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Nancy S. Kim
California Western School of Law

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Cover Page Footnote

ProFlowers Distinguished Professor of Internet Studies and Professor of Law, California Western School of Law. Versions of this paper were presented at the Southern California Business Law Workshop at the University of San Diego School of Law and the Works-in-Progress IP 2018 at Case Western Reserve University School of Law, and the author thanks those participants for their helpful comments and questions. Special thanks to Jordan Barry, Amelia Burns, Mina Burns, and Lynne Dallas for their insights, comments, and suggestions on an earlier draft of this Article, Derek Diener for research assistance, and to Jasmine Vitug, Iryna Riechkina, and the other members of the *Loyola of Los Angeles Law Review* for their careful work editing this Article. Any errors and omissions belong solely to the author

REVISITING THE LICENSE V. SALE CONUNDRUM

*Nancy S. Kim**

This Article seeks to answer a question that has become increasingly more important as commerce moves from the tangible to the intangible—to what extent may a business use a contract to control the use of a fully paid product? The characterization of a transaction as a license or a sale determines what may be done with a product, who controls how the product may be used, and what happens in the event of a dispute. The past generation has seen a seismic shift in the way businesses distribute their products to consumers. Businesses often "license" rather than "sell" their products, and view consumers as licensees, rather than owners, of the products they buy. Customers own their print copies of books, movies, and music but merely license the same content when they purchase it in digital form. The marketplace transition from sale to license has far and wide ripple effects affecting a range of issues from innovation to the environment. The rapid emergence of the Internet of Things adds to the urgency and importance of the question—are goods licensed or sold?

The question of whether a digital product is licensed or sold is often conflated with the question of whether a product should be licensed or sold. The problem lies, in large part, with the well-intentioned but misguided turn that contract law has taken away from the intent of the parties and toward a narrow vision of efficiency. When it comes to commercial transactions, the narrow efficiency view prioritizes quantity of completed transactions over quality, ignoring consumer expectations and the way in which distrust creates uncertainty in the marketplace. This Article proposes a methodology for resolving the license v. sale conundrum that promotes a more expansive view of efficiency and brings more predictability and fairness to an increasingly muddled area of the law.

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I. INTRODUCTION

This Article seeks to answer a question that has become increasingly more important as commerce moves from the tangible to the intangible—to what extent may a business use a contract to control the use of a fully paid product?

The past twenty years has seen a seismic shift in how businesses distribute consumer goods, which may alter long-held expectations of property ownership.[1] Businesses often "license" rather than "sell" their products and view consumers as licensees, rather than owners, of the products they buy.[2] Customers own their print copies of books, movies, and music but merely license the same content when they purchase it in digital form. Many products integrate licensed software with tangible components and many, if not most, digital products are characterized as "licensed, not sold."[3] License agreements restrict consumers' rights to use such goods. Consumers, however, may fail to distinguish these licensed goods from those that they own. Networked devices and home furnishings—the Internet of Things (IOT)—are also likely to be licensed to consumers rather than sold outright.[4]

The problems raised by the license v. sale dilemma have been the subject of recent scholarly concern. Professors Aaron Perzanowski and Jason Schultz summarize some of the consequences "for

1. *See generally* AARON PERZANOWSKI & JASON SCHULTZ, THE END OF OWNERSHIP: PERSONAL PROPERTY IN THE DIGITAL ECONOMY 2 (2016) ("[D]igital retailers insist that ownership depends on the terms of an end user license agreement . . . . Those terms—negotiated by lawyers working for retailers and publishers—determine your rights, not the default entitlements of personal property."); JOSHUA A.T. FAIRFIELD, OWNED: PROPERTY, PRIVACY, AND THE NEW DIGITAL SERFDOM 23 (2017) ("[W]hy did the development of online rights start turning the clock backward to digital feudalism, rather than continuing the progress of traditional property rights into new electronic markets? In short, courts and policymakers have struggled with how to apply property law to things they can't touch.")

2. PERZANOWSKI & SCHULTZ, *supra* note 1, at 4.

3. *Id.*

4. For a comprehensive treatment of the legal and regulatory issues surrounding the IOT, including the problem of post-purchase control by businesses, see STACY-ANN ELVY, A COMMERCIAL LAW OF PRIVACY AND SECURITY FOR THE INTERNET OF THINGS (forthcoming 2021). *See also* Stacy-Ann Elvy, *The Hybrid Transactions and the INTERNET of Things: Goods, Services, or Software?*, 74 WASH. & LEE L. REV. 77, 82 (2017) [hereinafter Elvy, *Hybrid Transactions*] (noting that the existing ambiguity in article 2 of the Uniform Commercial Code (UCC) regarding hybrid transactions "becomes more pressing in the age of the Internet of Things (IOT). Companies are increasingly adopting a software and service centric approach to the development and sale of goods").

individuals and society" of shifting away from ownership toward a "more conditional, impermanent access" to digital and physical goods:

> So what is at stake when we make these choices? The most immediate consequence of nonownership is the long list of substantive rights we lose. . . . You can't resell a product you don't own. You can't lend it, give it away, or donate it. You can't read, watch, or listen on unapproved devices. You can't modify or repair the devices you use. . . . Nor is the impact of the shift from ownership to licensing limited to individuals; our educational and cultural institutions are dealing with the fallout as well. When a library buys a printed book, for example, it can lend it to as many patrons as it chooses, without asking the publisher for permission of paying additional fees. Library books can remain in circulation for decades, serving the needs of hundreds of readers. But when libraries acquire ebooks, licensing terms and software code often impose hard ceilings on lending.[5]

Professor Joshua Fairfield issues an even starker warning, arguing that the shift away from ownership will result in a new feudalism:

> We must restore everyday property ownership. If we do not take back our ownership rights from software companies and overreaching governments, we will become digital peasants, only able to use our smart devices, our homes, our cars, and even our own software-enabled medical implants purely at the whim of others. Like the serfs of feudal Europe who lacked rights in the land they worked, without digital property rights, we aren't owners—we're owned.[6]

It is more than the ability to consume and possess that is at stake. It is the very ability to create. As Fairfield states, "[p]roperty provides resources and tools. . . . to turn a technical legal right into a living possibility."[7] The first sale right allows the buyer to transfer possession of a good that was the subject of a first sale.[8] If, however, the good was licensed and not sold, the right of first sale would not apply.[9] Accordingly, those who own the digital rights to property

5. PERZANOWSKI & SCHULTZ, *supra* note 1, at 6.
6. FAIRFIELD, *supra* note 1, at 3.
7. *Id.* at 19.
8. Nancy S. Kim, *The Software Licensing Dilemma*, 2008 BYU L. REV. 1103, 1111.
9. *Id.*

would be able to restrict how those who are merely licensees may use them. As more goods are licensed and not sold, the goods available to use in creative and productive pursuits diminish, further widening the gap between the digital haves and have-nots.[10]

The license v. sale question also has ramifications for privacy. Perzanowski and Schultz warn about the privacy problems associated with licensed products, noting that there are laws that restrict access to information associated with analog goods, such as the books library patrons read or the movies that consumers rent, and make obtaining such information burdensome.[11] Digital transactions, however, make tracking "far easier" and permit "unprecedented surveillance of consumer behavior."[12] The ability to tie use of a product with the collection of personal information depends upon whether the transaction at issue is a license and not a sale.[13] Companies that license instead of sell goods will continue to have access and control to collect information from the use of goods that consumers use in their homes and in their cars. This is especially true where the product is "tethered," a term that Aaron Perzanowski, Chris Hoofnagle, and Aniket Kesari use to refer to a product that has an "ongoing connection" with its seller and that "often renders that good in some way dependent on the seller for its ordinary operation. Such products present as physical goods but often function as vessels for the delivery of services."[14] IOT goods are tethered because their ongoing functionality depends upon the seller's service and constant updates and modifications.[15] Professor Stacy-Ann Elvy cautions that the IOT

> has the potential to transform the advertisement and marketing industry, and the data generated by IOT devices could be used to target vulnerable consumers for contracting. Goods can be made with a readable element in the packaging, which will allow manufacturers to assess, in real time, the

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10. This is not to suggest that the owner of a good acquires all rights to that good. The seller would still retain intellectual property rights as discussed in Part III.D.

11. PERZANOWSKI & SCHULTZ, *supra* note 1, at 7.

12. *Id.*

13. *Id.*

14. Chris Jay Hoofnagle et al., *The Tethered Economy*, 87 GEO. WASH. L. REV. 783, 785 (2019).

15. *Id.* at 793.

> types of consumers who are buying and using their products.[16]

These seismic changes have been taking place in the marketplace with relatively little fanfare because, like privacy degradation, they are gradual and intangible, involving no physical injuries or out-of-pocket losses. Yet, like privacy, a lack of public outcry should not be equated with public support or consent; nor does it mean that the changes are socially beneficial. Joshua Fairfield warns,

> If we are not cautious, the default rules of property, common decency, and constitutional ordering that have been tested by millions of people over generations will be discarded in favor of a contract written by a corporate attorney in the last few years to benefit her client and no one else. That is not going to be a pleasant society to live in.[17]

I first tackled the license v. sale dilemma a decade ago.[18] Since then, the rapid proliferation of digital, networked products has raised even more questions. Is the consumer restricted to the terms of the license? Can he or she resell the device if he or she chooses to switch to another brand? What if the device fails—is the consumer permitted to seek repairs from unauthorized service providers or modify devices to better suit his or her needs?

The Library of Congress attempted to answer the last question regarding repairs when it adopted the Register of Copyright's Recommendation and ruled that the Digital Millennium Circumvention Act's prohibition on circumventing technological measures that control access to copyright works (i.e., hacking) did not apply to "noninfringing" uses of work, notably the ability to repair a broken product.[19] By weighing in on the important issue of whether consumers could hack digital devices for the purpose of repairing them, the Library of Congress sought to resolve a longstanding and contentious issue. It was not entirely successful in doing so given that at least certain provisions require that the "owner" of the device initiate circumvention. For example, a subsection titled "Persons who may initiate circumvention" states:

16. Stacy-Ann Elvy, *Contracting in the Age of the Internet of Things: Article 2 of the UCC and Beyond*, 44 HOFSTRA L. REV. 839, 841 (2016) [hereinafter Elvy, *Internet of Things*].

17. FAIRFIELD, *supra* note 1, at 47.

18. *See* Kim, *supra* note 8, at 1112.

19. 37 C.F.R. § 201.40(a)–(b) (2018).

> To the extent authorized under paragraph (b) of this section, the circumvention of a technological measure that restricts wireless telephone handsets or other wireless devices from connecting to a wireless telecommunications network may be initiated by the owner of any such handset or other device, by another person at the direction of the owner, or by a provider of a commercial mobile radio service or a commercial mobile data service at the direction of such owner or other person, solely in order to enable such owner or a family member of such owner to connect to a wireless telecommunications network, when such connection is authorized by the operator of such network.[20]

It is unclear whether a licensee, as opposed to a purchaser, would be considered the "owner" of a product. Furthermore, the right to repair is limited and may not apply to the range of modifications that a consumer may want to make, which may better suit his or her needs and which may constitute enhancements and not repairs.[21] If licensing, rather than selling, becomes the predominant way by which goods are transferred in a market economy, what will the future of innovation look like if tinkerers are legally prohibited from altering the products for which they pay? How will the environment be affected if products cannot be reused, repaired or are made for a single user or use only?[22]

The marketplace transition from sale to license thus has far and wide ripple effects affecting a range of issues from innovation to the environment. The rapid emergence of the IOT adds to the urgency and importance of the question—are goods licensed or sold?

Raising the stakes of the license v. sale dilemma even higher is the problem of ubiquitous digital terms, what I refer to as "wrap contracts," as a shorthand for the myriad electronic adhesive form contracts, such as browsewraps, clickwraps, and hybrid/sign-in

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20. *Id.* § 201.40(c).

21. *See* Leah Chan Grinvald & Ofer Tur-Sinai, *Intellectual Property Law and the Right to Repair*, 88 FORDHAM L. REV. 63, 74 (2019) (proposing a theoretical framework for a right to repair that is consistent with intellectual property laws).

22. The European Commission adopted a "Right to Repair" as part of its Circular Economy Action Plan that aims to make the economy "fit for a green future, strengthen our competitiveness while protecting the environment and give new rights to consumers." This plan is not legislation until and unless it is approved by European Union Member States and the European Parliament. *Changing How We Produce and Consume: New Circular Economy Action Plan Shows the Way to a Climate-Neutral, Competitive Economy of Empowered Consumers*, EUR. COMM'N (Mar. 11, 2020), https://ec.europa.eu/commission/presscorner/detail/en/IP_20_420.

wraps.[23] Many customers are locked out of the devices they thought they purchased until they agree to updated terms of services.[24] These terms may be updated frequently. Professor Lori Andrews describes the experience of being locked out of her phone until she agreed to Apple's updated terms of service and being given only the alternative of returning the phone (containing her precious photos, texts, and music) for a refund if she refused.[25]

The problem of ubiquitous terms is exacerbated by the increasing use of contracting agents, which removes the consumer from the contracting process, resulting in what Stacy-Ann Elvy refers to as "Contract Distancing":

> The device, rather than the consumer, places the order for the goods, or the consumer places the order by clicking the Dash Button. . . . The consumer is not required to access the company's website or mobile application (which contains contract terms), review the company's terms and conditions, or click an "I agree" button before each subsequent order is placed. This complicates the analysis of mutual assent, as contract terms are not displayed on IOT devices. The ease with which goods can be purchased using these devices facilitates a contracting environment in which quick purchases without contract review are the norm, thereby further incentivizing consumers to fail to read and understand contract terms. In turn, this encourages businesses to continue to take advantage of consumer ignorance by including one-sided contract terms that impede the ability of consumers to obtain legal redress and may even lead to contractual abuse.[26]

The United States Supreme Court raised the license v. sale issue without resolving it in *Impression Products, Inc. v. Lexmark International, Inc.*[27] (*Impression*), which held that a patentee's

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23. I have discussed the problem of wrap contracts at length elsewhere. *See* NANCY S. KIM, WRAP CONTRACTS: FOUNDATIONS AND RAMIFICATIONS 2 (2013).

24. *See* Lori Andrews, *The Fragility of Consent*, 66 LOY. L. REV. 11, 11 (2020).

25. Andrews writes, "Of course, returning the phone was not an option. My photos for the past few years were on it, including the pictures of my younger sister before she died. The device also housed my phone directory. . . . For me, it was as if someone was holding my possessions hostage, asking me to give up basic human rights—like privacy—to get them back." *Id.*

26. Elvy, *Internet of Things*, *supra* note 16, at 843–44.

27. 137 S. Ct. 1523 (2017).

decision to sell a product subject to post-sale contract terms exhausted all of its patent rights to that product regardless of whether the sale occurred in the United States or abroad.[28] The Patent Act grants a patentee the "right to exclude others from making, using, offering for sale, or selling the invention"[29] so that anyone who does so without authority infringes the patent.[30] However, this right is subject to the patent exhaustion doctrine, which limits the patentee's rights so that the first authorized sale of a patented item terminates the patentee's rights with respect to that item.[31] The Supreme Court made a clear distinction between a license and a sale with respect to post-sale restrictions, stating:

> A patentee can impose restrictions on licensees because a license does not implicate the same concerns about restraints on alienation as a sale. Patent exhaustion reflects the principle that, when an item passes into commerce, it should not be shaded by a legal cloud on title as it moves through the marketplace. But a license is not about passing title to a product, it is about changing the contours of the patentee's monopoly: The patentee agrees not to exclude a licensee from making or selling the patented invention, expanding the club of authorized producers and sellers.[32]

The *Impression* decision answers an important question regarding the doctrine of patent exhaustion post-sale but pushes to the forefront an equally perplexing and problematic question: Can a patentee circumvent the patent exhaustion doctrine by licensing its products rather than selling them? This seemingly simple question opens a Pandora's box of other issues relating to the license v. sale conundrum because the classification of an item as a sale or license essentially dictates the rights and remedies of the parties and determines which regime of law governs.[33]

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28. *Id.* at 1531.
29. 35 U.S.C. § 154(a)(1) (2018).
30. *Id.* § 271(a).
31. *Impression*, 137 S. Ct. at 1531.
32. *Id.* at 1534.
33. If the transaction is a sale, article 2 of the UCC, consumer protection laws, and the common law of contracts govern the transaction. Although article 2 of the UCC covers transactions in goods, relevant provisions of the UCC refer to "sales" or "sellers." Consumer protection laws typically apply to sales or leases of consumer goods. For example, the warranty protection provided under the California consumer protection law, the Song-Beverly Consumer Warranty Act, applies to the "sale of consumer goods." CAL. CIV. CODE §§ 1790–1795.8 (Deering 2020). The Song-Beverly

At the heart of the license v. sale conundrum is contract law. The characterization of a transaction determines what may be done with the product, who controls how the product may be used, and what happens in the event of a dispute.[34] A contract may contain terms that determine how the transaction is characterized. Accordingly, contracts have the potential to alter consumer expectations in a profound way. For example, if a consumer pays for a television, he or she may expect to be able to later resell it or give it away when he or she no longer has a use for it. But could a consumer do so if, prior to purchase, he or she had agreed to contractual terms that stated that he or she was not the owner of the television, but a mere licensee? What if those terms were contained in the box that contained the television when the consumer purchased it—and never read them? Mass consumer contracting and the transfer, or retention, of rights through adhesive forms lack the signaling effects of negotiated and signed paper contracts. The proliferation of digital contracting, lack of consumer awareness, and the adhesive nature of standard form contracts raise important policy concerns regarding whether there should be constraints on the ability to license, rather than sell, goods in mass consumer transactions.

Because both the UCC and intellectual property regimes defer to the power of contracts to reallocate rights,[35] a circularity problem arises: if the transaction is a license instead of a sale, the terms of the contract govern, including any terms that prohibit selling the product;

Act defines "sale" as "the passing of title from the seller to the buyer for a price" or "a consignment for sale." *Id.* § 1791(n)(1)–(2). On the other hand, if the transaction is a license, intellectual property law (specifically copyright and patent law) govern. Kim, *supra* note 8, at 1110–11. For further discussion, see Elvy, *Hybrid Transactions*, *supra* note 4, at 79, where the author noted that "one of the thorniest issues in sale of goods transactions is how best to determine whether Article 2 applies to transactions involving the provision of goods and no-goods, such as services or software." *See also* Kim, *supra* note 8, at 1110 (stating that the "ramifications of characterizing software transactions as either license or sales are manifold" and "has a domino effect on the applicable regulatory regime, default rules, and available remedies"); Hoofnagle et al., *supra* note 14, at 794–95 (observing that "[s]oftware licensing has blended elements of the sale of goods and the provision of services" and "straddle accepted legal categories," and "courts struggle to conceptualize these transactions").

34. Elvy notes that companies may avoid the application of article 2 of the UCC "by providing different agreements that govern the device's hardware, software and services." Elvy, *Hybrid Transactions*, *supra* note 4, at 85.

35. Section 301 of the Copyright Act preempts a state law claim only if the work is within the subject matter of copyright and the right being asserted is equivalent to "any of the exclusive rights within the general scope of copyright." 17 U.S.C. § 301(a) (2018); *see also* Forest Park Pictures v. Universal Television Network, Inc., 683 F.3d 424, 430 (2d Cir. 2012) (noting that a contract claim is not preempted if there is an "extra element" that differs from the copyright infringement claim).

however, the contract itself may determine whether the transaction is characterized as a license or sale. Owners of tangible property have the power to restrict the use of their property, but their power to do so is tied to their ownership. Generally, if the transaction is characterized as a sale, then the seller's property rights are terminated. By contrast, a license allows the owner of intangible property to retain rights with respect to it even if it is integrated with tangible property that has been sold. This is the case in an increasing number of transactions that cannot be easily characterized as exclusively a license or a sale. Rather these license-sale transactions are a hybrid of both; the tangible component or medium is sold, but the digital content or intellectual property right associated with the product is licensed.[36]

This Article argues that the enforceability of contract terms in a license-sale transaction depends upon two factors: first, whether the terms affect the "sold" portion or the "licensed" portion; and second, whether the contract is formed pre- or post-sale. A contract cannot recharacterize a sale as a license *after* the transaction has occurred, but it can impose restrictions that may define or characterize that transaction if those restrictions are agreed to *before* the transaction has occurred.

Unfortunately, contract doctrine in the past three decades has adopted a narrow version of efficiency that confuses efficiency with facilitating transactions and accordingly, substitutes constructive assent with constructive notice. But contracts that significantly alter the parties' rights must reflect the intent of the parties. More transactions with hidden, unread, and unfair terms are suboptimal, do not leave the parties (or society) better off, and cannot be justified by any economic theory. A contract that contains terms that purport to

36. In order to avoid confusion with hybrid transactions under the UCC (where the term is used by courts to refer to transactions that involve the sale of goods and services), I will refer to transactions that involve the sale of a tangible component with the license of an intangible component as a "license-sale" and will eschew the use of the term "hybrid" transaction. *See generally* Elvy, *Hybrid Transactions*, *supra* note 4, at 104–35 (providing an extensive discussion of hybrid transactions, including whether software constitute goods or services, and the different tests employed by courts to determine whether the UCC applies). The determination of whether an offering is a "good" or "service" is important for purposes of the UCC; however, this Article focuses on the license v. sale conundrum that affects the application of the UCC but also other laws, significantly, the first sale doctrine. All transactions involving tethered goods under my definition would be considered license-sale transactions, but not all license-sale transactions involve tethered goods. Some involve products that involve no ongoing relationship between the buyer and the seller, yet the seller purports in a contract to maintain rights to that product.

transform what would otherwise be a sale into a license alters the buyer's first sale rights and requires scrutiny, especially when that contract is presented as a non-negotiated, mass consumer form.[37]

The question of whether a product is licensed or sold is too often conflated with the question of whether a product *should* be licensed or sold. The normative question typically arises in assessing the issue of infringement; however, the normative question must be disentangled from the descriptive question regarding whether a given transaction *is in fact* a license or a sale. This Article proposes a methodology for resolving the license v. sale conundrum that promotes a more expansive view of efficiency by bringing more clarity and fairness to an increasingly muddled area of the law.

Part II provides essential background and identifies the stakes involved in the license v. sale conundrum. Part III analyzes the pivotal role of contract law in assessing the nature of post-transaction restrictions. Part IV proposes a methodology for assessing whether a good is "licensed" or "sold." This Article concludes that the license v. sale conundrum is a problem created by contract law that can be resolved by contract law that focuses on the reasonable expectations of the parties.

II. BACKGROUND: THE CURRENT STATE OF THE LAW GOVERNING PRODUCTS "LICENSED, NOT SOLD"

This Part II provides an overview of the current law governing the license v. sale dilemma. Generally, the relevant cases addressed one or both of the following two issues: (i) whether a post-sale contract may restrict first sale rights and (ii) whether contractual language characterizes a transaction as a license or a sale.

A. A First Sale Exhausts a Patentee's Rights Despite Post-Sale Terms

In *Quanta Computer, Inc. v. LG Electronics, Inc.*,[38] the Supreme Court addressed the issue of post-sale restrictions on use and held that the doctrine of patent exhaustion applies to method patents and the sale of components that embody them.[39] In that case, LG Electronics (LGE) licensed its patents to Intel pursuant to a License Agreement

37. *See* discussion *infra* Part III.
38. 553 U.S. 617 (2008).
39. *Id.* at 621.

that permitted "Intel to 'make, use, sell (directly or indirectly), offer to sell, import or otherwise dispose of' its own products practicing the LGE patents."[40] The License Agreement also stated that no license was granted to "any third party" for the combination of other components with the licensed products.[41] Notably, it also stated, "[n]otwithstanding anything to the contrary contained in this Agreement, the parties agree that nothing herein shall in any way limit or alter the effect of patent exhaustion that would otherwise apply when a party hereto sells any of its Licensed Products."[42]

LGE and Intel signed a separate agreement, the Master Agreement, which required that Intel provide written notice to its customers that Intel products, which were licensed by LGE, did not "extend, expressly or by implication, to any product that you make by combining an Intel product with any non-Intel product."[43] The Master Agreement also provided that "a breach of this Agreement shall have no effect on and shall not be grounds for termination of the Patent License."[44] Quanta purchased microprocessors and chips from Intel.[45] Intel had given Quanta the notice required by the Master Agreement, but Quanta manufactured computers using Intel components combined with non-Intel components.[46] It did not alter or modify the Intel components but incorporated them into its own systems.[47] LGE sued Quanta, claiming that its use was infringing upon LGE patents.[48] Patent exhaustion is triggered only by an authorized sale, and LGE argued that the sale of the Intel components was not authorized because the License Agreement did not permit Intel to sell its products for use in combination with non-Intel products in a way that practiced the LGE patents.[49] The U.S. Supreme Court looked at the structure of the transaction to determine whether the sale was "authorized."[50] It stated:

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40. *Id.* at 623.
41. *Id.*
42. *Id.* (alteration in original).
43. *Id.* at 623–24.
44. *Id.* at 624.
45. *Id.*
46. *Id.*
47. *Id.*
48. *Id.*
49. *Id.* at 636.
50. *Id.* at 636–37.

> Nothing in the License Agreement restricts Intel's right to sell its microprocessors and chipsets to purchasers who intend to combine them with non-Intel parts. . . . In any event, the provision requiring notice to Quanta appeared only in the Master Agreement, and LGE does not suggest that a breach of that agreement would constitute a breach of the License Agreement. Hence, Intel's authority to sell its products embodying the LGE Patents was not conditioned on the notice or on Quanta's decision to abide by LGE's directions in that notice.[51]

The Court further noted that the disclaimer of a third-party license in the License Agreement was "irrelevant" to the issue of exhaustion since exhaustion turns on an authorized first sale and not on an implied license.[52] It concluded that because "[n]o conditions limited Intel's authority to sell products substantially embodying the patents," its sales to Quanta were authorized, which triggered patent exhaustion.[53] Accordingly, LGE could no longer assert its patent rights against Quanta.[54]

Although the *Quanta* case involved a negotiated agreement, the U.S. Supreme Court addressed the issue of post-sale terms in an adhesive form contract in a later case, *Impression*. Lexmark, a manufacturer of toner cartridges, offered its products at two different prices—one at full price and the other at a 20 percent discount through its "Return Program."[55] The company required that customers purchasing its Return Program cartridges agreed that they would use the cartridge only once and would not transfer the empty cartridge to any party other than Lexmark.[56] In addition, Lexmark installed a microchip on each Return Program cartridge to prevent its reuse.[57] Companies, however, soon found ways to circumvent the microchip and resell the Return Program cartridges.[58] Lexmark sued several of

51. *Id.*
52. *Id.* at 637.
53. *Id.*
54. *Id.*
55. *Impression*, 137 S. Ct. 1523, 1530 (2017).
56. *Id.* at 1529–30.
57. *Id.* at 1530.
58. *Id.*

these "remanufacturers" and eventually settled with all but Impression.[59]

Lexmark argued that Impression infringed Lexmark's patents when Impression refurbished and resold Lexmark's cartridges in express violation of the agreement between Lexmark and its customers.[60] Impression also acquired cartridges from purchasers overseas and imported them into the United States, which Lexmark claimed infringed its patent because it had never permitted their importation.[61] Impression, however, argued that Lexmark's sales of its cartridges exhausted its patent rights so that Impression was free to refurbish, resell and—for those cartridges acquired abroad—import them.[62]

The Supreme Court agreed with Impression, ruling that "a patentee's decision to sell a product exhaust[ed] all of its patent rights in that item, regardless of any restrictions the patentee purports to impose or the location of the sale."[63] This was the case even if the sale had been made by a licensee and not the patentee itself; if the licensee's customers signed a contract agreeing to restrict their use of the product, "the sale nonetheless exhausts all patent rights in the item sold."[64] The Court alluded to the possibility of a contract remedy in that situation, stating that if the purchaser did not comply with the use restriction, "the only recourse for the licensee is through contract law, just as if the patentee itself sold the item with a restriction."[65]

The Court distinguished another case, *General Talking Pictures Corp. v. Western Electric Co.*,[66] which involved a licensee who knowingly made sales unauthorized by its license.[67] It characterized

59. *Id.* ("Eventually, the lawsuit was whittled down to one defendant, Impression Products, and one defense: that Lexmark's sales, both in the United States and abroad, exhausted its patent rights in the cartridges, so Impression Products was free to refurbish and resell them, and to import them if acquired abroad."); Michele Korkhov & Anna Marienko, *Impression Products v. Lexmark International*, LEGAL INFO. INST., https://www.law.cornell.edu/supct/cert/15-1189 (last visited Dec. 17, 2020) ("In 2010, Lexmark sued Impression Products and several other re-manufacturers for direct and contributory patent infringement under 35 U.S.C. § 271. The only defendant remaining in this case is Impression Products.")

60. *Impression*, 137 S. Ct. at 1530.

61. *Id.*

62. *Id.*

63. *Id.* at 1529.

64. *Id.* at 1535.

65. *Id.*

66. 305 U.S. 124 (1938).

67. *Id.* at 126.

that case as standing for the "modest principle that, if a patentee has not given authority for a licensee to make a sale, that sale cannot exhaust the patentee's rights."[68] The *Impression* opinion differentiated authorized sales from unauthorized ones, noting that, '[o]nce a patentee decides to sell—whether on its own or through a licensee—that sale exhausts its patent rights, regardless of any post-sale restrictions the patentee purports to impose, either directly or through a license."[69] Accordingly, a patentee could not use licenses to impose post-sale restraints upon purchasers.[70]

The *Impression* decision clarified that a patentee who sells a product could not enforce a contractual reuse or resale restriction with an infringement lawsuit. In doing so, the Court rejected a significant Federal Circuit court decision, *Mallinckrodt, Inc. v. Medipart Inc.*,[71] which permitted post-sale use restrictions of a patented item.[72] In *Mallinckrodt*, the Federal Circuit held that a "single use only" restriction was enforceable even after the first sale of the item.[73] The Supreme Court in *Impression* stated that the Federal Circuit had "got off on the wrong foot" by relying upon *Mallinckrodt*.[74] The Federal Circuit believed that the exhaustion doctrine was a presumption about the authority of the purchaser to use a patented item; thus, that presumption would be inapplicable if the patentee withheld some of rights to use the item.[75] The Supreme Court disagreed, stating that patent exhaustion is "not a presumption about the authority that comes along with a sale; it is instead a limit on the 'scope of the *patentee's rights*.'"[76]

Furthermore, the Court made clear that its analysis applied to copyright as well as patent first sale, stating that "differentiating the patent exhaustion and copyright first sale doctrines would make little theoretical or practical sense: The two share a 'strong similarity . . . and identity of purpose.'"[77] The Copyright Act's first sale doctrine

68. *Impression*, 137 S. Ct. at 1535.
69. *Id.* at 1535.
70. *Id.* at 1534–35.
71. 976 F.2d 700 (Fed. Cir. 1992), *abrogated by Impression*, 137 S. Ct. 1523 (2017).
72. *Id.* at 709.
73. *Id.*
74. *Impression*, 137 S. Ct. at 1533.
75. *Id.* at 1533–34 (citing Lexmark Int'l, Inc. v. Impression Prods., Inc., 816 F.3d 721, 734, 742, *rev'd*, 137 S. Ct. 1523 (2017)).
76. *Id.* at 1534 (quoting United States v. Gen. Elec. Co., 272 U.S. 476, 489 (1926)).
77. *Id.* at 1536 (quoting Bauer & Cie v. O'Donnell, 229 U.S. 1, 13 (1913)).

permits "the owner of a particular copy or phonorecord lawfully made . . . without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord."[78]

The *Impression* case limits the patentee's ability to control the purchaser's use of a product post-sale. The Court also clearly indicated that the case was not limited to patent first sale, but also applied to copyright first sale, thus implicating a much wider swath of goods and services.[79]

Impression involved a product that was sold and one that did not contain licensed components. Significantly, the Supreme Court decision applied only to *post-sale* restrictions. The Supreme Court suggested that patent exhaustion may not apply to situations where a patented item was distributed pursuant to a license, or where the sale was unauthorized, as in *General Talking Pictures*.[80] Consequently, the case did not resolve the fundamental question regarding whether (and to what extent) owners could use a contract to shape the nature of the rights they transferred. The significance and future impact of *Impression* may be greatly limited if a patentee (or copyright holder) is permitted to achieve through licensing what it could not through a sale.

Impression was a case about patent exhaustion and international sales, so the Supreme Court only glossed over the contract issues. Those contract issues were squarely confronted in a different case that also involved Lexmark and a contractual prohibition against the reuse of cartridge. In *Arizona Cartridge Remanufacturers Association Inc. v. Lexmark International Inc.*,[81] the Ninth Circuit Court of Appeals considered the validity of Lexmark's "Prebate" program contract.[82] Lexmark required its customers to select one of two types of printer cartridges.[83] Apparently the only differentiating factor between the two was that the Prebate cartridges cost less and contained terms that purported to restrict the consumers' use of the cartridge.[84] The

78. 17 U.S.C. § 109(a) (2018).

79. *See Impression*, 137 S. Ct. at 1536.

80. *Id.* at 1538. *See generally* Gen. Talking Pictures Corp. v. W. Elec. Co., 305 U.S. 124 (1938).

81. 421 F.3d 981 (9th Cir. 2005).

82. *Id.* at 984–85. The "Prebate" program was later renamed the Return Program. *See* Lexmark Int'l., Inc. v. Ink Tech. Printer Supplies, LLC, No. 1:10-CV-564, 2014 WL 1276133, at *1 (S.D. Ohio Mar. 27, 2014), *rev'd*, 816 F.3d 721 (Fed. Cir. 2016), *rev'd*, 137 S. Ct. 1523 (2017).

83. *Arizona Cartridge*, 421 F.3d at 983–84.

84. *Id.*

customer did not sign an actual contract; rather, the terms were printed across the top of the cartridge box so that the customer could not avoid seeing them.[85] The terms stated that the customer accepted them by opening the package; rejecting the terms required returning the unopened package to the place of purchase.[86] The plaintiffs, who remanufactured printer cartridges for reuse, sued Lexmark claiming that it engaged in deceptive and unfair business practices when it told customers that they had to honor the post-sale restrictions on the cartridge package.[87] The plaintiffs argued that Lexmark could only impose such a restriction with a valid contract, which the Prebate contract was not.[88]

The Ninth Circuit disagreed and affirmed the lower court's finding of enforceability.[89] In addressing the validity of the contract, the court cited California Commercial Code, which adopted the UCC provision, which permits a contract to be formed "in any manner sufficient to show agreement . . . . even though the moment of its making is undetermined."[90] Interestingly, in a footnote, the court of appeals stated that its holding did not "preclude challenges to the contract" which could be raised by a customer who was a party to the contract—which the plaintiffs were not.[91]

B. The Nature of the Restrictions Distinguishes a License from a Sale

Perhaps not surprisingly, given the presence of Silicon Valley and Hollywood within its jurisdiction, the Ninth Circuit has been particularly active in hearing cases involving the license v. sale quandary in the context of copyright first sale.

In the first significant Ninth Circuit case on this topic, *United States v. Wise*,[92] the defendant operated a business which sold copyrighted feature-length motion picture and prints.[93] The movie

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85. *Id.*
86. *Id.*
87. *Id.* at 984.
88. *Id.* at 987.
89. *Id.* at 988 (reasoning that consumers "(1) have notice of the condition, (2) have a chance to reject the contract on that basis and (3) receive consideration in the form of a reduced price in exchange for the limits placed on reuse of the cartridge").
90. CAL. COM. CODE § 2204(1) (Deering 2020).
91. *Arizona Cartridge*, 421 F.3d at 988 n.8.
92. 550 F.2d 1180 (9th Cir. 1977).
93. *Id.* at 1183.

studios that owned the copyright to the films did not sell them but licensed their use for limited purposes and for limited periods of time to movie theatres, airlines, private groups and members of the motion picture industry.[94] The license agreements pursuant to which these films were distributed generally reserved title in the studios and contained restrictions, including their return after the expiration of the license period, prohibition on copying of the prints, and, in some cases, limiting the print to personal use.[95] The court stated that with respect to the films that were the subject of the agreements, "[n]one of the films had been subject to an outright sale,"[96] meaning there was no payment in exchange for the films.

The court noted that before the first sale doctrine could be applied, a "transfer of title" must have occurred rather than "mere possession."[97] In determining whether the transactions were "sales" for purposes of the first sale doctrine, the court considered several factors, including their designation as licenses, the purported transfer of only limited rights for a limited purpose and period of time, the reservation of title in the studio, prohibitions on copying, and the requirement of return at the end of the contract term.[98] It concluded that most of the contracts "were consistent with the theory of a limited license and inconsistent with the concept of a sale."[99] The court took special note of two agreements with similar provisions. The first agreement contained a provision that "Licensor may *buy* from NBC" prints made at a mutually agreed upon price; if no price was reached, NBC agreed to destroy the prints.[100] It also contained a provision that the licensor retained title to the prints.[101] The court concluded that the agreement indicated that the transaction was a license and not a sale.[102] The court came to a different conclusion with respect to the second agreement (that was not labeled as a license) because although it also contained a provision regarding the return of prints, it contained no provision regarding the retention of title by the licensor.[103] More

94. *Id.* at 1184.
95. *Id.*
96. *Id.*
97. *Id.* at 1187.
98. *Id.* at 1190–91.
99. *Id.* at 1191.
100. *Id.*
101. *Id.*
102. *Id.*
103. *Id.*

importantly, it contained a provision that "[a]t ABC's election and cost a file-screening copy shall be retained."[104] The court found that the provision "clearly contemplates the sale of a film print to ABC at ABC's election."[105] Prints that were loaned to actors subject to agreements that contained personal use restrictions, prohibited copying, and reserved rights to the studio were also considered licenses, not sales.[106] An exception was an agreement between Warner Brothers and the actress, Vanessa Redgrave.[107] That agreement provided that Redgrave would pay for the print but contained a provision that the print was for her "personal use and enjoyment" only, must remain in her possession, could not be "sold, leased, licensed or loaned," and could not be reproduced.[108] The court stated that while the payment provision alone did not establish a sale, together with the rest of the agreement, the transaction "strongly" resembled a sale with use restrictions.[109]

The Ninth Circuit revisited the license v. sale issue in three cases often referred to as the "*MAI* trio," which involved whether customized software was licensed or sold for the purposes of the essential step defense under the Copyright Act.[110] The essential step defense permits the owner of a copy of a software program to make a copy of a program as an "essential step in the utilization of the computer program" or for "archival purposes."[111] The Ninth Circuit distinguished a license from a sale based upon the nature of the restrictions imposed by the agreement.[112] If the agreement imposed significant restrictions, the software was deemed licensed and not sold.[113] Accordingly, the first sale doctrine did not apply. The *MAI* trio

104. *Id.*
105. *Id.*
106. *Id.* at 1192.
107. *Id.*
108. *Id.*
109. *Id.*
110. *See* Wall Data Inc. v. L.A. Cty. Sheriff's Dep't, 447 F.3d 769 (9th Cir. 2006); Triad Sys. Corp. v. Se. Express Co., 64 F.3d 1330 (9th Cir. 1995); MAI Sys. Corp. v. Peak Comput., Inc., 991 F.2d 511 (9th Cir. 1993).
111. 17 U.S.C. § 117(a)(1)–(2) (2018); *see also* Krause v. Titleserv, Inc., 402 F.3d 119, 122 (2d Cir. 2005) (noting that an owner may copy software as an essential step in using the program).
112. *See Wall Data Inc.*, 447 F.3d at 785; *Triad Sys. Corp.*, 64 F.3d at 1337; *MAI Sys. Corp.*, 991 F.2d at 517.
113. *See Wall Data Inc.*, 447 F.3d at 785; *Triad Sys. Corp.*, 64 F.3d at 1333; *MAI Sys. Corp.*, 991 F.2d at 517.

became the foundation upon which the Ninth Circuit decided a spate of subsequent cases in 2010 and 2011.

In *Vernor v. Autodesk, Inc.*,[114] Vernor purchased used copies of Autodesk's software and resold them on eBay.[115] He sought a declaratory judgment that by doing so, he was not infringing upon Autodesk's copyright.[116] The district court agreed, holding that "Vernor's sales were lawful" under "the first sale doctrine and the essential step defense" of the Copyright Act.[117] The Ninth Circuit, however, disagreed, holding that a software user is a licensee rather than the owner of a copy where the copyright owner "(1) specifies that the user is granted a license; (2) significantly restricts the user's ability to transfer the software; and (3) imposes notable use restrictions."[118]

In a subsequent case, *UMG Recordings, Inc. v. Augusto*,[119] the Ninth Circuit noted the distinction between a transfer of title and transfer of possession—and hinted that software may be different from other goods.[120] That case involved promotional music compact discs (CDs) distributed by the music company, UMG.[121] The CDs were distributed without seeking payment.[122] Some of the CDs contained a statement indicating that the license was for personal use only, prohibiting transfer or resale, and stating that acceptance of the CD constituted acceptance of the terms of the "license."[123] Other CDs simply contained a "Promotional Use Only—Not for Sale" label.[124] UMG did not send Augusto the CDs, but he managed to acquire them and then sold them online.[125] UMG sued, alleging copyright infringement.[126] Augusto argued that the first sale doctrine permitted him to sell or transfer the CDs without permission from UMG.[127] UMG argued that the first sale doctrine did not apply because the promotional statement meant that the recipients were licensees and not

114. 621 F.3d 1102 (9th Cir. 2010).
115. *Id.* at 1103.
116. *Id.*
117. *Id.*
118. *Id.* at 1111.
119. 628 F.3d 1175 (9th Cir. 2011).
120. *Id.* at 1180.
121. *Id.* at 1177.
122. *Id.*
123. *Id.* at 1177–78.
124. *Id.* at 1178.
125. *Id.*
126. *Id.*
127. *Id.* at 1179.

owners of the CDs.[128] The court disagreed, stating that "[n]otwithstanding its distinctive name, the [first sale] doctrine applies not only when a copy is first sold, but when a copy is given away or title is otherwise transferred without the accouterments of a sale."[129]

The court, citing its decisions in *Vernor* and the *MAI* trio, noted that "[p]articularly with regard to computer software" a transfer of possession of a copy did not necessarily entail a transfer of title.[130] However, UMG did not keep track of the CDs and entitled the recipients to use or dispose of them as they liked.[131] Significantly, under 39 U.S.C. § 3009, the CDs were unordered merchandise and the recipients had the right to treat them as gifts without any obligation to the sender.[132] Because the recipients of the CDs could transfer them under the federal statute, they were owners and not licensees for purposes of the first sale defense.[133] According to the court, the effect of the unordered merchandise statute distinguished the case from *Vernor* and the *MAI* trio.[134]

The court noted that other factors weighed against finding a license. The "Promotional Use Only—Not for Sale" restriction did not identify itself as a license.[135] Even the longer notice was insufficient in the court's view.[136] That version stated as follows:

> This CD is the property of the record company and is licensed to the intended recipient for personal use only. Acceptance of this CD shall constitute an agreement to comply with the terms of the license. Resale or transfer of possession is not allowed and may be punishable under federal and state laws.[137]

Interestingly, the court did not mention another case, *MDY Industries, LLC v. Blizzard Entertainment, Inc.*,[138] which was argued

128. *Id.*
129. *Id.*
130. *Id.* at 1180.
131. *Id.*
132. *Id.* at 1180–81.
133. *Id.* at 1181.
134. *Id.*
135. *Id.* at 1182.
136. *Id.*
137. *Id.*
138. 629 F.3d 928 (9th Cir. 2010). Both *UMG Recordings* and *Blizzard* were argued and submitted on June 7, 2010.

on the same day before the Ninth Circuit.[139] MDY developed and sold a software program that automatically played the early levels of the popular role-playing computer game, World of Warcraft (WoW).[140] Citing *Vernor*, the Ninth Circuit held that WoW players were licensees because Blizzard reserved title in the software, granted players a non-exclusive limited license, and imposed significant transfer and use restrictions.[141]

Finally, in *F.B.T. Productions, LLC v. Aftermath Records*,[142] the Ninth Circuit addressed the issue of whether iTunes downloads were licensed or sold.[143] In 1998, the parties entered into a contract that required F.B.T. to transfer the exclusive rights to the musician Eminem's recordings to Aftermath.[144] In a contractual provision that the parties referred to as the "Records Sold provision," the parties agreed that Aftermath was to pay F.B.T. 12 to 20 percent of the adjusted retail price for all "full price records sold in the United States . . . through normal retail channels."[145] Another provision, which the parties referred to as the "Masters Licensed" provision, stated that "[n]otwithstanding the foregoing," Aftermath would pay F.B.T. "50% of Aftermath's net receipts '[o]n masters licensed by us . . . to others for their manufacture and sale of records or for any other uses.'"[146] In 2002, Aftermath entered into an agreement with Apple, which allowed the Eminem masters to be sold as permanent downloads through the iTunes store.[147] Aftermath entered into other contracts with cell phone carriers to sell ringtones.[148] After a 2006

139. *See id.* at 929; *UMG Recordings, Inc.*, 628 F.3d at 1175.

140. *Blizzard*, 629 F.3d at 934–35.

141. For example, if a player transferred the license, the player must transfer all packaging, permanently delete the game client, and transfer only to someone willing to accept the end user license agreement. The software was only for non-commercial use and Blizzard was able to remotely alter the game client and terminate the license in the event the terms were violated. Termination of the license required the immediate destruction of all copies of the game and the removal of the game client from computers. *Id.* at 938–39.

142. 621 F.3d 958 (9th Cir. 2010).

143. *Id.* at 961.

144. *Id.*

145. *Id.* at 961.

146. *Id.* (alterations in original).

147. *Id.* at 962. The agreement was actually between Aftermath's parent company and Apple. Aftermath's parent company, UMG Recordings, Inc., was also a defendant in the lawsuit. For the sake of simplicity, I will refer to the defendants as Aftermath.

148. In 2003, F.B.T. and Aftermath entered into a new agreement that replaced the 1998 agreement. The 2003 agreement retained the wording of the 1998 contract with respect to the royalty rates for records and masters. The parties amended the agreement in 2004 to include a

audit showed that Aftermath had been calculating permanent downloads under the Records Sold provision (with a royalty rate of 12 to 20 percent of the adjusted retail price), F.B.T. sued, arguing that the applicable royalty rate should be that specified under the Masters Licensed provision (50 percent of net receipts).[149] Aftermath argued that the permanent downloads should be calculated pursuant to the Records Sold provision.[150]

In order to determine whether the Masters Licensed provision applied, the court had to decide whether Aftermath licensed the Eminem masters.[151] The Ninth Circuit noted the distinction between license and sale under federal copyright law:

> When one looks to the Copyright Act, the terms "license" and "sale" have well differentiated meanings, and the differences between the two play an important role in the overall structures and policies that govern artistic rights. For example, under the language of the Act and the Supreme Court's interpretations, a "sale" of a work may either be a transfer in title of an individual copy of a work, or a sale of all exclusive intellectual property rights in a work.[152]

It concluded that Aftermath "did not 'sell' anything" to Apple and other download distributors because the distributors "did not obtain title to the digital files."[153] On the contrary, Aftermath retained the digital files, reserved the right to regain possession of them, and obtained recurring payments based on the volume of downloads.[154] It added that under Ninth Circuit cases interpreting and applying federal copyright law, including the *MAI* trio, "where a copyright owner transfers a copy of copyrighted material, retains title, limits the uses to which the material may be put, and is compensated periodically based on the transferee's exploitation of the material, the transaction is a license."[155]

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provision that "Sales of Albums by way of permanent download shall be treated as [U.S. Normal Retail Channel] Net Sales for the purposes of escalations." *Id.* (alteration in original).

149. *Id.*

150. *Id.*

151. *Id.* at 964.

152. *Id.* at 964–65.

153. *Id.* at 965.

154. *Id.*

155. *Id.*

The Ninth Circuit implicitly acknowledged a difference between the permanent downloads, which remained on the end user's computer and were "sold," and the masters, which were "licensed."[156] It stated that the agreement between Apple and Aftermath enabled the Eminem masters "to be sold" as permanent downloads.[157] It wrote that the agreement was one of several that Aftermath entered into to "sell sound recordings in digital formats" and to "sell sound recordings as mastertones."[158]

These Ninth Circuit cases do not provide a bright-line test but set forth criteria to assess whether a transfer of physical possession or a grant of access to a copyrighted item is a license or a sale.[159] Contractual language identifying the transaction as a license instead of a sale is helpful but not determinative; what is crucial is *when* the contract was presented and the *nature of the restrictive provisions*. Part III delves further into the swirl of contractual issues involved in license-sale transactions.

III. CONTRACTUAL ISSUES AT THE HEART OF THE LICENSE V. SALE DILEMMA

As this Part III explains, the license v. sale question requires (i) determining whether the agreement was properly formed and (ii) assessing whether the licensing restrictions are drafted as conditions or covenants.

A. Adhesive Forms to Protect Self-Replicating Innovations

As previously discussed, an adhesive contract may be formed after the acts typically constituting the transaction have been performed. At least in some cases, a rolling contract (also known as a "pay-first-terms-later") is used to prevent opportunistic[160] buyers from knowingly exploiting a product in ways that diminish economic gains

156. *Id.* at 962.
157. *Id.*
158. *Id.*
159. *See also* Universal Instruments Corp. v. Micro Sys. Eng'g, Inc., 924 F.3d 32, 45 (2d Cir. 2019) (noting that MSEI was an owner of the station and server source code because it was not restricted from "discarding or disposing of the software as it wished").
160. I use the term "opportunistic" to mean that the buyer is acting in a way that it knows the seller does not approve in order to obtain a benefit that was not part of the express bargain between the parties.

for the seller and deter future innovation.[161] The problem of opportunism looms large for businesses that have invested substantial resources in creating a product.

The Supreme Court addressed the problem of opportunism's effect on innovation in *Bowman v. Monsanto Co.*,[162] a case involving Roundup Ready soybean seeds that were genetically modified to resist glyphosate-based herbicides.[163] Monsanto invented and patented Roundup Ready seeds and sold them to growers subject to a licensing agreement.[164] The agreement allowed a grower to plant the seeds only for one season.[165] The grower could consume or sell the crop, but it could not save any harvested soybeans for replanting.[166] The restriction prevented growers from producing their own Roundup Ready seed, which would force them to repurchase the seeds each season.[167] Bowman purchased Roundup Ready seeds every year for his first crop of the season.[168] He complied with the terms of the agreement, using the seeds for planting once and then selling his crop to a grain elevator.[169] For the second crop of the season, however, Bowman purchased soybean seeds from a grain elevator, which were cheaper than the premium price of the Roundup Ready seeds.[170] The supply from the grain elevator contained a mix of seeds, and Bowman surmised they included Roundup Ready seeds from local farmers' prior harvests.[171] Bowman sprayed a glyphosate-based herbicide on his crops, and the surviving plants produced the genetically modified

161. *See* Jonathan M. Barnett, *Why Is Everyone Afraid of IP Licensing?*, 30 HARV. J.L. & TECH. 123, 129–30 (2017) (noting four "facts of life" about innovation markets: "First, an innovation cannot earn a positive return unless it is embedded in a viable product delivered at a competitive cost to market. Second, successful commercialization requires that some entity place at risk significant capital and expertise. Third, the innovator is often not the individual or entity best suited to undertake the commercialization process. Fourth, in the vast majority of cases, any IP-protected asset faces competition from actual or potential substitutes, in which case it is the market, not the IP holder, that sets the terms of exchange . . . ."). The first two factors tend to be the most relevant considerations in assessing the effect of opportunism on innovation.

162. 569 U.S. 278 (2013).

163. *Id.* at 280–81.

164. *Id.* at 281.

165. *Id.*

166. *Id.*

167. *Id.*

168. *Id.*

169. *Id.* at 281–82.

170. *Id.* at 282.

171. *Id.*

Roundup Ready seeds.[172] He replanted the seeds and grew more crops producing Roundup Ready seeds.[173] When Monsanto learned what Bowman was doing, it sued on the grounds of patent infringement.[174] Bowman raised the defense of patent exhaustion, claiming that the seeds were the product of a prior authorized sale.[175] The Federal Circuit rejected Bowman's argument and the Supreme Court affirmed.[176]

The Supreme Court decision in *Monsanto* did not resolve the license v. sale issue even though that issue is arguably the most significant one looming over the case. The Court addressed the license agreement only in passing, noting that it gave the purchaser the right to plant the seed and harvest and market one crop of beans.[177] The Court employed the language of "sale" when referring to the transaction, but one that required compliance with the terms of a "license agreement."[178] In other words, the transaction involved the sale of a licensed product. Accordingly, the licensed product should be subject to the first sale doctrine, meaning that Monsanto's patent rights terminated with respect to that item.[179] Ordinarily, this poses no problem. A buyer who purchases a patented item may resell that specific item, but it may not make that item (or a duplicate) and sell it. The *Monsanto* case, however, involved a self-replicating product.[180] The Court stated that the patent exhaustion doctrine only applied to the item sold and did not affect the patentee's right to prevent a purchaser from making new copies of the patented item.[181] Accordingly, the patent exhaustion doctrine did not permit the purchaser to recreate or construct a new product.[182] The Court

172. *Id.*
173. *Id.*
174. *Id.*
175. *Id.* at 282–83.
176. *Id.* at 283.
177. *Id.* at 285 n.3.
178. *Id.*
179. *See* Quanta Comput., Inc. v. LG Elecs., Inc., 553 U.S. 617, 625 (2008) ("The longstanding doctrine of patent exhaustion provides that the initial authorized sale of a patented item terminates all patent rights to that item.").
180. PERZANOWSKI & SCHULTZ, *supra* note 1, at 163 (discussing the problem of self-replicating technologies and the *Bowman v. Monsanto* case, observing that "patent exhaustion has also been complicated by technological advances, and in particular technologies where reproduction or replication is simple or even self-executing").
181. *Bowman*, 569 U.S. at 284.
182. *Id.*

concluded that, by replanting the seeds and growing plants from which he could harvest additional patented soybeans, Bowman was "making" Monsanto's patented invention.[183] It reasoned that any other conclusion would provide Monsanto with "scant benefit," in that, after receiving payment for the initial sales of its Roundup Ready seeds, growers could simply reproduce the seed themselves.[184] Monsanto would not profit from its investment in the seeds, undermining the incentive for innovation, which is the objective of the Patent Act.[185] Bowman knew what the conditions of sale were, valued Monsanto's invention, received the benefit from the invention, and yet, "devised a less orthodox approach" because he "did not want to pay the premium price that Monsanto charges for Roundup Ready seed."[186] In other words, in the Court's view, Bowman was an opportunistic buyer, and his opportunism threatened the economic investment in innovation made by Monsanto.[187]

An opportunistic buyer threatened a business's investment in a reproducible innovation in an earlier, and possibly even more consequential, case. *ProCD, Inc. v. Zeidenberg*[188] had nothing to do with patent exhaustion but caused a seismic change in the way courts viewed assent to standard form contracts. ProCD created a computer database containing information from thousands of telephone directories.[189] It made two versions of the software, one for sale to the trade and the other, which was lower-priced, for sale to the general public for personal use.[190] The software package that was sold to the general public contained a shrinkwrap license agreement, which restricted use of the software for "non-commercial purposes" only.[191] Matthew Zeidenberg purchased a package of ProCD software.[192] Despite knowing that the agreement prohibited it, he formed a company to copy and sell copies of the software on his own website at a lower price than ProCD itself charged.[193] ProCD sued to enforce

183. *Id.* at 284–85.
184. *Id.* at 285.
185. *See id.* at 285–87.
186. *Id.* at 282.
187. *Id.* at 287.
188. 86 F.3d 1447 (7th Cir. 1996).
189. *Id.* at 1449.
190. *Id.*
191. *Id.* at 1450.
192. *Id.*
193. *Id.*

the contract.[194] Zeidenberg argued that because the terms were contained in the box, and inaccessible until after the purchase was completed, the agreement did not bind him.[195] The Seventh Circuit Court of Appeals disagreed, finding that Zeidenberg had notice that terms governed the transaction prior to purchase and, after purchase, he had an opportunity to read the terms. Accordingly, he would be deemed to have accepted the terms if he failed to return the software.[196]

Judge Easterbrook's opinion focused on Zeidenberg's opportunism and the way that it detrimentally affected ProCD's ability to capitalize on its investment. Zeidenberg was fully aware of the restrictions on copying; he not only chose to ignore them, but he created a company to exploit and profit from ProCD's investment.[197] Zeidenberg paid only $150 for each set of five discs.[198] By contrast, ProCD had invested more than $10 million to compile and maintain the software.[199] The court noted that ProCD engaged in a price differentiation strategy that ultimately benefited consumers.[200] Arguably, *ProCD* helped foster the development of mass consumer software products by creating a precedent that provided greater protection for a business's investment in innovation from opportunistic purchasers.

Unfortunately, *ProCD* also upended the existing law of contract formation and paved the way for opportunism, this time from businesses with the power to draft adhesive contracts with one-sided terms. Rolling contracts, such as the one in *ProCD*, are generally understood to be contractual terms that are attached to a transaction after the acts typically associated with the transaction have been completed.[201] They are generally enforceable if there was notice of

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194. *Id.*

195. *Id.*

196. *Id.* at 1452 ("ProCD proposed a contract that a buyer would accept by *using* the software after having an opportunity to read the license at leisure.").

197. *Id.* at 1450.

198. *Id.* at 1449.

199. *Id.*

200. *Id.* ("If ProCD had to recover all of its costs and make a profit by charging a single price—that is, if it could not charge more to commercial users than to the general public—it would have to raise the price substantially over $150.").

201. *See* Robert A. Hillman, *Rolling Contracts*, 71 FORDHAM L. REV. 743, 744 (2002) (describing a rolling contract as one where the "consumer orders and pays for goods before seeing most of the terms, which are contained on or in the packaging of the goods").

terms prior to the transaction and an opportunity to reject them after the transaction. For example, *Norcia v. Samsung Telecommunications America, LLC*[202] involved a brochure containing an arbitration agreement that was contained within a box and that could not be accessed without opening the package after purchase.[203] The court in that case concluded that silence could not constitute acceptance where nothing on the outside of the packaging indicated that opening the box meant acceptance of terms contained in the box.[204] By contrast, the court in *Arizona Cartridge*, found consumers accepted license terms printed on the outside of a printer cartridge box by opening it.[205]

B. The Importance of Specific Language in Contract Formation

Because some wrap contracts,[206] such as browsewraps and shrinkwraps, are unsigned, their formation depends on whether the recipient manifested assent after receiving reasonable notice. Precise wording may determine whether a contract was validly formed and thus, whether the license terms are binding. In *Disney Enterprises, Inc. v. Redbox Automated Retail, LLC*,[207] the court emphasized the language of reasonable notice.[208] Disney offered films on "Combo Packs," which contained a Blu-Ray disc, a digital versatile disc (DVD), and a piece of paper with an alphanumeric code.[209] The code, which could be redeemed at RedeemDigitalMovies.com or DisneyM oviesAnywhere.com, permitted the user to stream and download the movie.[210] On the outside and bottom third of the Combo Pack box, the print stated, "Codes are not for sale or transfer."[211] In "[v]ery fine

202. 845 F.3d 1279 (9th Cir. 2017).

203. *Id.* at 1281–82.

204. *Id.* at 1287.

205. Ariz. Cartridge Remanufacturers Ass'n, Inc. v. Lexmark Int'l Inc., 421 F.3d 981, 987–88 (9th Cir. 2005). Furthermore, the court stated that customers were provided consideration in the form of a reduced price. *Id.* at 985.

206. Wrap contract is the general term I use to refer to shrinkwraps, clickwraps, browsewraps, and other contract forms that are unilaterally imposed upon the adherent and that do not require a signature in order to be binding. *See* KIM, *supra* note 23, at 2–3 (defining a "wrap contract" as a "blanket term to refer to a unilaterally imposed set of terms which the drafter purports to be legally binding and which is presented to the nondrafting party in a nontraditional format. . . . the adhering party does not have to use a pen in order to accept the terms"); *see also* MICHAEL L. RUSTAD, GLOBAL INTERNET LAW 186–95 (2d ed. 2016) (discussing different types of wrap contracts).

207. No. CV 17-08655 DDP (AGRx), 2018 WL 1942139 (C.D. Cal. Feb. 20, 2018).

208. *Id.* at *3.

209. *Id.* at *1.

210. *Id.*

211. *Id.*

print" at the bottom of the box, it stated that "Terms and Conditions apply" to the "Digital HD."[212] The download code insert stated that "Codes are not for sale or transfer."[213]

The Redeem Digital Movie website stated that the user "represents that [he] is the owner of the physical product that accompanied the digital code at the time of purchase. The redemption of a digital code sold or transferred separate from the original physical product is prohibited."[214]

The Movies Anywhere Terms of Use stated that the consumer "can enter authorized . . . Digital Copy codes from a Digital Copy enabled . . . physical product that is owned by [that consumer]."[215] They also stated that the "sale, distribution, purchase, or transfer of Digital Copy codes . . . is strictly prohibited."[216] Thus, the member was granted a "limited, personal use, non-transferable, non-assignable, revocable non-exclusive and non-sublicensable right" to use the service and restricted the right to copy the copyright works in accordance with the terms of service.[217]

Redbox, the defendant, purchased Combo Packs and removed the digital download codes, placed them into their own Redbox packaging, and offered them for sale at Redbox kiosks.[218] Disney sued, seeking a preliminary injunction to stop Redbox from offering standalone digital codes.[219] It argued that Redbox entered into the contract when it purchased the Combo Packs that contained terms on the outside, which stated that "Codes are not for sale or transfer."[220] The court denied Disney's motion based on the specific language printed on the outside of the Combo Pack boxes,[221] stating: "The phrase 'Codes are not for sale or transfer' cannot constitute a shrink wrap contract because . . . Disney's Combo Pack box makes no

212. *Id.*
213. *Id.*
214. *Id.* at *2 (alteration in original).
215. *Id.* (alteration in original).
216. *Id.* (alteration in original).
217. *Id.*
218. *Id.*
219. *Id.*
220. *Id.* at *3.
221. *Id.* at *1.

suggestion that opening the box constitutes acceptance of any further license restrictions."[222]

The court differentiated the box-top license language in *Arizona Cartridge*, because Lexmark

> not only provided consumers with specific notice of the existence of a license and explicitly stated that opening the package would constitute acceptance, but also set forth the full terms of the agreement, including the nature of the consideration provided, and described a post-purchase mechanism for rejecting the license. Here, in contrast, Disney relied solely upon the phrase "Codes are not for sale or transfer" to carry all of that weight.[223]

The court criticized "similarly assertive but unquestionably non-binding language" on the boxes.[224] In particular, it noted that the language that "[t]his product . . . cannot be resold or rented individually" was "demonstrably false" because it violated the Copyright Act's first sale doctrine.[225] Accordingly, the "clearly unenforceable 'cannot be resold individually' language conveys nothing so much as Disney's preference about consumers' future behavior, rather than the existence of a binding agreement. At this stage, it appears that the accompanying 'Not For Sale or Transfer' language plays a similar role."[226]

Finally, the court indicated that Disney engaged in copyright misuse because it did not have the power to prevent consumers from selling or transferring the Blu-Ray discs or DVDs, yet the license agreements of both Redeem Digital Movies and Movies Anywhere assumed it did, and prohibited purchasers of Combo Packs from accessing the digital movie content even though they had already paid for it.[227]

222. *Id.* at *4 (citing Norcia v. Samsung Telecommc'ns. Am., LLC, 845 F.3d 1279, 1284 (9th Cir. 2017)).
223. *Id.*
224. *Id.* at *5.
225. *Id.* (alteration in original).
226. *Id.*
227. *Id.* at *6.

The court also addressed the first sale doctrine as it related to the transaction but found it was inapplicable.[228] Redbox argued "Disney's attempts to prohibit transfer of digital download codes [were] barred by the first sale doctrine."[229] Disney, on the other hand, argued that the first sale doctrine was inapplicable because the digital download codes were not "copies" until they were fixed on a downloader's hard drive.[230] According to Disney, the transaction involved the exclusive right to reproduce copyrighted work, not the right of distribution.[231] The court agreed, finding that "Disney appears to have sold something akin to an option to create a physical copy at some point in the future."[232] It concluded that, because there was no "particular, fixed copy of a copyrighted work" at the time Redbox purchased the download code, the first sale doctrine did not apply.[233]

Subsequently, Disney changed the language on its Combo Pack boxes.[234] The front of the box indicated that it contained a "Digital Code."[235] The back of the box stated in large print, "Digital Code Included*."[236] The asterisk corresponded to a textbox at the bottom of the package, which stated in all-capitalized but smaller text, "Digital code redemption requires prior acceptance of license terms and conditions. Codes only for personal use by recipient of this combination package or family member. Digital movie code . . . subject to expiration after May 15, 2023."[237] Elsewhere, in smaller type, the packaging stated, "The digital code contained in this package may not be sold separately and may be redeemed only by the recipient of this combination package or a family member. Visit MoviesAnyw here.com, RedeemDigitalMovie.com, and disneytermsofuse.com for

228. *Id.* at *7 (stating that "the issues presently before the court can be resolved irrespective of the first sale doctrine question. Indeed, at this stage of proceedings, it appears to the court that the first sale doctrine is not applicable to this case").

229. *Id.*

230. *Id.*

231. *Id.* ("Thus, Disney contends, this case is solely about the exclusive right to reproduce a copyrighted work, and has nothing to do with the right of distribution or, by extension, the first sale doctrine's limitation on that exclusive right.").

232. *Id.* at *9.

233. *Id.*

234. Disney Enters., Inc. v. Redbox Automated Retail, LLC, 336 F. Supp. 3d 1146, 1150 (C.D. Cal. 2018).

235. *Id.*

236. *Id.*

237. *Id.* (alteration in original).

code redemption and other applicable terms and conditions."[238] The paper with the code contained a similar notice and stated, "This digital code is part of a combination package and may not be sold separately" and "Digital code redemption is subject to prior acceptance of license terms and conditions."[239]

Disney also changed the terms of use on the digital download websites.[240] On the RedeemDigitalMovie.com was a pop-up box that stated that the digital movie codes were owned by Disney and could not be sold separately from the original combination package.[241] It also stated that the codes could be used "to obtain licensed access to digital movies only as specifically authorized" under the terms and conditions.[242] The Movies Anywhere Terms of Use stated that a license to download or stream content did not create an ownership interest; that users would not redeem an unauthorized digital code; and that by redeeming a digital code, the user was representing that the user obtained the code in an original package and did not purchase the code separately and that the "representation is a condition of redemption."[243] In addition, the consumer was required to redeem the code by clicking in order to view the content.[244]

Disney then renewed its motion for a preliminary injunction against Redbox.[245] It alleged that Redbox customers who purchased a Disney code from Redbox violated Disney's copyright because they were essentially making a false representation that they did not obtain the Code separate from the Combo Pack.[246] Accordingly, any download using the code was unauthorized and infringed Disney's copyright, and Redbox was contributorily liable for that infringement.[247] The court stated that there was "no dispute" that the language on the download sites imposed significant use restrictions, and it granted Disney's motion.[248] In reaching that conclusion, the court focused on the enforceability of the relevant terms, both on the

238. *Id.*
239. *Id.*
240. *Id.*
241. *Id.*
242. *Id.*
243. *Id.*
244. *Id.*
245. *Id.* at 1151.
246. *Id.*
247. *Id.*
248. *Id.* at 1152.

packaging and on the download sites.[249] But what the court found to be "critically important" was that consumers who did not accept the terms of the digital license could return the Combo Packs for a refund.[250] The court also rejected Redbox's copyright misuse defense.[251] Because digital access was conditioned on the manner of obtaining the digital code, and not on continued possession of the physical discs, there was no copyright misuse.[252] As the court noted, "the right to transfer a separate Code" is not protected by the first sale doctrine.[253]

The court's analysis is somewhat confounding; a simpler way to understand the difference in the two cases involves recognizing the Combo Packs as license-sale transactions (one involving both a sale and a license). The physical discs were sold, while the digital content was licensed, not sold. Combo Pack purchasers did not purchase the slips of paper containing the digital codes; they purchased a license to the digital content. The paper merely directed the purchaser to a website where the purchaser could license the content. Disney retained control over the purchasers' use of the digital content; by contrast, it did not control the purchasers' access to the physical discs after purchase. Disney (through the download websites) retained the power to control the purchasers' access to the digital content. It did not retain the power to control the purchasers' access to the content stored on the physical discs.

Yet, a conclusion that digital content is licensed and not sold should not necessarily lead to a finding that a violation of any contract provision constitutes copyright infringement. In granting Disney's refiled motion for preliminary injunction, the court focused on the specificity of the redrafted language.[254] While the new language did

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249. *Id.* at 1153.

250. *Id.* at 1155.

251. *Id.* at 1157.

252. *Id.* ("Under the old terms, a Combo Pack owner who disposed of the discs was indeed left with a worthless code because continued possession of the discs was a condition of digital access. Now, however, digital access is conditioned not on possession of the discs, but on the manner of Code acquisition. A Combo Pack owner who disposes of the discs is left with the same digital access rights he or she always possessed.").

253. *Id.*

254. *Id.* at 1154. The court stated:

> It is undisputed that Redbox has actual knowledge of the redemption sites' clickwrap terms, which do appear to create a restrictive license. Both sites specify that the user is only granted a license rather than ownership. The RedeemDigitalMovie.com terms state, "You may use digital movie codes to obtain

provide better notice than the original language, the court did not consider whether that new language imposed a *condition* to the license grant or whether it was merely a covenant on the part of the purchaser.[255] The difference is integral to the license v. sale dilemma.

C. Conditions v. Covenants in Patent and Copyright Licenses

Even with valid contract formation, a restrictive licensing clause may not be enforceable, or it may not be enforced the way the licensor expects or desires. For example, in *U.S. Naval Institute v. Charter Communications, Inc.*,[256] the Second Circuit Court of Appeals addressed whether a licensee's premature publication of the paperback edition of a book constituted copyright infringement.[257] The plaintiff, United States Naval Institute ("Naval"), and the defendant, Berkley Publishing Group ("Berkley"), entered into an agreement "made this 14th day of September 1984" that granted Berkley "the exclusive right to publish and reproduce, distribute and sell English-language paperback editions" of the novel *The Hunt for Red October*.[258] Paragraph 2 of the agreement stated that the term of the license "will begin on the date written above" and would continue for at least five years after Berkley's first publication of the book.[259] Paragraph 4 of the agreement stated that "Berkley was to publish the paperback

> licensed access to digital movies only as specifically authorized . . . [,]" and the Movies Anywhere terms refer to a "Copyright License Grant" and state that "[t]he purchase of a license to stream or download any Movies Anywhere Content does not create an ownership interest in the licensed Content." These and other terms restrict downloaders' use or transfer of the digital content.

Id. (alteration in the original).

255. It also skated around but did not directly tackle the issue of digital first sale. In another case, however, the Second Circuit found that the first sale doctrine did not apply to digital media. In *Capitol Records, LLC v. ReDigi Inc.*, 910 F.3d 649 (2d Cir. 2018), ReDigi sought to host an online marketplace for reselling lawfully purchased digital music files. *Id.* at 652. The plaintiff record companies sued, alleging that ReDigi's system infringed their copyrights. *Id.* at 654. On appeal, the court framed the "primary issue" to be "whether ReDigi's system version 1.0 lawfully enables resales of its users' digital files" and found that resales of ReDigi infringed because they violated the plaintiffs' exclusive right of reproduction under 17 U.S.C. § 106(1). *Id.* at 655–64. In so ruling, the Second Circuit agreed with the lower court. *Id.* at 652. The lower court also found that the digital files were not subject to the first sale doctrine because they were not "lawfully made," but the Second Circuit, finding sufficient grounds for affirmance, declined to rule on this issue. *Id.* at 656.

256. 936 F.2d 692 (2d Cir. 1991).

257. *Id.* at 694.

258. *Id.* at 693, 695.

259. *Id.* at 695.

edition 'not sooner than October 1985.'"[260] Berkley shipped the paperback edition early so that retail sales began on September 15, 1985.[261] Naval sought recovery for copyright infringement.[262] Berkley argued that it "could not be held liable for copyright infringement since [it was] the exclusive licensee of the paperback edition copyright as of September 14, 1984."[263] The Second Circuit Court of Appeals agreed, finding that because Berkley was the owner of the right to publish the paperback edition of the book, its early publication could not constitute copyright infringement.[264] It did, however, constitute a breach of contract.[265]

Under the Copyright Act, "[a]n exclusive license granted by the copyright owner constitutes a transfer of ownership of the copyright rights conveyed in the license."[266] But the condition v. covenant distinction is not limited to exclusive licenses. In *Blizzard*, after deciding that WoW players were licensees and not owners of copies of the software, the court addressed the issue of contractual covenants and license conditions.[267] It characterized contractual terms that limited the scope of the license as "conditions," and distinguished them from other terms which were "covenants."[268] Thus, in order for Blizzard to demonstrate that a user committed copyright infringement, it had to demonstrate that the term that the user violated was a condition rather than a covenant.[269]

In order to determine whether a provision is a covenant or a condition, courts look to contract law. In a license v. sale transaction, contract law determines which legal regime—copyright or contract—applies to the underlying claim and thus, whether the claim is for copyright infringement or breach of contract. As the *Blizzard* court explained, "[a] covenant is a contractual promise . . . to act or refrain

260. *Id.*
261. *Id.* at 693.
262. *Id.* at 694.
263. *Id.*
264. *Id.* at 695.
265. *Id.* at 696; *see also* U.S. Naval Inst. v. Charter Commc'ns, Inc., 875 F.2d 1044, 1051 (2d Cir. 1989) (finding that Berkley violated the contractual ban on pre-October 1985 publication).
266. *U.S. Naval Inst.*, 936 F.2d at 695; *see also* 17 U.S.C. § 101 (2018) ("A 'transfer of copyright ownership' is an assignment, mortgage, exclusive license, or any other conveyance . . . of a copyright or of any of the exclusive rights comprised in a copyright, whether or not it is limited in time or place of effect, but not including a nonexclusive license.").
267. MDY Indus., LLC v. Blizzard Ent., Inc., 629 F.3d 928, 939 (9th Cir. 2010).
268. *Id.*
269. *Id.*

from acting in a particular way" while "[a] condition precedent is an act or event that must occur before a duty to perform a promise arises."[270] The *Blizzard* court stated that "[t]o recover for copyright infringement based on breach of a license agreement, (1) the copying must exceed the scope of the defendant's license and (2) the copyright owner's complaint must be grounded in an exclusive right of copyright (e.g., unlawful reproduction or distribution)."[271]

Significantly, it stated that "for a licensee's violation of a contract to constitute copyright infringement, there must be a nexus between the condition and the licensor's exclusive rights of copyright."[272]

Courts generally apply an interpretive preference in favor of finding a covenant rather than a condition where the language is uncertain; this is particularly true where the failure to meet a condition would result in a forfeiture.[273] Consequently, in *Blizzard*, the court found that despite the relevant section being titled "Limitations on Your Use of the Service," the contractual prohibitions against bots and unauthorized third-party software were covenants and not conditions because they did not condition Blizzard's grant of license on the players' compliance to the prohibitions.[274]

D. Ownership Rights and the Limits of Contractual Authority

Although the Supreme Court noted the "historical kinship" between copyright and patent law, as Justice Ruth Bader Ginsburg noted, they are not "identical twins."[275] Their dissimilarities are especially relevant where the license agreement does not give the licensee the right to "sell." A patent gives the patentee the right to

270. *Id.*

271. *Id.* at 940.

272. *Id.* at 941; *see also* Accusoft Corp. v. Quest Diagnostics, Inc., No. 12-cv-40007-TSH, 2015 U.S. Dist. LEXIS 156693, at *72 (D. Mass. Aug. 19, 2015) ("It is settled law in this circuit that uses of a copyrighted work that stay within the scope of a nontransferable license are immunized from copyright claims.").

273. *See Blizzard*, 629 F.3d at 939 (noting that "[c]onditions precedent are disfavored because they tend to work forfeitures" and "[w]herever possible, equity construes ambiguous contract provisions as covenants rather than conditions"); *see also* Richard F. Kline, Inc. v. Shook Excavating & Hauling, Inc., 885 A.2d 381, 388 (Md. Ct. Spec. App. 2005) ("Whether a provision in a contract constitutes a condition precedent is a question of 'construction, dependent on the intent of the parties to be gathered from the words they have employed and, in case of ambiguity, after resort to the other permissible aids to interpretation.'").

274. *Blizzard*, 629 F.3d at 939–40.

275. *Impression*, 137 S. Ct. 1523, 1539 (2017) (Ginsburg, J., concurring in part and dissenting in part).

exclude others from making, using, selling, and importing the invention.[276] A copyright owner, on the other hand, has the exclusive right to reproduce, prepare derivative works, distribute, publicly perform, and publicly display the copyrighted work.[277] The ownership rights determine the types of restrictions that may be placed on subsequent transactions.

Patent licenses where the licensee is a distributor of product usually include the right to make, use, sell, and offer to sell. Copyright licenses, on the other hand, do not. The reason for this difference stems from the different rights of copyright and patent holders. For example, if Patentee licenses to Licensee the right to make and use, but not to sell, the patented invention, Licensee may not enter into a subsequent transaction with a third party *unless* Patentee has given Licensee a right to sublicense the invention. Even then, Licensee may only sublicense the rights that he or she has. Because the agreement between Patentee and Licensee did not permit Licensee to sell the invention—and Patentee did not sell the invention to Licensee—there has been no "authorized sale," and neither the Licensee nor the Sublicensee is authorized to sell the invention.

By contrast, if Copyright Owner licenses to Licensee the right to make copies and distribute an item, the Licensee may make a copy and sell it to Customer since the Copyright Owner does not have the right to exclude the Licensee from selling. If Copyright Owner and Licensee's contract prohibited the Licensee from selling the copy, the Licensee would have breached their contract although he or she would not have infringed the license. In this important respect, transactions involving patented items and copyrighted items typically differ.

There is also the question of contractual authority and enforceability. The cases tend not to distinguish between contract terms that are negotiated, those that are non-negotiated due to lack of bargaining power, and those that are unilaterally imposed by one party after the transaction has occurred. Yet, these scenarios are quite different. Where the parties have negotiated the contract, any conditions on the transaction shape the nature of the transaction. Where one party has unilaterally imposed terms with a standard form, it is not clear that the terms should be enforced. As I have noted

276. 35 U.S.C. § 154(a)(1) (2018).
277. 17 U.S.C. § 106 (2018).

elsewhere, a notice is not always a contract.[278] A notice does not constitute a *contract* unless the other party intended to agree to it.[279] There can be no bargain, no mutual assent, and no contract unless the non-drafting party intends to engage in conduct that manifests assent.[280] The silence of the offeree generally does not manifest acceptance.[281] As the Ninth Circuit noted in a recent case, "[a]n offeree may demonstrate acceptance through conduct, but not where . . . the contractual provisions are 'inconspicuous' and 'contained in a document whose contractual nature is not obvious.'"[282]

If the offeree does not manifest assent, then the terms are merely a notice and their effectiveness depends upon whether the entity drafting the notice had the authority to unilaterally impose terms. The authority of the drafter to unilaterally impose terms is tied to property ownership. For example, *X*'s authority to enforce a "No Smoking" sign depends on whether *X* owns the property where the sign is posted. *X*'s authority to unilaterally impose terms does not extend to property that *X* does not own. Furthermore, *X*'s authority to enforce a "No Smoking" sign does not mean that *X* can unilaterally impose upon *Y* a one-hundred-dollar fee for smoking, even if *Y* smokes on *X*'s property. If *X* wishes to impose a one-hundred-dollar fee on those who smoke on *X*'s property, the "$100 Fee for Smoking on Property" notice must be conspicuous enough so that *Y* understands that by entering *X*'s property, *Y* must adhere to those terms. In that situation, the notice "$100 Fee for Smoking on Property" is contractual and *Y* manifests assent by entering the property. However, *after* the transaction has occurred, *X* has no power to unilaterally impose terms. For example, *X* cannot charge *Y* an entrance fee *after* the visit unless Y had notice of the fee *prior* to the visit. *X*'s power is tied to *X*'s property.

278. KIM, *supra* note 23, at 135 (noting that the "essential problem with wrap contract doctrine is that courts mistake the role of notice with that of contract" but that notice is "very different from contract").

279. KIM, *supra* note 23, at 134.

280. RESTATEMENT (SECOND) OF CONTRACTS § 19(2) (AM. L. INST. 1981) ("The conduct of a party is not effective as a manifestation of his assent unless he intends to engage in the conduct and knows or has reason to know that the other party may infer from his conduct that he assents.").

281. *Id.* (noting that the silence of the offeree without intent to engage in conduct does not manifest acceptance); *see also* Norcia v. Samsung Telecommc'ns. Am., LLC, 845 F.3d 1279, 1284 (9th Cir. 2017) (citing California's general rule that "silence or inaction does not constitute acceptance of an offer").

282. Velasquez-Reyes v. Samsung Elecs. Am., Inc., 777 F. App'x 241, 241 (9th Cir. 2019) (quoting Windsor Mills Inc. v. Collins & Aikman Corp., 101 Cal. Rptr. 347, 351 (Cal. Ct. App. 1972)).

Moreover, the power of the parties to reorder their rights and obligations is limited to those rights and obligations; they do not have the power to recharacterize relationships that are defined by law, although they may define their rights and obligations so that they fall into a particular legal definition. Contracting parties, for example, cannot define whether their relationship is a partnership; that relationship is defined by the law and determined by whether they are engaged in a business for profit. If they are, they may alter the particulars of that relationship, but they cannot deny that they are in a partnership by writing it on a piece of paper that they both sign. Similarly, contracting parties cannot recharacterize an employment relationship as an independent contractor relationship.[283] These terms are beyond the contract-making purview of the parties. For the same reason, the parties cannot change a sale into a license simply by so stating in their contract.

The court in *Blizzard* made a fundamental error because it did not distinguish the sale of the *software* from the sale of the *license*. The WoW software was not sold, but the license to use that software was.[284] The transfer of the license is subject to the first sale doctrine. The licensor does not have the power to recharacterize the transaction or to restrict its sale because that is not one of the exclusive rights of a copyright owner.[285] It may, however, limit the scope of the license or subject the license to a condition precedent with properly drafted language.[286]

Similarly, a patentee may not recharacterize a transaction that is a sale as a license; it may, however, restrict the license so that certain conditions must be met before a sale is authorized. The doctrine of patent exhaustion means that the patentee may not impose post-sale restrictions.[287] The result is different under copyright's first sale

283. *See Type of Relationship*, IRS, https://www.irs.gov/businesses/small-businesses-self-employed/type-of-relationship (last reviewed or updated July 31, 2020) (stating that "[a]lthough a contract may state that the worker is an employee or an independent contractor, this is not sufficient to determine the worker's status. The IRS is not required to follow a contract stating that the worker is an independent contractor, responsible for paying his or her own self employment tax. How the parties work together determines whether the worker is an employee or an independent contractor").

284. MDY Indus., LLC v. Blizzard Ent., Inc., 629 F.3d 928, 938 (9th Cir. 2010).

285. *See* 17 U.S.C. § 106 (2018).

286. *See Blizzard*, 629 F.3d at 939.

287. *Impression*, 137 S. Ct. 1523, 1531 (2017).

doctrine. A copyright holder *may* impose post-sale restrictions as long as they derive from her exclusive copyright rights.[288]

For example, Patentee enters into an agreement with Retailer where Retailer may sell, but only at its stores in North America, patented items to Customers. If Retailer sells patented items to Customers at its stores in North America, those Customers are not limited by the terms of the agreement between Patentee and Retailer. Accordingly, Customer may sell the patented item in Europe *provided that* Customer made her original purchase at Retailer's store in North America (i.e., it was an "authorized sale").

The result is different for copyright restrictions. Assume Copyright Owner enters into an agreement with Retailer where Retailer may sell, but only at its stores in North America, items to Customers with certain copyright restrictions. If Retailer sells those copyright items to Customer, those items continue to be subject to the copyright restrictions. Customer may not, for example, make copies of the item if the license prohibits copying. Customer may, however, *sell* the licensed item because a copyright owner does not have the power to limit sales of copyrighted works because the right to exclude others from selling is not one of the copyright holder's exclusive rights.[289]

IV. A METHODOLOGY FOR EVALUATING LICENSE V. SALE TRANSACTIONS

The case law at first glance may seem impenetrable but on closer examination yields several important principles that can be used to assess the license v. sale issue. First, an authorized sale—and only an authorized sale—triggers the copyright first sale doctrine and patent exhaustion. Second, a contractual breach differs from infringement. Infringement occurs when the licensee exceeds the scope of the license but not where the licensee breaches another provision. Finally, a contract may give rise to both a claim for breach and a claim for infringement; however, the claims cannot be for violating the same provision. In short, it is important to distinguish the provisions of a contract and to understand their legal effect. Some provisions may express an undertaking (i.e., a covenant) and thus create an obligation;

288. *See* 17 U.S.C. § 106.
289. *Id.*

other provisions may express permission (i.e., a grant) and thus authorize actions that would otherwise be impermissible.

In this Part IV, I propose a methodology for analyzing whether a transaction is a license or a sale. This methodology requires first analyzing the structure of the transaction in order to characterize it as a license, a sale, or a sale of a license. Then it analyzes the nature of the terms to assess the nature and enforceability of the restrictions. As previously mentioned, the *characteristics* of the transaction, and not what the parties call it in their contract, determine whether it is a license or sale and whether the UCC applies. *However, the parties may shape the characteristics of the transaction contractually*. The power to do that differs depending on whether the transaction involves a patent or a copyright.

Software poses unique challenges because it may involve both a patent and a copyright. In negotiated transactions where the license agreement was entered into prior to the acts that constitute the transaction (i.e., the transaction did not involve a rolling contract), the transaction is a license, not a sale, which may involve both patent rights and copyrights. Consequently, a restriction on subsequent transfers is enforceable because there was no patent exhaustion. However, in mass consumer transactions where the license agreement is a rolling contract, the transaction is a sale. The sale results in patent exhaustion and the copyright first sale doctrine also applies. The license terms that purport to restrict the purchaser's right to transfer the software should not be enforceable as the patentee's exclusive rights are exhausted with respect to that product. However, the license terms that restrict the purchaser's *use* of the product *are* enforceable because the copyright holder's rights are not exhausted under the first sale doctrine, which only permits subsequent transfers. Yet, not every violation of the license agreement constitutes infringement. The effect of any given provision depends on whether the provision is drafted as a covenant or a condition.

My proposed methodology recognizes the difference between a license restriction in a negotiated agreement and one in a mass adhesive form agreement. The enforcement of the reasonable expectations of the parties is a bedrock principle of contract law that has been discarded by law-and-economics-minded courts in their quest for a type of efficiency that considers only the elimination of transactional hurdles. My proposed methodology reflects the realities of mass adhesive form contracting to better reflect the reasonable expectations of the parties.

A. Reasonable Expectations and the Form of Wrap Contracts

Studies have demonstrated that most consumers do not read standard form software license contracts.[290] Although an actual intent to be legally bound to terms may not be required for contract formation, contract terms should reflect what the parties intended.[291] The role of courts in construing a contract is to determine the intent of the parties and to ascertain what they "reasonably understood to be the terms of the agreement."[292] As one court noted, "[s]tandardized contracts of adhesion do not squarely fit within a traditional analysis of contractual intent."[293] As a result, in the context of standardized contracts, a factfinder may consider "'the totality of the circumstances in determining the intent of the parties, rather than being strictly confined to the four corners of a standardized agreement' when the parties' 'true intent was not accurately reflected in the written contract.'"[294]

Section 211(3) of the Restatement (Second) Contracts states that "[w]here the other party has reason to believe that the party manifesting such assent would not do so if he knew that the writing contained a particular term, the term is not part of the agreement."[295] This principle of "reasonable expectations" with standardized

290. Yannis Bakos et al., *Does Anyone Read the Fine Print? Consumer Attention to Standard-Form Contracts*, 43 J. LEGAL STUD. 1, 1 (2014) (finding that "only one or two of every 1,000 retail software shoppers" accesses license agreements); Nathaniel S. Good et al., Noticing Notice: A Large-Scale Experiment on the Timing of Software License Agreements 5 (2007) (conference paper) (reporting that only 1.4% of 222 subjects read end-user license agreements often and 66.2% reported rarely reading or browsing them).

291. RESTATEMENT (SECOND) OF CONTRACTS § 21 (AM. L. INST. 1981) ("Neither real nor apparent intention that a promise be legally binding is essential to the formation of a contract, but a manifestation of intention that a promise shall not affect legal relations may prevent the formation of a contract.").

292. *See* Mitchell v. Wells Fargo Bank, 280 F. Supp. 3d 1261, 1288 (D. Utah 2017) (quoting State v. Terrazas, 336 P.3d 594, 605 (Utah Ct. App. 2014)) (stating that the "underlying purpose in construing a contract is to ascertain the intentions of the parties, and to identify what the parties reasonably understood to be the terms of the agreement" (quoting *Terrazas*, 336 P.3d at 605)).

293. *Id.*

294. *Id.* at 1289 (quoting Allen v. Prudential Prop. & Cas. Ins. Co., 839 P.2d 798, 810 (Utah 1992) (Stewart, J., concurring)).

295. RESTATEMENT (SECOND) OF CONTRACTS § 211(3) (AM. L. INST. 1981); *see also* Lauvetz v. Alaska Sales and Serv., 828 P.2d 162, 165 (Alaska 1991) (applying the analysis of section 211 outside the insurance context).

agreements recognizes that "[a]lthough customers typically adhere to standardized agreements and are bound by them without even appearing to know the standard terms in detail, they are not bound to unknown terms which are beyond the range of reasonable expectation."[296] Professor Eric Zacks notes, "[s]ection 211 was an elegantly designed, thoughtful solution by impressive contract theorists to address the problem of assent to standardized contracts," but it is "rarely cited with respect to any standardized contract dispute, and even where cited, it rarely provides relief to the non-drafting party."[297] Notwithstanding its underappreciated status, section 211(3) is, as Professor Wayne Barnes writes, "a rule that is consistent with the objective theory of contracts and with general principles of the assent-based nature of contracts."[298]

The reasonable expectations doctrine captured in section 211(3) may be particularly helpful in mitigating the problems associated with wrap contracts. The expectations of the non-drafting party are often established by the form of the contract.[299] A consumer signing a contract with a pen has awareness that the transaction is a legal one, even if he or she has not read the terms. A consumer clicking an "Agree" icon may be less aware of the legally binding nature of that click, and a consumer simply browsing a website with a conspicuous hyperlink may be completely unaware of the legal nature of that

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296. RESTATEMENT (SECOND) OF CONTRACTS § 211 cmt. f (AM. L. INST. 1981); *see also* Gove v. Career Sys. Dev. Corp., 689 F.3d 1, 4–5 (1st Cir. 2012) (stating that "where the parties are in unequal bargaining positions, such as '[w]here a standard-form, printed contract is submitted to the other on a "take it or leave it" basis, upon equitable principles the provisions of the contract are generally construed to meet the reasonable expectations of the party in the inferior bargaining position" (alteration in original) (quoting Barrett v. McDonald Invs., Inc., 870 A2d. 146, 150 (Me. 2005))).

297. Eric A. Zacks, *The Restatement (Second) of Contracts § 211: Unfulfilled Expectations and the Future of Modern Standardized Consumer Contracts*, 7 WM. & MARY BUS. L. REV. 733, 736 (2016). *But cf.* Max True Plastering Co. v. U.S. Fid. & Guar. Co., 912 P.2d 861, 864 (Okla. 1996) (noting that "[t]he doctrine of reasonable expectations has evolved as an interpretative tool to aid courts in discerning the intention of the parties bound by adhesion contracts. It . . . takes into account the realities of present day commercial practice").

298. Wayne R. Barnes, *Toward a Fairer Model of Consumer Assent to Standard Form Contracts: In Defense of Restatement Subsection 211(3)*, 82 WASH. L. REV. 227, 231 (2007). Barnes also noted that it is "[o]verlooked and underappreciated in the debate over the proper treatment of standard form contracts." *Id.*; *cf.* Zacks, *supra* note 297, at 758 (finding "only 196 cases cited section 211 of the Restatement (Second) of Contracts" with only 34 where the non-drafting party received "some form of relief").

299. *See* KIM, *supra* note 23, at 200–01 ("The form of a contract, like its function, sets expectations. . . . The reasonable expectations of parties depend upon *what type of contract* is at issue.").

transaction. Courts should consider the form of a contract in assessing the reasonable expectations of the parties.[300]

License-sales transactions accomplished with adhesive wrap contracts raise unique policy concerns. Bargaining imbalance and the failure to read and understand the fine print are problems associated with adhesive contracts generally; however, they are particularly striking in the context of license-sale transactions that may affect important rights to use or transfer a product.

Consumer reasonable expectations of the substance of terms should be distinguished from consumer complacency or inaction, which is related to the likelihood that a given term will be enforced. Some provisions in standard commercial transactions may be overlooked because they relate to events that consumers believe are not likely to occur. For example, terms such as those imposing mandatory arbitration, warranty disclaimers, and limitations of liability become relevant only if a dispute arises between the parties. These terms[301] may never be raised or enforced in a transaction if there is no dispute between the parties. By contrast, license terms alter the very essence of a transaction that otherwise resembles an ordinary sale. A typical license-sale transaction *seems* like a sales transaction to the average consumer at the time the transaction is completed, and the consumer may expect to have the benefits of ownership post-purchase.

To recognize consumer reasonable expectations does not mean that the company *cannot* impose other rules or conditions by agreement; however, if it wishes to do so, it cannot unilaterally impose terms in a standard form subject only to a standard of "reasonable notice." Instead, the business should be required to have the consumer specifically assent to those terms by separately signing the relevant provision. Bringing the specific term to the consumer's attention makes it more salient, and thus more likely to be within that consumer's reasonable expectations.[302] This type of specific assent is

300. *Id.* at 201 ("An interpretive framework that expressly considers the form and function of a contract reflects reality and better protects the reasonable expectations of the parties.").

301. *See generally id.* at 44–48 (describing how various contract terms may be used to limit liability in certain circumstances).

302. Even in this scenario, the term may be unenforceable if it is against public policy or subject to a contract defense, such as unconscionability.

also consistent with the common law,[303] the UCC,[304] and with current trends in electronic contracting law.[305] In an influential case, the court in *Berkson v. Gogo LLC*[306] proposed a four-part test to analyze electronic adhesive contracts that asks, in part: "Did the merchant clearly draw the consumer's attention to material terms that would alter what a reasonable consumer would understand to be her default rights when initiating an online consumer transaction from the consumer's state of residence . . . ?"[307]

Imposing a specific assent requirement accords with canons of construction. Courts generally construe ambiguous terms in a contract against the drafter, especially if the contract is one of adhesion.[308] As previously mentioned, there is also an interpretive preference against conditions that would result in a forfeiture. Given these canons of construction and the realities of standard form contracting, in order for a restriction in a standard form license agreement to be interpreted as a condition, the non-drafting party should have specifically assented to it.

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303. Certain provisions, such as limitations of liability, must be drawn to the attention of the adhering party. *See* Berrios v. United Parcel Serv., 627 A.2d 701, 705 (N.J. Super. Ct. Law Div. 1992) (noting that limitations of liability are ineffective where motorists were not made aware of it), *aff'd per curiam*, 672 A2d. 665 (N.J. Super. Ct. App. Div. 1993); Allright, Inc. v. Schroeder, 551 S.W.2d 745, 747 (Tex. Civ. App. 1977) (noting that posted notice limiting liability must be called to attention of bailor before it can be deemed part of bailment contract).

304. *See, e.g.*, U.C.C. § 2-207(2)(a) (AM. L. INST. & UNIF. L. COMM'N 1951) (stating that additional terms are proposals and not part of the contract if the other party is not a merchant); *id.* § 2-209(2) (requiring no-oral modification clause to be separately signed by non-merchant).

305. Berkson v. Gogo LLC, 97 F. Supp. 3d 359, 402 (E.D.N.Y. 2015) (four-part test that includes inquiry regarding notice of specific terms); Sgouros v. TransUnion Corp., 817 F.3d 1029, 1035 (7th Cir. 2016) (clicking on a box does not mean that consumer has notice of all contract terms); Scotti v. Tough Mudder Inc., 97 N.Y.S.3d 825, 835 (Sup. Ct. 2019) (despite conspicuousness of agreement, the arbitration provision was not sufficiently conspicuous).

306. 97 F. Supp. 3d 359 (E.D.N.Y. 2015).

307. *Id.* at 402. The *Berkson* court mentioned specifically "[t]he right to (a) not have a payment source charged without notice (i.e., automatic payment renewal); (b) bring a civil consumer protection action under the law of her state of residence and in the courts in her state of residence; and (c) participate in a class or collective action? If not, then (a), (b), or (c) should not be enforced against the consumer." *Id.*

308. *See* Mitchell v. Wells Fargo Bank, 280 F. Supp. 3d 1261, 1286 (D. Utah 2017) ("Ambiguous language is construed against the drafter, particularly in the context of adhesion contracts."); Gove. v. Career Sys. Dev. Corp., 689 F.3d 1, 4 (1st Cir. 2012) (noting that a contract "is to be interpreted to effect the parties' intentions as reflected in the written instrument, construed with regard for the subject matter, motive, and purpose of the agreement, as well as the object to be accomplished. . . . [A]mbiguities in a document are construed against its drafter. . . . This rule is intended to effectuate the intent of the parties" (citations omitted)).

Furthermore, the requirement of specific assent to material terms is consistent with commercial law and its efforts to balance the needs of the marketplace with contract law objectives. In particular, section 2-207 of the UCC balances the realities of form contracts with the expectations of the parties by requiring specific assent to material terms to avoid unfair surprise.[309] Notably, additional or different terms contained in a form agreement between a merchant and a consumer are not part of a contract unless agreed to by the consumer.[310] Similarly, a provision in a standard form that seeks to condition use of the license in a way that defeats the reasonable expectations of the consumer should not be considered part of the contract.

B. Transaction Sequence and Contractual Consequence

A business may use restrictive contractual terms to try to characterize a transaction as a license or sale. If the transaction involves a patented item, the contractual terms determine whether the transaction is a sale or a license because the patentee has the right to characterize the transaction. If, however, the transaction involves a copyrighted item, the contractual language is useful in assessing the characteristics of the transaction, but it is not determinative. The copyright holder does not have the right to *characterize* the transaction as a sale or a license; it may, however, structure the transaction in such a way that it fits the legal definition of a license or a sale.

A business also may use contracts in an effort to impose post-sale restrictions. If the transaction is a sale, then the patentee's patent rights are exhausted, and the purchaser may sell that item to another party regardless of a contractual prohibition on subsequent sale. Similarly, the sale of a copyrighted item means that the purchaser may subsequently sell that item to another party. However, unlike with a patent transaction, a sale does not terminate the copyright holder's rights. Finally, contractual language determines the scope of the license. Restrictive contractual terms may be either conditions or covenants. Failure to comply with a condition that limits a license's

309. U.C.C. § 2-207(2)(b) (AM. L. INST. & UNIF. L. COMM'N 1951) (permitting additional terms in a standard form acceptance between merchants unless the terms "materially alter" the terms of the offer); *see also id.* cmt. 3 (stating that terms that materially alter the original bargain are not included "unless expressly agreed to by the other party").

310. U.C.C. § 2-207(2) (AM. L. INST. & UNIF. L. COMM'N 1951) (stating that additional terms in a standard form acceptance are "proposals for addition to the contract" unless the terms are between merchants).

scope means that the licensee has infringed.[311] A failure to comply with any other provision may constitute a breach of contract but will not constitute infringement.

1. Contractual Restrictions and Transactions Involving Patents

Although a patentee may prevent a licensee from selling the patented item, it may not prevent a *purchaser* of that item from doing so.[312] Consequently, the nature of subsequent transactions depends upon the original transaction between the patentee and the licensee or purchaser. The following illustrates how the license v. sale question should be analyzed for transactions involving patented items:

(1) If the first transaction by the patentee is a sale, then subsequent transactions involving that same item can also be sales. For example, if Patentee enters into a contract where it sells patented items to Retailer, Retailer may sell that item to Customer *Z*.

(2) If the first transaction by the Patentee is a license, then subsequent transactions may be either licenses or sales depending on the scope of the license between Patentee and Licensee.

The license agreement may have the following types of provisions: (a) it might permit the Licensee to sell patented items without any restrictions on the Licensee's ability to do so; (b) it might permit the Licensee to sell items with restrictions on the Licensee's ability to do so; (c) it might permit the Licensee to sell items without restrictions on the Licensee's ability to do so but require the Licensee to impose conditions on his or her customers; and (d) it might allow Licensee to sublicense patented items. The validity of each of these terms is discussed below:

a. If the license agreement provides that Licensee may sell patented items without restrictions on the Licensee's ability to

311. *See* Universal Instruments Corp. v. Micro Sys. Eng'g, Inc., 924 F.3d 32, 49 (2d Cir. 2019) (stating that despite parties being in contractual privity, "vindication of an exclusive right under the Copyright Act, read into a license by negative implication, is preempted by the Copyright Act"); *see also* Kamakazi Music Corp. v. Robbins Music Corp., 684 F.2d 228, 230 (2d Cir. 1982) (stating that because licensor sued licensee for publishing works after the contract had expired, the claim was for copyright infringement and not breach of contract); Marshall v. New Kids on the Block P'ship, 780 F. Supp. 1005, 1008–09 (S.D.N.Y. 1991) (noting that "if the plaintiff-licensor seeks relief directly under the licensing agreement . . . then the claim is merely a state law contract claim," but that if the licensee uses the copyright material in a manner that "exceeds either the duration or the scope of the license," then the action "arises under the copyright laws just as if the claim were against any other infringer who is a stranger to the plaintiff").

312. *See Impression*, 137 S. Ct. 1523, 1535 (2017).

do so, then subsequent transactions can be sales. For example, if Patentee licenses to Manufacturer the right to make, use, sell, and offer to sell patented items, then Manufacturer can sell the item to Customer.

b. If the license agreement provides that Licensee may sell patented items but imposes restrictive conditions on the Licensee's ability to do so, then subsequent transactions are authorized sales only if the Licensee complied with the conditions.

If Patentee licenses to Manufacturer the right to make, use, sell, and offer to sell patented items only in North America, then Manufacturer's sale of the item in France is unauthorized, and patent exhaustion does not apply.

If Patentee licenses to Manufacturer the right to make, use, sell, and offer to sell patented items only in North America, then Manufacturer's subsequent sale of the item to Customer in Canada is authorized. That item may be subsequently sold by Customer in France (or anywhere else in the world), and the territorial limitation in the agreement between Patentee and Manufacturer does not prevent patent exhaustion.

c. If the license agreement provides that Licensee may sell patented items but requires that Licensee impose post-sale restrictions upon his or her customers, subsequent transactions nevertheless can be sales which are not subject to those post-sale restrictions.

Patentee licenses to Manufacturer the right to make, use, sell, and offer to sell items but requires Manufacturer to have its customers sign contracts restricting the use of the patented products. Manufacturer's subsequent sale of patented item to Customer is authorized and triggers patent exhaustion even if Manufacturer neglected to have Customer sign contract restricting the use of the patented product. Manufacturer may have breached its contract with Patentee, and Patentee may sue for breach of contract; it may not, however, sue Manufacturer (or Customer) for patent infringement. Similarly, if Manufacturer had Customer sign a contract as required under Manufacturer's agreement with Patentee, but Customer breached the contract, Manufacturer (and likely Patentee as third-party beneficiary) may sue Customer for breach of contract, but Patentee may not sue Customer for patent infringement.

d. If the license agreement permits Licensee to sublicense but does not permit the Licensee to sell the patented item, then subsequent transactions are not sales.

If Patentee licenses to Manufacturer the right to sublicense, then Manufacturer's subsequent transaction with Customer cannot be a sale and Customer's use is limited to the terms of the sublicense because there was no authorized first sale.

2. Contractual Restrictions and Transactions Involving Copyright

Software is at the heart of the license v. sale dilemma because in order to use it, the purchaser of the license must make a copy or distribution, and doing so implicates an exclusive right of the copyright holder. Someone who transfers previously used software to another party in violation of a "no transfer/no copying" provision may be liable for contributory copyright infringement because the use of that software necessarily requires copying the content a second time—a right that a license containing a "no transfer/no copying" provision does not grant. By contrast, someone who transfers a copy of a tangible item, such as a book or painting, in violation of a "no transfer/no copying" provision does not infringe, because the transferee, despite such a provision, may use the tangible item in a way that does not infringe the copyright holder's exclusive rights (such as by reading the book or viewing the painting, but not by making copies and distributing it).

Streaming content and hosted content, however, are not sold; rather, access to the content is licensed and conditioned upon adherence to the host website's terms of service. Yet, simply because digital content is licensed and not sold does not mean that every violation of the terms of service constitutes a copyright violation. Rather, only violations of those provisions upon which the license grant is conditioned constitute copyright infringement; violations of other provisions would be contractual breaches. As with software, a user who has already used a digital code could not then transfer the code to another user in violation of a "no transfer/no copying" clause because, although temporary, streamed content is still copied regardless of the type of violation (copyright infringement or contractual breach), and the terms of use typically grant the copyright holder (through the hosting service) the right to control and discontinue the user's access to the content. If the terms of service state that the copyright holder retains control, whether the violation is rooted in contract or copyright, the user's ability to access content may be terminated.

Contractual language may be used in copyright transactions in two different ways. First, it can demonstrate the licensor's continuing control over the copyright item (which would indicate a license rather than a sale). Second, it can create a condition or a covenant, which determines whether the licensee's act constitutes infringement or a contractual breach.

Contract law requires that the parties use clear and unambiguous language to create an express condition.[313] Courts will interpret ambiguous language as a promise rather than an express condition, especially if interpreting it as an express condition would result in a forfeiture.[314] In order for contractual language to constitute a condition of the copyright license, it must implicate one of the exclusive statutory rights of the Licensor *and* be drafted clearly to indicate words of condition, such as *provided that* or the *if . . . then* duo. Contractual language can be helpful in characterizing a transaction as a license or a sale, even if it is not determinative. The following examples illustrate how a restriction should be interpreted in a software license agreement. These examples assume a negotiated agreement between businesses; provisions in adhesive form contacts should also meet the reasonable expectations test.[315]

<u>Example 1</u>:

"Licensor grants Licensee a non-exclusive, non-transferable license to make two copies, use, and display the Software on one device. This is a license and not a sale of the Software."

In the above, the language is not conditional, and the Licensee may sell the Software (and the license that accompanies it). Even though the language states that the license is "non-transferable,"

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313. *See* Richard F. Kline, Inc. v. Shook Excavating & Hauling, Inc., 885 A.2d 381, 388 (Md. Ct. Spec. App. 2005) (stating that if the language is doubtful, the language will be interpreted as a promise or constructive condition rather than an express condition).

314. Oppenheimer & Co. v. Oppenheim, Appel, Dixon, & Co., 660 N.E.2d 415, 418 (N.Y. 1995) (noting that "[t]his interpretive preference is especially strong when a finding of express condition would increase the risk of forfeiture").

315. The lack of bargaining power underlies the unfairness of adhesive forms and may affect small businesses as well as consumers. *See, e.g.*, Daniel D. Barnhizer, *Inequality of Bargaining Power*, 76 U. COLO. L. REV. 139, 141 (2005) (arguing that the legal conception of bargaining power is unrealistic and "systematically disadvantage[s] parties who do not fit within the courts' traditional narratives of disempowerment").

transferability is not one of the Licensor's exclusive rights as a copyright owner, so it does not limit the scope of the license. Although the Licensee may sell the Software to Customer, the Licensee and Customer must not exceed the scope of the license. The sale is of the license to the software, not of the underlying intellectual property. If the Licensee sells the software, it cannot retain copies because the license is limited to the right to make two copies, and to use and display the Software on one device.

Example 2:

"Licensor grants Licensee a non-exclusive, non-transferable license to make two copies, use, and display the Software on one device. Licensee agrees to pay the fees listed on Schedule 1."

The language above creates a covenant. If Licensee sells the Software to Customer, Licensor may sue for breach of contract but not for infringement as long as the Licensee and Customer do not exceed the scope of the license.[316]

Example 3:

"Licensor grants Licensee a non-exclusive license to make two copies, use, and display the Software on one device *provided that* Licensee may not transfer, assign, or sell the Software to any party. The license grant is expressly conditioned upon Licensee's compliance with this provision."

The clause contains words that signal a condition. Yet, a court may be reluctant to construe the language as creating a condition if doing so would result in a forfeiture of the Licensee's rights under the agreement. The prohibition against transfers does not implicate one of the copyright holder's exclusive rights, and thus, a violation of that provision cannot be considered an infringement. More importantly, unless the Licensor retains rights to control the software (e.g., remote control, right to terminate), the transaction should be characterized as sale, and not a license. The Licensee may transfer the software, but the transferee must abide by the terms of the license grant with respect to copying and displaying the software.

Example 4:

"Licensor grants Licensee a non-exclusive license to make two copies, use, and display the Software if and only so long as Licensee

316. This does not mean, however, that Licensor would prevail on a breach of contract claim. The Licensee could raise contract defenses, such as unconscionability.

does not transfer, assign or sell the Software to any party. The license grant is expressly conditioned upon Licensee's compliance with this provision. If Licensee attempts to transfer, assign, or sell the Software, this license immediately terminates and is void."

In the above example, the intent of the parties to create a condition to the license is clear. Consequently, it might be much more difficult for a court to find a covenant rather than a condition in a negotiated agreement. However, to avoid a forfeiture, the transaction may still be characterized as a sale of the license if the Licensor does not retain rights to control the software. In that case, the prohibition against transferring should fail (similar to Example 3), although the transferee must abide by the terms of the license grant.

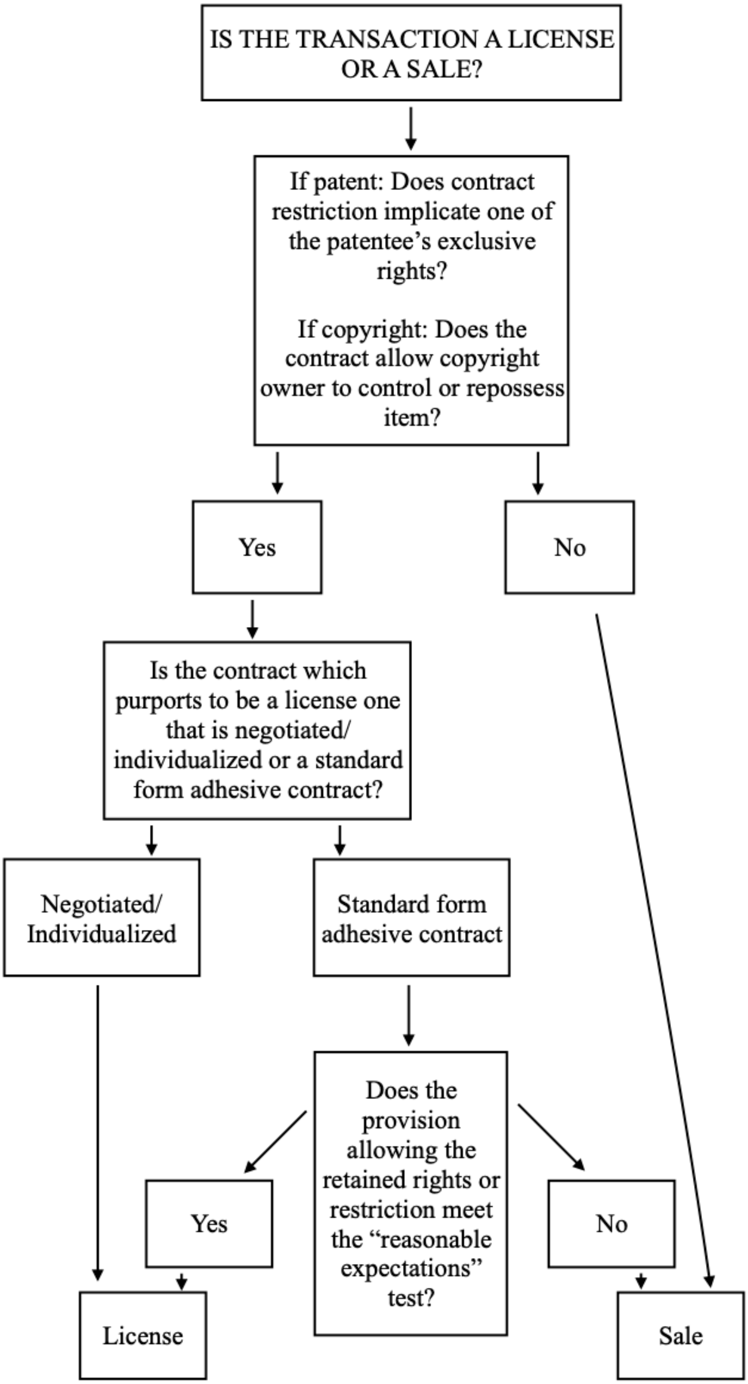
<u>Example 5</u>:

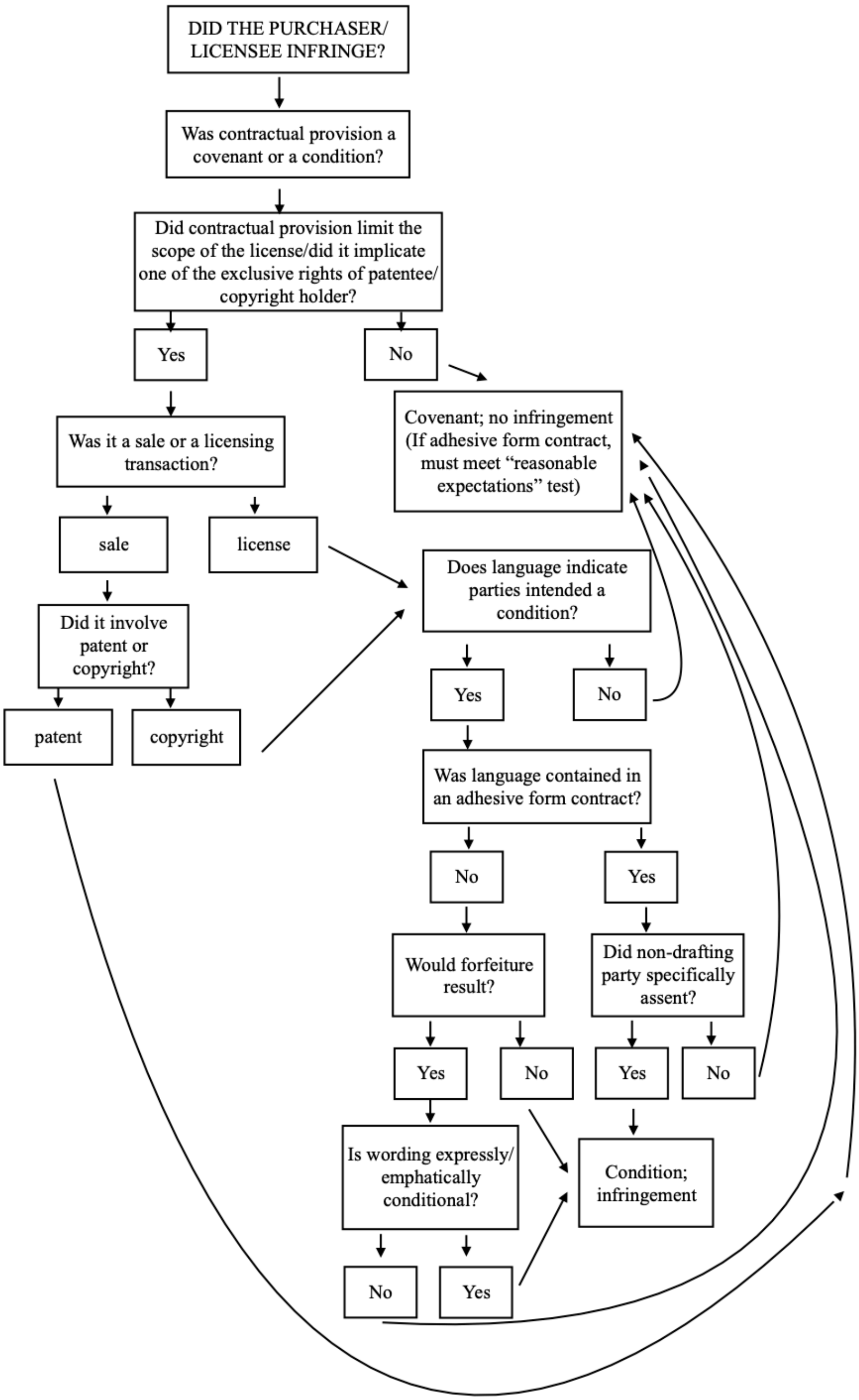
"Licensor grants Licensee a non-exclusive license to make two copies, use, and display the Software if and only if Licensee has paid the fees set forth in Schedule 1 within thirty days of the date of the invoice."

The intent of the parties is clearly to condition the license grant on payment of the license fee. There would be no forfeiture because the Licensee had not paid the license fees. Accordingly, failure to pay the license fees means the license grant is invalid and continued use by the Licensee will be considered infringement.

C. Visualizing the Methodology: Two Flow Charts

The license v. sale quandary is complex because the analysis must run along two different axes. The first involves characterizing the transaction—is it a license or a sale? The second axis involves analyzing the nature and effect of the contractual terms—did it involve a contract or a covenant, meaning did the licensee infringe or breach? Each line of inquiry differs depending upon whether the transaction involves a patent or a copyright. There are, however, two caveats where the terms are contained in an adhesive standard form contract. First, the contract must be properly formed, which may be subject to dispute if the legal nature of the form is not reasonably communicated and the consumer has not actively and deliberately manifested consent. Second, even if the contract is properly formed, the terms should meet the reasonable expectations test.


IS THE TRANSACTION A LICENSE OR A SALE?
If patent: Does contract restriction implicate one of the patentee's exclusive rights?
If copyright: Does the contract allow copyright owner to control or repossess item?
Yes
No
Is the contract which purports to be a license one that is negotiated/ individualized or a standard form adhesive contract?
Negotiated/ Individualized
Standard form adhesive contract
Does the provision allowing the retained rights or restriction meet the "reasonable expectations" test?
Yes
No
License
Sale


DID THE PURCHASER/ LICENSEE INFRINGE?
Was contractual provision a covenant or a condition?
Did contractual provision limit the scope of the license/did it implicate one of the exclusive rights of patentee/ copyright holder?
Yes
No
Covenant; no infringement (If adhesive form contract, must meet "reasonable expectations" test)
Was it a sale or a licensing transaction?
sale
license
Did it involve patent or copyright?
patent
copyright
Does language indicate parties intended a condition?
Yes
No
Was language contained in an adhesive form contract?
No
Yes
Would forfeiture result?
Did non-drafting party specifically assent?
Yes
No
Yes
No
Is wording expressly/ emphatically conditional?
Condition; infringement
No
Yes

V. CONCLUSION

Licensing goods—rather than selling them outright—was an important way for businesses to protect themselves from opportunistic buyers who took advantage of legal gaps to exploit new product offerings. To encourage innovation and allow businesses to reap the rewards from their investments, courts accepted the idea of licensing as a way to impose post-sale restrictions. In doing so, they accepted a watered-down version of assent for the purposes of contract formation.[317] Today, businesses exploit the licensing model to impose onerous contractual terms and defeat reasonable expectations to use products.

The license v. sale question looms over the IOT and the proliferation of goods that are both licensed and sold. The stew of judicial opinions and the different adhesive contracting forms portend doctrinal chaos. This Article proposes a way to resolve the license v. sale dilemma that considers the reasonable expectations of parties. The methodology is complex because the underlying issues are intertwined and involve multiple strands of law; however, it may help steer the case law toward a more unified and predictable approach and away from doctrinal incoherence.

Some may argue that requiring adherents to standard form contracts to specifically assent to terms would undermine the efficiency of using standard forms. Yet, the benefits of transactional efficiency should not accrue to only one party.[318] While both parties could potentially benefit from the use of adhesive standard forms, only the drafting entity benefits when the forms contain one-sided terms that take advantage of the other party. Imposing the standard of "reasonable expectations" upon standard form contracts preserves the efficiency of form contracts while imbuing it with fairness.

Others might argue that having consumers specifically assent would not right the imbalance because businesses would continue to have more power to offer terms on a take-it-or-leave-it basis.

317. *See* Danielle Kie Hart, *Contract Formation and the Entrenchment of Power*, 41 LOY. U. CHI. L.J. 175, 203 (2009) (noting that modern contract law makes contract formation "much easier"). Hart notes that because mutual assent is easy to establish, modern contract law suffers from the "process problem" that requires relying upon policing doctrines to bad bargains and so places "the burden . . . on the coerced party to prove that a contract term(s) is unreasonable using one or more of the expanded contract policing doctrines." *Id.* at 202–12.

318. While some might argue that the use of standard forms results in lower prices for consumers, there is a dearth of evidence to support this claim.

Furthermore, consumers would likely not read even if they were forced to click more frequently. The purpose of a specific assent requirement, however, is not primarily to encourage consumers to read but to discourage businesses from imposing too many terms. Although bargaining parity and substantive fairness with standard forms may be unrealistic, introducing a transactional hurdle such as specific assent to certain terms—even if those terms remain unread—adds friction to the transaction and so negatively affects the consumer's experience with the company and the company's product or service. This negative experience diminishes the good will that the consumer has toward the company. The contracting experience becomes part of the product offering and can enhance or diminish a customer's interaction with the business. In addition, it would increase the salience of the term and may result in increased competition; it may also attract the attention of regulators or lawmakers. The proposed methodology does not resolve the normative question whether businesses *should* be permitted to license rather than sell their goods and services. The normative question is a policy question that requires a broader discussion of incentives. However, a specific assent requirement aligns with the goals of contract law and forces companies to be more transparent about their intentions or suffer the consequences in terms of loss of customer good will and negative publicity.