensing of trade secrets and know-how. This time, the framework of reference is that of English law. But how does U.S. law on the licensing of factual information and databases or English law on the licensing of trade secrets and know-how fit in within the international legal framework? How would similar issues be analysed under the laws of other countries? Upon which aspect(s) of the legal framework examined here can be drawn to develop a global regulatory framework on intellectual property contract law?
- 9 Without diminishing in any way the quality of *Robert Gomulkiewicz’s* chapter on the enforcement of open source licences, the introduction of some elements of comparative law could have added support to his argumentation. Gomulkiewicz discusses the issue of what qualifies as a condition placed on a licence grant, potentially giving rise to injunctive relief. He bases his analysis on the Federal Circuit’s decision in the *Jacobsen v. Katzer* case<sup>1</sup>. He then analyses the consequences brought about by a trilogy of cases rendered by the 9<sup>th</sup> Circuit on the definition of a licence. In the *MDY Industries* case<sup>2</sup>, the Court related the definition of a licence to the payment of royalties, which, in the case open source licensing, is unfortunate. The 9<sup>th</sup> Circuit decision also had an impact on the application of the first sale doctrine to software transactions. Looking across the Atlantic, the case law of the European Court of Justice could have shed additional insight on the definition of a licence: in the *Usedsoft* case<sup>3</sup>, the European Court indeed ruled that ‘Since an acquirer who downloads a copy of the program concerned by means of a material medium such as a CD-ROM or DVD and concludes a licence agreement for that copy receives the right to use the copy for an unlimited period in return for payment of a fee, it must be considered that those two operations likewise involve, in the case of the making available of a copy of the computer program concerned by means of a material medium such as a CD-ROM or DVD, the transfer of the right of ownership of that copy’. As a consequence of this definition, the Court applied the exhaustion doctrine to software downloaded from a website. Because of the link made to the payment of a fee in the definition of a licence, the question arises in Europe as well, as to whether royalty-free open source licences are subject to the application of the exhaustion/first sale doctrines.
- 10 Three, and connected to the previous point, the general lack of international harmonisation of the body of rules pertaining to intellectual property agreements has led some jurisdictions to adopt specific rules on IP licensing, rules which were given special treatment in the book. Two chapters in Part I of the book describe such distinctive sets of rules: chapter 3 on the ‘ALI principles of the law of software contracts’, written by *Robert A. Hillman* and *Maureen A. O’Rourke*; and chapter 8 on ‘Technology licensing between academic institutions and private companies’ written by *Heinz Goddar*. The ALI Principles constitute a typically U.S. approach to software licensing based on the fact that the American software industry is undeniably the most innovative in the world, for which special rules on licensing needed to be developed. Hillman and O’Rourke did place the Principles in an international perspective, referring where relevant to the UNIDROIT principles. In their conclusion, the authors ‘hope that the ALI Principles prove useful in producing a dialogue about adopting international rules for transactions in software’. On the other hand, Goddar examines article 42 of the German Law concerning Employee’s Inventions, which is a unique feature

of German patent law. The Law generally regulates the rights and obligations of both employees and employers with respect to the proprietary exploitation rights associated with the invention and the intellectual property rights arising from them. Article 42 of the Law governs the specific issue of technology licensing. Unfortunately, Goddar did not situate the German provision within a broader legal context nor did he explain how the German legislature came up with this particularly suitable solution. How can the German rules then serve as a model for a global regulatory framework on intellectual property contract law, if the general context behind their initial adoption is not explicated?

- 11 Four, the depth of the overall analysis in the book would have strongly benefitted from greater cross-references between chapters. The most obvious example is the co-existence of chapters 14 and 15 in the book which both deal with IP licensing and arbitration. Both chapters stand in parallel to each other without any explanation as to their respective aim and place in the scholarly discussion on the subject. Coordinating these two chapters would certainly have enriched the argumentation of both.
- 12 And five, the chapters included in Parts II and III of the book reflect a number of editorial choices that could have been better substantiated in the Preface, or elsewhere in the book. Part II of the book aims at analysing issues that are independent from the type of IP right concerned. This is certainly true for *Lorin Brennan and Jeff Dodd's* chapter proposing a 'model intellectual property commercial law', for *Mark Reutter's* chapter on IP licensing and bankruptcy, for *Pedro de Miguel Asensio's* chapter on conflict of laws, and for the two chapters of *Dessemontet* and *de Werra* on arbitration. It is less clear however, for the first chapter in the section dealing with non-exclusive licensing initiatives in the pharmaceutical sector. All chapters are captivating – yes, even the one on bankruptcy! – but the first one stands a little at odds with the rest. Would it not have fit better in the first part? If not, then some extra words on the structure of the section might have been useful.
- 13 Similarly, the chapters in Part III of the book are meant to highlight the diversity of local solutions, adopting a geographic approach and presenting the intellectual property licensing policies of India, China, Japan and Europe. The justification given in the Preface for the choice of countries is rather succinct. Here as well, one chapter stands out in my opinion: considering that European law is the object of extensive study in numerous previous chapters, did European IP licensing policy warrant this additional attention in the book? Would it not have been interesting to read instead (or in addition) about at least one country in Central or South America. Knowing how active Brazil is nationally and internationally in matters of intellectual property and how much the open content ideology has progressed in this country, might it not have been an interesting addition to the selection of countries?
- 14 All in all, the Research Handbook on Intellectual Property Licensing is an absolute must read for anyone who deals with IP licensing policy and practice. It provides invaluable insight on a vast array of issues relating to IP licensing and it ventures into paths of analysis that are less often explored. The comment formulated above should be read as an attempt to raise awareness for transparency in the use of scientific methods and approaches, with the belief that if the reader understands at the outset what assumptions are made and what the framework of analysis is, he will be more easily convinced by the conclusion.

- 1 *Jacobsen v. Katzer*, 535 F. 3d 1373, 1380 (Fed. Cir. 2008)
- 2 *MDY Industries v. Blizzard Entertainment*, 629 F.3d 928 (9<sup>th</sup> Cir. 2010); see also *Vernor v. Autodesk*, 621 F.3d 1102 (9<sup>th</sup> Cir. 2010); and *UMG Recordings v. Augusto*, 628 F.3d 1175 (9<sup>th</sup> Cir. 2010).
- 3 Case C-128/11, Decision of the European Court of Justice, 3 July 2012, (*Oracle v. UsedSoft*).

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