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In April 2003, Apple Computer Inc. unveiled to United States consumers its iTunes Music Service, which provides a legal means of buying digital phonorecords. iTunes works by selling a digital phonorecord file (DPF) and the rights to play, 'burn', and store these DPFs on up to three computers of the iTunes account holder<sup>1</sup>. Under iTunes Fair Play rights management, in order to play, 'burn' or store a DPF, a specific computer needs to be authorized by the account holder via the Apple iTunes system.

Mr. George Hotelling, an iTunes member, sold an iTunes DPF of Frankie Smith's song "Double Dutch Bus," which he'd originally purchased through the iTunes Service for 99 cents. Being aware of the iTunes account restrictions, Hotelling had to transfer his iTunes account to the buyer, a Mr. Keith Elder, in order for Elder to play, burn and store. There are no sections in the iTunes Terms of Service agreement<sup>2</sup> denying DPF or account transferability, which seems to make this sale of "Double Dutch Bus" legal. § 9(b) of this agreement, however, provides the potential for a violation when the DPF was exchanged:

“Any burning or exporting capabilities are solely an accommodation to you and shall not constitute a grant or waiver (or other limitation or implication) of any rights of the copyright owners in any content, sound recording...”

Although it would initially seem that Hotelling's transaction is not a violation of the copyright owner due to the First Sale Doctrine, it is unclear that this Doctrine, originally designed for non-digital phonorecords, applies to DPFs. § 109 of the Copyright Act allows Hotelling to dispose of his "particular phonorecord," but does not grant any reproductive rights. It could be argued that when Hotelling sent his DPF to Elder, either in electronic form or by physical media, Hotelling sent a reproduction of the DPF, not the "particular phonorecord<sup>3</sup>." In doing so, he violated the "rights of the copyright owners," and thus, violated § 9(b) of the iTunes Terms of Service agreement.

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<sup>1</sup> See Apple iTunes Terms of Service, § 9b

<sup>2</sup> Apple's new Terms of Agreement, with § 3 addressing this kind of transferability transaction.

<sup>3</sup> See UMG Recordings, Inc. v. MP3.com, Inc.

Considering this situation, should transactions such as Hotelling's be allowed? From a purely legal perspective, I believe this transaction is in a gray area of the law, and should not be allowed. Although it is clear that non-digital formats of music such as records and CDs can be sold under the First Sale Doctrine, I believe this same Doctrine is not applicable for digital DPFs due to the reproductions required for the distribution of Hotelling's transaction, as noted previously. For example, even if someone owns a CD, legally they cannot download an MP3 that originated from the same CD title, from someone else<sup>4</sup>. Furthermore, when someone buys a CD, the Copyright owner does not lose their rights, such as their rights to prevent reproduction of their work. Considering this, it should also be noted that the First Sale Doctrine covers transfers of ownership<sup>5</sup>, not transfers of possession, such as iTunes DPF sales. Hotelling's rights are associated with that "particular phonorecord," in this case, the AAC MPEG-4 digital file that he originally downloaded from the iTunes' Service. The First Sale Doctrine allows Hotelling to do two things: he may destroy<sup>6</sup> his "particular" DPF, or he may distribute his "particular" DPF. This strict definition seems to restrict even playing the DPF (and thus, copying the DPF to RAM) on the original computer or defragmenting a hard drive. In short, I believe an implied license in these cases exists, however, § 109 does not provide an implied license for further distribution. If Hotelling had originally saved the download on to a USB Thumb Drive, for example, (i.e. not the hard drive) and mailed the USB Thumb Drive to Elder, this would still be the "particular" DPF described and codified in § 109(a) of the Copyright Act, and be a legal distribution.

Other legal issues would need to be considered before this transaction should be allowed. During the Hotelling-Elder transaction, should Elder be required to agree to the Apple Terms of Service as did Hotelling? Since Apple does not allow downloading outside of the United States, is it possible to have a similar, yet international transaction?

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<sup>4</sup> Again, see *UMG Recordings, Inc. v. MP3.com, Inc.*

<sup>5</sup> 17 U.S.C. §109(d) (1994).

<sup>6</sup> File systems do not actually destroy a file when one deletes them, leaving residual data of the file.

Demonstrating my economic strips, however, I am inclined to address this transaction from a socio-economic standpoint, and feel this transaction should be allowed. Most industries would love to control (or eliminate) their respective secondhand market. The recording industry in particular is not fond of the ‘used music’ market, which they claim cannibalizes new CD sales, and encourages piracy, since a CD buyer can digitally copy the CD and sell the original CD to a used CD store. Just last year, the recording industry executives proposed legislation requiring used CD stores to pay royalties on used albums. Basic economics teaches that the removal of a portion of supply will necessarily raise prices and that restriction of supply is the traditional action of a classic ‘cartel.’ In the iTunes example, iTunes and perhaps other DPF retailers could greatly benefit by effectively eliminating the secondhand market. Thus, from a socio-economic perspective, society would benefit from allowing used DPF transactions like Hotelling’s, since some consumers who would not buy a DPF at iTunes’ 99 cents price may purchase a used DPF at a lower price, reducing dead weight loss in the supply-demand analysis. In addition, we should be particularly mindful of the estimated 60 million illegal file sharers<sup>7</sup> in the United States, many who feel there are no legal alternatives for DPF distribution. By restricting the First Sale rights of iTunes Service members, it may further discourage those currently using file sharing networks as their illegal means of distributing unauthorized copies of copyrighted music. Some may argue that in this digital age, by allowing the sale of DPFs and because of the ease of instant distribution of unlimited, near-perfect DPFs, we could be encouraging thousands of people to enjoy the one “particular” DPF purchased on iTunes. However, this is not a new problem and iTunes has an integrated DRM system restricting this illicit reproduction, which is additionally enforced by the DMCA anti-circumvention sections. Considering this, this type of transfer transaction should be allowed.

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<sup>7</sup> *Music File Sharers Keep Sharing*, New York Times, Amy Harmon September 19, 2003.