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## **Copyright Owners Should Be Protected From Digital First Sale Schemes**

**by**

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### **I. Introduction and Summary**

Under copyright law, the owners of music, movies, TV shows, and books get to control the copying, selling, and licensing of their creative works. But a spate of bills filed in state legislatures over the last two years would impair the rights of publishers and authors by forcing them to license their works to public libraries on terms dictated by state law. Aside from their conflict with federal law, which should serve to invalidate them, those state ebook licensing bills are rooted in a misguided idea known as "digital first sale."

Advocates for a novel "digital first sale" right claim that individual purchasers of copyrighted works should be able to disseminate digital files of those works through secondary market transactions – without authorization of the copyright owner. But copyright law contains no "digital first sale" defense to infringement when individual purchasers make new digital copies and transmit them for "resale." Such unauthorized copying violates the copyright owners' reproduction rights. As this *Perspectives from FSF Scholars* explains, incorporating a

"digital first sale" defense into copyright law would significantly curtail exclusive rights of copyright owners, unfairly reduce their opportunities to generate returns on their labors and investment, and disincentivize the creation of high-quality creative works. Congress, states, and courts should protect copyrights owners from the harms of unauthorized mass-scale copying and selling of digital files of creative works under "digital first sale" schemes.

In the past two years, bills have been introduced in states such as Connecticut, Illinois, Massachusetts, Missouri, New York, Rhode Island, and Tennessee that seek to grant public libraries a compulsory license to lease ebooks on "reasonable terms" set by state laws, and not by the copyright owners. The Maryland legislature passed such a bill, only to have it struck down in February 2022 by the U.S. District Court in *Association of American Publisher v. Frosh* (*AAP v. Frosh*). The court found that Maryland's forced licensing bill was preempted, and therefore invalidated, because it interfered with copyright owners' exclusive right to determine "whether, when, and to whom they must distribute their copyrighted works."

Free State Foundation President Randolph May and I analyzed the District Court's decision in a March 2022 *Perspectives from FSF Scholars*, titled "State Laws Forcing Publishers to License Ebooks to Libraries Are Unlawful." Our *Perspectives* concluded that the court's decision ought to dissuade other states from forced licensing and rate controlling ebooks.

Aside from the legal defects of state-level ebook licensing restrictions under preemption doctrine and case law, a deeper problem with those ebook licensing bills is that they are grounded in the misguided idea known as "digital first sale." In *AAP v. Frosh*, the state of Maryland defended its ill-fated ebook licensing bill as a response to the lack of a "digital first sale" in copyright law. The state argued that "the proliferation of digital media has outpaced the first sale doctrine," and that publishers supposedly had capitalized unfairly on that outpacing through its decisions regarding e-book and digital audiobook pricing and offerings to public libraries. Conversely, plaintiff publishers argued that Maryland's bill constituted "an unprecedented first sale scheme by which publishers (and authors) are deemed to have exhausted their statutory rights to control digital disseminations to library customers simply because they have made an initial consumer offering." Indeed, outside of the state of Maryland, some opponents of protecting copyrights have urged Congress to limit copyrights in digital files, and thereby impose a "digital first sale" defense to infringements by individuals who buy copyrighted works at retail and then reproduce and sell digital file copies of those works.

Copyright law does contain an exception to the exclusive right of distribution known as the first sale doctrine. Under that doctrine, a copyright owner's control over the distribution of a *physical* copy that was lawfully made terminates when that copy is distributed to its initial retail purchaser. This means that the buyer of a music CD, a Blu-Ray disc containing a movie, or a print book may sell his or her copy to a third party without infringing the copyright.

But there is no "digital first sale" recognized in federal copyright law. And there are strong reasons why Congress and states, as well as courts, should continue to reject "digital first sale" or any similar types of restrictions on the reproduction and distribution rights of copyright owners.

In the Digital Millennium Copyright Act of 1998 (DMCA), Congress declined to adopt any "digital first sale" for digital reproductions of works that are not "fixed" in material objects. And in a 2001 report, the U.S. Copyright Office recognized that an individual's resale of digital files constitutes infringement because the unauthorized digital transmission of the work causes the recipient to obtain an entirely new copy. A new copy of a digital file is created each time it is uploaded to a reseller's server and another new copy is created on the computer of the secondary market purchaser. Generating new copies undermines the copyright owner's reproduction right and it is therefore outside the scope of Section 109(a).

The rejection of "digital first sale" in copyright law was confirmed by the U.S. Court of Appeals for the Second Circuit in its 2018 decision in *Capitol Records, LLC v. ReDigi Inc.* ReDigi offered a service that transferred digital music files from a purchaser's computer, through ReDigi's server, to a new purchaser. The court found that the fixing of digital files in ReDigi's server and in new purchasers' devices created unauthorized reproductions. Also, the court found that supposed deletion of an original purchaser's digital file did not nullify the infringement because the service created new intangible reproductions of copyrighted works. The lower court in that case found that ReDigi's service also infringed on distribution rights because Section 109(a) applies only to physical copies that a copyright owner markets, and not to the distribution of copyrighted code to ReDigi's servers and its users' hard drives.

Imposition of "digital first sale" would not be a mere extension of the first sale doctrine; it would instead involve a radical change to copyright law. "Digital first sale" would significantly reduce copyright owners' opportunities to seek returns, upend the settled expectations of creative content markets, and undermine incentives for new creative works.

Whereas the first sale doctrine is rooted in the right to transfer *tangible* personal property, that right is not furthered by "digital first sale." The purchaser of a digital copy of a copyrighted work who makes new digital copies is not exercising dominion over tangible property. Conversely, the right to transfer tangible personal property is not limited by a copyright owner maintaining control over digital reproductions and transmissions of a creative work.

Moreover, the impact of "digital first sale" on copyright owners would be potentially far more significant and harmful to their economic opportunities than application of the first sale doctrine to physical goods. Time and space limit the impact of secondary markets for tangible goods on copyright owners. Physical goods wear out with age or repeated use. Transport costs, geography, and scarcity of retail space also constrain the availability of used physical goods.

Yet copyrighted works in digital format are not subject to the same wear and tear as physical copies of copyrighted works. Digitization and high-speed Internet connectivity enable near-instantaneous, world-wide, mass-volume distribution of digital copies. As a result of these factors, incorporation of "digital first sale" into copyright law would significantly curtail exclusive rights of reproduction and distribution and unfairly reduce copyright owners' opportunities to generate returns on their labors and investment. It would enable initial purchasers and entities that offer reproductions of digital files to reap where copyright owners

have sown, discouraging incentives for the creation of high-quality creative works. Additionally, "digital first sale" poses increased risks of online piracy. It would be difficult to verify that the copies belonging to the original purchasers have been deleted and that "resale" digital files are legitimate.

Furthermore, "digital first sale" could inflict significant harm on markets for license-based or access-based services for consuming copyrighted works. Subscription-based services for access to streaming movies and TV services – such as Netflix and Hulu Plus – have millions of users, and streaming music – such as Spotify and Pandora – also have millions of users. Consumers also have choices among subscription services such as Audible and Audiobook.com, and OverDrive is a commercial service that makes ebooks and audiobooks available to public libraries for lending to their patrons. However, increased availability of digital "resale" copies of creative works likely would reduce demand for popular subscription-based services and thereby reduce their ability to generate new high-quality content.

Significantly, there is no failure in digital content services markets to justify imposition of "digital first sale." Absent evidence of market failure and consumer harm, such a drastic intervention by government is unjustifiable. Any anticompetitive conduct in digital markets for creative content could be better addressed through antitrust on a case-by-case basis.

## **II. State Legislation to Restrict Ebook Licensing and Connections to "Digital First Sale"**

In the past two years, bills have been introduced in states such as Connecticut, Illinois, Massachusetts, Missouri, New York, Rhode Island, and Tennessee that seek to bestow on public libraries a compulsory license to lease copyrighted ebooks according to "reasonable terms" set by state laws, and not by the copyright owners. The Maryland legislature passed such a bill, only to have it struck down in February 2022 by the U.S. District Court in *Association of American Publisher v. Frosh*. The court found that Maryland House Bill 518's forced licensing is preempted because it interferes with copyright owners' exclusive right to determine "whether, when, and to whom they must distribute their copyrighted works."

Free State Foundation President Randolph May and I analyzed the District Court's decision in a March 2022 *Perspectives from FSF Scholars*, titled "State Laws Forcing Publishers to License Ebooks to Libraries Are Unlawful." Our *Perspectives* reaffirmed the soundness of the District Court's application of preemption principles in light of the Copyright Act and relevant case law, and it concluded that the court's correct decision ought to dissuade other states from passing laws imposing forced licensing and rate controls on ebooks. Additionally, in a May 2022 *Perspectives*, "State Laws Forcing Publishers to License Ebooks to Libraries Are Unlawful," I explained why any future attempts by states to evade the preemptive result in *AAP v. Frosh* by imposing rate controls on ebook licensing to libraries – but not requiring licensing – also would be subject to preemption because such controls would conflict with uniform national policy regarding copyright owners' exclusive rights of distribution.

It also is important to recognize that advocacy for these legally faulty ebook licensing bills is partly grounded in a misguided idea known as "digital first sale." In *AAP v. Frosh*, the state of

Maryland defended its ill-fated ebook licensing bill as an ostensible response to the lack of a "digital first sale." That state's bill was intended to impose restrictions on copyright owners and publishers that at least partially embodied "digital first sale." In particular, the bill would have effectively deemed publishers' and copyright owners' rights to set ebook licensing terms exhausted upon their initial leasing of ebooks to public libraries in Maryland.

However, there is no "digital first sale" in federal copyright law and Maryland's bill unlawfully interfered with distribution rights secured by the 1976 Act. And there are strong reasons why Congress and states, as well as courts, should continue to reject first sale or any similar types of restrictions on copyrights.

### **III. Maryland's Misguided "Digital First Sale" Scheme for Ebooks**

In *AAP v. Frosh*, plaintiff publishers filed a legal brief in which they argued that the Maryland law created "an unprecedented first sale scheme by which publishers (and authors) are deemed to have exhausted their statutory rights to control digital disseminations to library customers simply because they have made an initial consumer offering."<sup>1</sup> The Maryland bill would have required copyright owners and publishers who license ebooks to one segment of the population within the state to also license ebooks to public libraries on "reasonable terms" to be defined by state courts and subject to restriction such as "limitation[s] on the number of electronic literary product licenses a public library may purchase on the same date the electronic literary product license is made available to the public."<sup>2</sup>

The connection between Maryland's ebook licensing bill and "digital first sale" also was confirmed by the state of Maryland. In a brief defending the ebook licensing bill, the state argued that "the proliferation of digital media has outpaced the first sale doctrine, and publishers have capitalized on this loophole through both price discrimination against public libraries and withholding from public libraries access to e-books and audiobooks, to the detriment of library patrons."<sup>3</sup>

Although the District Court did not expressly address the parties' arguments regarding "digital first sale," the court did reject Maryland's alleged purposes in correcting imbalances and expanding library access to digital literary products as being inapposite for purposes of federal preemption analysis.<sup>4</sup> As the District Court concluded, the "controlling principle" in Supremacy Clause jurisprudence is whether a state law frustrates Congress's objectives. The court found that Maryland's bill likely stands as an obstacle to Congress's objectives and purposes in the Copyright Act because it "interferes with the copyright owners' exclusive right

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<sup>1</sup> *AAP v. Frosh*, U.S. Dist. Ct. Dist. Md., Case No. 21-03133, Plaintiff's Reply Brief in Support of Its Motion for Preliminary Injunction and Opposition to Defendant's Motion to Dismiss (filed January 31, 2022), at 9.

<sup>2</sup> Md. Code Ann., Educ. § 23-702(c) (2022), available at: <https://legiscan.com/MD/drafts/HB518/2021>.

<sup>3</sup> *AAP v. Frosh*, U.S. Dist. Ct. Dist. Md. Case No. 21-03133, Defendant's Consolidated Memorandum in Support of Defendant's Motion to Dismiss and Opposition to Plaintiff's Motion for a Preliminary Injunction, at 5 (filed January 14, 2022).

<sup>4</sup> *AAP v. Frosh*, Case No. 21-03133, Memorandum Opinion, at 17.

to distribute by dictating whether, when, and to whom they must distribute their copyrighted works.<sup>5</sup>

The District Court's conclusion was correct as a matter of copyright law and preemption precedents. Resolution of the case did not require the court to respond to the substance of Maryland's policy arguments about the supposed need to overcome lack of "digital first sale" in copyright law with a state-level workaround for licensing ebooks to public libraries. But as even the state of Maryland conceded in its legal brief, there is no "digital first sale" in copyright law. And there are strong reasons why Congress and states, as well as courts, should continue to reject first sale or any similar types of restrictions on copyrights.

#### **IV. Copyright's First Sale Doctrine Applies Only to Physical Copies**

Although there is no "digital first sale" in copyright law, there is a limited exception to copyright owner's exclusive right of distribution known as the first sale doctrine. Under this doctrine, a copyright owner's control over the distribution of a physical copy that was lawfully made terminates when that copy is distributed to its initial retail purchaser. This means that the buyer of a music CD, a Blu-Ray disc containing a movie, or a print book may sell his or her copy to a third party without infringing the copyright owned by the content's creator. First sale is thus a valid legal defense to claims of copyright infringement.

The Supreme Court first recognized the first sale doctrine in its 1908 decision in *Bobbs-Merrill Co. v. Straus*.<sup>6</sup> The first sale doctrine is grounded in rights of personal property; in particular, common law's refusal to permit restraints on the alienation of chattels.<sup>7</sup> And the Copyright Act of 1909 Act's original codification of first sale indicates that the doctrine is premised on the distinction between rights in intellectual property – such as an author's rights to control the vending of copies of a fictional story or a music artist's rights to control vending of physical copies of a sound recording – and the rights in personal property – such as a consumer's purchased copy of a book or vinyl music record. Today, the first sale doctrine is codified in Section 109(a) of the 1976 Act, which states:

Notwithstanding the provisions of section 106(3), the owner of a particular copy or phonorecord [a copy of a sound recording] lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord.

Another premise of the first sale doctrine is that it applies only to sales of *physical* copies that embody the creative work. Also, the first sale doctrine is only a partial limit on the right of distribution secured under Section 106(1); it does *not* limit the right of reproduction under Section 106(3).

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<sup>5</sup> *Id.* at 17-18.

<sup>6</sup> 210 U.S. 339, 351, 28 S.Ct. 722.

<sup>7</sup> See, e.g., *Kirtsaeng v. John Wiley & Sons, Inc.*, 568 U.S. 519, 530 (2013).

## V. Congress, Copyright Office, and Courts Reject "Digital First Sale"

Some opponents of copyright protections have urged Congress to limit copyrights in digital files of copyrighted works, and thereby impose a "digital first sale" defense to infringements by individuals who buy copyrighted works at retail and then reproduce and sell digital file copies of those works. But in the Digital Millennium Copyright Act of 1998 (DMCA), Congress declined to adopt any new "digital first sale" doctrine regarding digital copies of copyrighted works that are not "fixed" in material objects.

The DMCA authorized the U.S. Copyright Office to examine the issue, and in its 2001 report the Copyright Office rejected "digital first sale" in both its reading of the law and as a matter of public policy. Its 2001 report recognized that an individual's resale of digital files constitutes infringement because his or her unauthorized digital transmissions of the copyrighted work causes the recipient to obtain an entirely new copy of the work.<sup>8</sup> In other words, a new copy of a digital file is created each time it is uploaded to a re-seller's server and another new copy is created on the computer of the secondary market recipient of the digital file. The generating of new copies undermines the copyright owner's exclusive right of reproduction and therefore falls outside the scope of the classic first sale doctrine contained in Section 109(a). As the report reiterated, the first sale doctrine is a limit only on the exclusive right of distribution.

The rejection of "digital first sale" in copyright law was further confirmed by the U.S. Court of Appeals for the Second Circuit in its 2018 decision in *Capitol Records, LLC v. ReDigi Inc.* ReDigi offered a commercial service that would transfer digital music files from an original purchaser's computer, through ReDigi's server, to a new purchaser. The court found that "[t]he fixing of the digital file in ReDigi's server, as well as in the new purchaser's device, creates a new phonorecord, which is a reproduction" under the 1976 Act.<sup>9</sup> The court held that such reproduction was unauthorized and "not protected, or even addressed by § 109(a)."<sup>10</sup> Also, the court found that supposed deletion of an original purchaser's authorized copy does not legally offset the creation of an unauthorized copy. As the court wrote: "We are not free to disregard the terms of the statute merely because the entity performing an unauthorized reproduction makes no efforts to nullify its consequences by counterbalancing destruction of the preexisting phonorecords."<sup>11</sup>

Although the Second Circuit did not address whether ReDigi's service also infringed on distribution rights, the lower court in that case answered that question in the affirmative. Section 109(a), wrote the lower, only applies to distribution by "the owner of a *particular* copy or phonorecord... or *that* copy or phonorecord."<sup>12</sup> It found that "the first sale defense is limited to material items, like records, that the copyright owner put into the stream of

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<sup>8</sup> *AAP v. Frosh*, U.S. Dist. Ct. Dist. Md., Case No. 21-03133, Memorandum Opinion (February 16, 2022), at 79-80.

<sup>9</sup> 910 F.3d at 657 (2d. Cir. 2018) (citing *Cartoon Network LP v. CSC Holdings*, 536 F.3d 121, 127 (Cir. 2008)).

<sup>10</sup> *Id.* at 657.

<sup>11</sup> *Id.* at 658.

<sup>12</sup> 934 F.Supp.2d 640, 655 (S.D.N.Y. 2013).

commerce,"<sup>13</sup> but ReDigi distributed reproductions of code to its servers and users' hard drives.

## **VI. Policy Arguments Against "Digital First Sale" and Equivalents Remain Strong**

"Digital first sale" would not be a mere extension of the classic first sale doctrine or further the doctrine's purposes, but instead would constitute a much more radical change to copyright law that would harm copyright owners and undermine incentives for new creative works.

Whereas the first sale doctrine is rooted in the right to transfer tangible personal property, that right is not furthered by "digital first sale." The purchaser of a digital copy of a copyrighted work is not exercising dominion over his or her tangible property by reproducing digital copies of that work. Conversely, the right to transfer tangible personal property is not in any way limited by a copyright owner maintaining control over digital reproductions and transmissions of his or her creative works.

Moreover, the impact of "digital first sale" on copyright owners would be potentially far more significant and harmful to their economic opportunities than the first sale doctrine. Markets for new physical copies of copyrighted works surely are impacted by secondary markets for used physical copies. But time and space limit the impact of those secondary markets, as physical goods degrade or wear out with age or repeated use. Transport costs, geographical distance, and scarcity of retail space also impose constraints on the availability of used physical goods.

But copyrighted works in digital format are not subject to the same wear and tear as physical copies of copyrighted works. Digitization and high-speed Internet connectivity enable near-instantaneous, world-wide, mass-volume distribution of digital copies. As a result of these factors, incorporation of "digital first sale" into copyright law would significantly curtail exclusive rights of reproduction and distribution and unfairly reduce copyright owners' opportunities to generate returns on their labors and investment. "Digital first sale" would enable initial purchasers and entities that offer their own reproductions of digital files on "resale" to reap significant economic benefits where copyright owners have sown. This would undermine financial incentives for the creation of high-quality creative works.

Additionally, "digital first sale" poses increased risks of online piracy. Copyrighted works are highly susceptible to piracy because of digitization and high-speed Internet connectivity. Under a "digital first sale" regime, it would be exceedingly difficult for services offering "secondhand" digital files to verify that the copies belonging to the original purchasers have been deleted and the "resale" digital files are legitimate.

Furthermore, "digital first sale" could inflict significant harm on markets for license-based or access-based services for consuming copyrighted works. Subscription-based services for access to streaming movies and TV services – such as Netflix and Hulu Plus – have millions of users, and streaming music – such as Spotify and Pandora – also have millions of users.

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<sup>13</sup> *Id.*

Consumers also have choices among subscription services such as Audible and Audiobook.com, and OverDrive is a commercial service that makes ebooks and audiobooks available to public libraries for lending to their patrons. But increased availability of digital resale copies of creative works almost certainly would reduce demand for popular subscription-based services and thereby reduce their ability to generate new high-quality content.

Significantly, there is no identifiable failure in these digital streaming services markets that would justify imposition of "digital first sale." Absent evidence of market failure and consumer harm, such a drastic intervention by government is unjustifiable. Any anticompetitive concerns in the markets for music, video, or ebook subscription services or digital download sales could be better addressed through antitrust on a case-by-case basis.

## VII. Conclusion

There is no "digital first sale" in copyright law, and there are strong reasons for keeping it that way. Congress, states, and courts should give careful attention to the contours of the first sale doctrine for physical copies. And they should protect copyrights owners and incentives for commercial creativity from the harms of unauthorized mass-scale copying and selling of digital reproductions of creative works under "digital first sale" schemes.

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## Further Readings

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