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Antitrust

United States

Second Circuit reverses a price-fixing cartel verdict against Chinese defendants on international comity grounds

By Valerio Cosimo Romano

On 20 September 2016, the United States Court of Appeals for the Second Circuit (the "Appeals court") in New York reversed a federal district court judgment in an antitrust lawsuit against two Chinese companies accused of conspiring to fix the price and output of vitamin C sold to the United States.

In 2005, several vitamin C purchasers in the United States filed suit against two Chinese companies, alleging that the defendants and their co-conspirators had established an illegal cartel with the purpose and effect of fixing prices, controlling the supply of vitamin C exported to the United States and worldwide, and inflating the prices of vitamin C in the United States and elsewhere. Defendants argued that they had acted in line with Chinese regulations on vitamin C export pricing which, in essence, requires coordination on prices and creation of a supply shortage, and that pursuant to the principle of international comity (i.e., the recognition granted by a nation within its territory to the legislative, executive, or judicial acts of another nation) the Court should have abstained from exercising jurisdiction in the case. The case went to trial, and in March 2013 a jury awarded plaintiffs approximately USD 147 million in damages and issued an injunction barring defendants from fixing the price or output of vitamin C. Defendants appealed the district court's judgment.

Preliminarily, the appeals court determined whether Chinese law required defendants to engage in a conduct contrary to U.S. antitrust laws.

Defendants' argument was supported by the Chinese Ministry of Commerce, which filed an *amicus curiae* brief in support of Defendants' motion to dismiss, confirming that it had compelled Defendants to sell the goods at industry wide-coordinated prices and export volumes, in order to assist China in its transition from a state run command economy to a market-driven economy. Consistent with prior case law, the appeals court reaffirmed the principle that when a foreign government participates in U.S. court proceedings providing a reasonable evidentiary proffer on the construction and effect of its laws and regulations, the U.S. court is bound to defer to those statements. On that basis, the Court concluded that Chinese law required Defendants to engage in activities that amounted to U.S. antitrust violations.

Once ascertained the existence of a “true conflict” of laws between the applicable Chinese regulations and the relevant U.S. law, the Court determined whether it had to abstain from asserting jurisdiction on comity grounds.

In order to do so, it applied the *Timberlane Lumber-Mannington Mills* multi-factor balancing test, which involves the analysis of: the degree of conflict with foreign law or policy; the nationality of the parties, locations or principal places of business of corporations; the relative importance of the alleged violation of conduct here as compared with conduct abroad; the extent to which enforcement by either state can be expected to achieve compliance, the availability of a remedy abroad and the pendency of litigation there; the existence of intent to harm or affect U.S. commerce and its foreseeability; the possible effect upon foreign relations if the court exercises jurisdiction and grants relief; whether a party will be placed in the position of being forced to perform an act illegal in either country or be under conflicting requirements by both countries; whether the court can make its order effective; whether an order for relief would be acceptable in this country if made by the foreign nation under similar circumstances, and lastly whether a treaty with the affected nations has addressed the issue.

Applying the test, the Court held that China’s interests outweigh the U.S. antitrust enforcement’s interests and thus that the factors counsel against exercising jurisdiction in the case. The Court further noted that Plaintiffs are not without recourse in respect to China’s export policies, since they can always resort to the executive branch, which would deal with the issue with foreign policy instruments.

Consequently, the Appeals court held that the district court had abused its discretion by not abstaining from asserting jurisdiction, and reversed the court’s order.

This judgment is an exercise of legal diplomacy aimed at balancing the enforcement of U.S. antitrust and the right to recourse for U.S. citizens on the one hand, and the recognition and deference to be granted to the legislative and governmental acts performed by sovereign states on the other hand. In fact, the complex intersection of legal, political, and economic effects stemming from the clash of legal systems mandates a prudential approach in deciding matters like this. However, sovereign self-limitation shall not be intended as a legitimization of a free riding behavior over foreign economies. Thus, its application shall be kept to a minimum in order not to impair the effectiveness of national antitrust laws.

Antitrust

United States

Partial victory for BMI: Federal judge rules against full-work licensing requirement

By Martin Miernicki

On 16 September 2016, Judge Stanton issued an opinion interpreting the BMI Consent Decree. He concluded that the decree does not require BMI to issue "full-work" licenses.

Background

On 4 August 2016, the U.S. Department of Justice (DOJ) published a closing statement concluding its review of the ASCAP and BMI Consent Decrees. It stated that said decrees prohibited ASCAP and BMI from issuing fractional licenses and required them to offer full-work licenses.[1] Both ASCAP and BMI immediately announced to fight the opinion, the latter seeking a declaratory judgement, asking the "rate court" for its opinion.[2]

The court's opinion

In its declaratory judgement, the court rejected the DOJ's interpretation of the BMI Consent Decrees, ruling that "nothing in the Consent Decree gives support to the [Antitrust] Division's view." It held that the issue of full-work licensing remained unregulated by the Consent Decree; rather, this question should be analyzed under other applicable laws, like copyright or contract law. In conclusion, the court explained that the decree "neither bars fractional licensing nor requires full-work licensing." The court furthermore distinguished the question at hand from its decision in *BMI v. Pandora*,[3] where it struck down attempts by major publishers to partially withdraw rights from BMI's collective licensing regime.

The way forward

The court's opinion is a clear success for BMI, but also for ASCAP, since it can be expected that Judge Stanton's ruling will be influential in analogous questions regarding the ASCAP Consent Decree. However, this success is not final. BMI reported that the DOJ appealed the decision on 11 November 2016. It is hence up to the Court of Appeals for the Second Circuit to clarify the meaning of the decree.

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[1] Under a full-work license, a user obtains the right to publicly perform the entire work, even if not all co-owners are members of the organization issuing the license. Conversely, a fractional license only covers the rights held by the licensing organization.

[2] For more information on the background of the decision see Transatlantic Antitrust and IPR Developments Issue No. 3-4/2016.

[3] *BMI v. Pandora, Inc.*, No. 13 Civ. 4037 (LLS), 2018 WL 6697788 (S.D.N.Y. Dec. 19, 2013).

Antitrust
European Union

European Commission publishes a preliminary report on the e-commerce sector inquiry

By Nikolaos Theodorakis

On 6 May 2015, the European Commission launched a sector inquiry into e-commerce within the context of the Digital Single Market strategy, and in connection with Article 17 of Regulation 1/2003. In March 2016, the Commission published its initial findings on geo-blocking, which refers to business practices whereby retailers and service providers prevent the smooth access of consumers to the digital single market. In doing so, geo-blocking usually has three dimensions: (i) it prevents a consumer from accessing a website because of his IP address; (ii) it allows the consumer to add an item to his online shopping basket, but it cannot be shipped to his location and (iii) it redirects the consumer to another local website to complete his order.

As part of the sector inquiry, the Commission requested information from various actors in e-commerce throughout the EU, both related to online sales of consumer goods (e.g. electronics and clothing) as well as the online distribution of digital content. For that purpose, the Commission gathered evidence from nearly 1,800 companies operating in e-commerce and analyzed around 8,000 distribution contracts. The inquiry wished to look into the main market trends and gather evidence on potential barriers to competition linked to the growth of e-commerce.

E-commerce has been growing rapidly over the past years, and the EU is the largest e-commerce market in the world. As a result, any barrier in online trade may have severe consequences and distort healthy competition. In September 2016, the Commission published a preliminary report with certain findings. It identified issues arising from distribution agreements, which pertain to trade in goods, and licensing agreements, which pertain to trade in services.

Issues arising from distribution agreements

Distribution agreements may create geo-blocking restrictions, both from the manufacturers' and the retailers' side.

Manufacturers have adjusted to the increasing popularity of e-commerce by adopting a number of business practices that help them control the distribution of their products and the positioning in the market. These practices are not by default illegitimate, however under specific conditions, they can be.

For instance, manufacturers use selective distribution systems in which products can only be sold by pre-selected authorized sellers online. They also use contractual sales restrictions that may make cross-border shopping or online shopping more difficult and ultimately harm consumers since they prevent them from benefiting from greater choice of products and lower prices. The reasoning behind selective distribution systems is to control the quality of the product and safeguard brand consistency. This, nonetheless could classify as a vertical restraint and could be considered discordant with the principles of EU competition law.

Retailers use geo-blocking to restrict cross-border sales. Several retailers collect data on the location of their customers with a view to applying geo-blocking measures. This most commonly takes the form of refusal to deliver and refusal to accept payment from cards issued in other countries.

Issues arising from licensing agreements

With respect to digital content, the availability of licenses from the holders of copyrights in content is essential for digital content providers and a key determinant of competition in the market. The Preliminary Report finds that copyright licensing agreements can be complex and exclusive. The agreements provide for the territories, technologies and digital content that providers can use. As such, the Commission is expected to assess on a case-by-case basis whether certain licensing practices are unaccounted for and restrict competition.

In fact, one of the key determinants of competition in digital content markets is the scope of licensing agreements that determine online transmission. These agreements, between sellers of rights, use complicated definitions to define the reach of the service, creating differences in technological, temporal and territorial level. These contractual restrictions are practically the norm, whereas access to exclusive content increases the attractiveness of the offer of digital content providers.

A striking 70% of digital content providers restrict access to their digital content for users from other EU Member States. Further, the 60% of digital content providers are contractually required by rightsholders to geo-block. This practice is more prevalent in agreements for films, sports and TV series. Licensing agreements enable rightsholders to monitor that content providers comply with territorial restrictions, otherwise they ask for compensation. These agreements usually have a very long duration and they may make it more difficult for new online business services to emerge and try to win a stake in the market.

Additional questions arise when online rights are sold exclusively on a per Member State basis, or bundled with rights in other transmission technologies and then are not used. This might signal a semi perfect price discrimination policy depending on how much money each Member State is willing to pay, and a consequent further balkanization of the digital single market.

Next Steps

After publishing the preliminary report, the Commission is soliciting views and comments of interested stakeholders until 18 November 2016. The final report of the sector inquiry is expected in the first quarter of 2017. As a follow-up to the sector inquiry, the Commission may further explore if certain practices are compatibility with the EU competition rules and launch investigations against specific distributors and/or resellers on matters of both goods and digital content.

Finally, the results of the sector inquiry provide useful information for the debate on Commission initiatives relating to copyright and the proposed geo-blocking regulation.

Antitrust

European Union

Gun-jumping: the French Competition Authority issues highest fine ever for premature engagement in post-M&A integration

By Valerio Cosimo Romano

On 8 November 2016 the French Competition Authority (FCA) imposed a whopping EUR 80 million fine on Altice Luxembourg and its subsidiary SFR Group for implementing two notified transactions before obtaining appropriate merger clearance.

In France, the effective implementation of a concentration is suspended until clearance by the FCA. Pending approval, the concerned parties must behave as competitors and not act as a single entity. Violation of the rule triggers the application of Section II of Article L. 430-8 of the Commercial Code, which provides for a fine of up to the 5 per cent of the notifying parties' turnover.

In 2014, Altice and its subsidiary Numbericable had notified the Authority about two distinct concentrations: the acquisition of SFR and that of OTL. Both transactions were approved. However, in 2015 the Authority started suspecting an early implementation of the two transactions and raided the companies' premises. Evidence showed that the behavior implemented by Altice led to the exercise of decisive influence on its targets and allowed the company to access strategic information before getting the green light from FCA.

More specifically, Altice had repeatedly validated a number of SFR's strategic decisions such as pricing and promotional policy, the participation in a tender, the renegotiation of a contract and the joint preparation of an offer. Further, the two companies had exchanged a large amount of strategic information concerning performances and forecasts at a very senior level.

In the second case, Altice had been involved in the OTL's operational management, had set up a mechanism which allowed access to commercially sensitive information, and had allowed the participation of OTL's CEO in the group's decision-making and periodic reporting of commercial performance.

In the past, the FCA had already fined companies for failing to notify or for breach of commitments, but this is the first case in which it ruled on the early implementation of a merger prior to authorization (so called *gun-jumping*). The fine is also the highest ever imposed for a gun-jumping offence, and is four times higher than the highest sanction registered in Europe to date. According to the FCA, the high amount of fine is justified by the importance of the acquisitions in terms of purchase price and the impact on the telecommunications industry, the breadth, duration, reiteration and deliberate nature of the conduct. Remarkably, the FCA added that in setting the amount of the sanction it had taken account of the fact that the companies had not questioned the circumstances behind the fine and their legal characterization.

This sanction confirms an increased global attention by competition agencies in challenging the practice of gun-jumping. It also denotes a shift in the enforcement leadership on the matter from U.S. to European competition authorities. On a more practical ground, the judgment contributes to shedding legal certainty on the behavior to be avoided in the no man's land between antitrust notification and clearance. Also, it opens up the debate on how to immediately achieve all the synergies expected from M&A transactions without violating competition law.

Antitrust

European Union

European Commission approves a joint venture between the third and fourth largest telecom operators in Italy, subject to structural remedies.

By Valerio Cosimo Romano

On 1 September 2016 the European Commission approved a proposed joint venture between Vimpelcom and CK Hutchison, respectively the owners of Wind and H3G (the third and fourth largest telecom operators active in the Italian market). The approval was conditioned on a divestment of assets, which would enable a new operator to enter the market and roll out its own mobile network.

Earlier in 2016, the European Commission had halted the proposed acquisition of O2 by Hutchison in the UK, citing strong concerns that it would have led to less choice and higher prices for consumers, and that the deal would have harmed innovation in the mobile sector.

Currently, the Italian mobile market has four mobile network operators (MNOs) and a number of mobile virtual operators (MVNOs), which use the networks provided by MNOs at wholesale rates.

Vimpelcom and CK Hutchison notified the EU Commission of the proposed joint venture on February 5, 2016. After an in-depth phase-II review, the EU Commission came to the conclusion that the transaction would have reduced competition in the market. More in detail, the European Commission found that the three resulting operators (TIM, Vodafone and the Wind/H3G joint venture) would have had fewer incentives to compete, resulting in a lessening of choice and a decrease in quality of services for consumers, as well as higher retail mobile prices. Further, the Commission identified the possibility of coordination on a sustainable basis, likely to result in an increase in retail mobile prices for Italian consumers. The European Commission also expressed concern that, following the transaction, the incumbent and entrant MVNOs would have less choice of host networks and hence a weaker negotiating position to obtain favorable wholesale access terms.

In order to address the Commission's concerns, the concerned parties offered to divest and share sufficient assets (mobile radio spectrum; mobile base station sites, access to 2G, 3G and 4G, and newer technologies) to allow Iliad to enter the Italian market as a fourth mobile network operator and use the joint venture's network to offer customers nationwide mobile services until the new mobile network operator has built its own mobile network.

The Commission found that the proposed structural remedies offered by Hutchison and VimpelCom fully address its concerns and will preserve effective competition, maintain incentives to invest in innovative technologies, and ensure that consumers will continue to benefit from effective competition. For the reasons above, the Commission approved the proposed transaction.

Intellectual property

United States

Who's on Second (Circuit)? Transformative fair use

By Marie-Andrée Weiss

The Second Circuit found on 11 October 2016 that verbatim use of the famous Who's on First'Abbott and Costello routine in the *Hand to God* play was not transformative enough to be fair use. The Second Circuit nevertheless affirmed the dismissal of the lower judgment as Plaintiffs did not have a valid copyright interest in the routine. The case is TCA Television Corp. v. McCollum, No. 1:16-cv-0134 (2d Cir. Oct. 11, 2016).

William 'Bud' Abbott and Lou Costello formed a comedy duo which was popular in the thirties and forties. *Who's on First* is one their most famous routines, where Abbott plays the manager of a baseball team which Costello just joined. The newbie wants to know the name of his fellow players and the manager obliges: they are "Who," "What," and "I Don't Know." Misunderstandings ensue, fired up at a rapid pace. The routine was named "Best comedy routine of the 20th Century" by *Time* magazine in 1999.

The play *Hand to God*, written by Robert Askins, was shown off-Broadway in 2011 at The Ensemble Studio Theatre, and has since been shown on Broadway and in London. The play is about Jason, an introverted young man from a small Texas town who participates in his church's "Christian Puppet Ministry," a sock puppet show. Tyrone, Jason's sock puppet takes a life on its own and blurts out embarrassing facts, maybe because it is an incarnation of the devil, maybe because Jason uses him to say what he truly thinks. Jason recites Who's on First, with Tyrone as his partner, to a young woman in order impress her, and then pretends that he is the one who came up with the routine. Tyrone then calls him a liar and tells the girl she is stupid for believing that Jason indeed created the routine. An excerpt of that scene was used in a promotional video for the play.

When Abbott and Costello's heirs learned about this use, they filed a copyright infringement suit against the Ensemble Studio Theatre and the playwright in the Southern District of New York (SDNY). Defendants conceded that they had used part of the routine, but argued in defense that is was "*part of a sophisticated artistic expression*" and also that Plaintiffs do not own a valid copyright in the routine.

On December 17, 2015, Judge Daniels from the SDNY dismissed the copyright infringement suit brought by Plaintiffs because, while Plaintiffs had indeed established a continuous chain of title in the copyright, use of the routine by Defendants was fair use. Plaintiffs appealed.

The use of the routine is not protected by fair use

Plaintiffs had argued that the play had not added anything new to the original routine as Jason merely recited it without transforming it, and that therefore is was not fair use. The Second Circuit agreed.

When examining whether a particular use of a work protected by copyright is fair, courts use the four factors enumerated by Section 107 of the Copyright Act: the purpose and character of the use, the nature of the copyrighted work, the amount and substantiality of the portion used and the effect of the use on the market.

Judge Daniels had found, when examining the purpose and the character of the use of the routine in the play, that it was transformative enough to be fair use. He had cited the Second Circuit Cariou v. Prince case, where the Court had found that Richard Prince's use of Cariou's photographs to create new works was transformative enough to be fair use because Prince had "employ[ed] new aesthetics with creative and communicative results distinct from Cariou's" and also had incorporated "new expression" in his works.

For Judge Daniels, "the performance through the anti-hero puppet… create[d] new aesthetics and understandings about the relationship between horror and comedy that are absent from Abbott and Costello's… routine." He further explained that "[t]he contrast between Jason's s seemingly soft-spoken personality and the actual outrageousness of his inner nature, which he expresses through the sock puppet, is, among other things, a darkly comedic critique of the social norms governing a small town in the Bible Belt."

The Second Circuit found this reasoning to be "flawed in what it identifies are the general artistic and critical purpose and character of the [p]lay" and that the court did not explain how "extensive copying of [the] routine was necessary to this purpose." Section 107 enumerates the uses which are fair: criticism, comment, news reporting, teaching, scholarship and research. For the Second Circuit, the use of the routine "does not appear to fit within any of these statutory categories."

Even though the Second Circuit had held in *Cariou* that it is not essential that a use comments on the original work to be transformative, it also held that a use is transformative only if it alters the original work with "new expression, meaning, or message." For the Second Circuit, this was not the case as the routine had not been altered in the play, but used for what it is, a famous classic routine, instantly recognizable by the audience. The Court quoted its own On Davis v. Gap, Inc. case which explained that a use is not transformative if it used the original "in the manner it was made to be" used. The Court pointed out that it was necessary that the routine is not altered, so that the audience can recognize it and laugh when Jason pretends he created it. For the Second Circuit, the use of the routine is a mere "McGuffin," an event which sets the plot, in that case informing the audience that Tyrone the sock puppet can speak unprompted and has a foul mouth. However, not "any new dramatic purpose justif[ied] [d]efendants' extensive copying of the [r]outine." As the use was not transformative, the purpose and character of the use factor weighed in Plaintiff's favor.

The Court also found that the nature of the work factor weighed in favor of Plaintiffs, as the routine was created to entertain the public, and thus is "at the heart of copyright's intended protection." It dismissed Defendants' argument that use of the routine was justified by the need to use "an instantly recognizable "cultural" touchstone in the relevant scene" because Defendants could have used another cultural touchstone, such as "inventing the Internet" or "out-swimming Michael Phelps." These examples are not convincing as they are not examples of cultural touchstones performed by a duo, a format which was needed in a play about a man and his evil sock puppet.

The amount and substantiality of the use factor weighted "strongly" in favor of Plaintiffs as the copying of the original work was "substantial" and because, while even a substantial use can be fair use "if justified," it was not the case here. The fourth factor, the effect on the potential market, also did weigh in favor of Plaintiffs because there is a licensing market for the routine.

However, even though all of the fair use factors weighed in favor of Plaintiffs, the Second Circuit nevertheless affirmed the dismissal of the case because Plaintiffs failed to prove they own a valid copyright in the routine.

Plaintiffs do not own the copyright in *Who's on First*

Judge Daniels had found that Plaintiffs had proven a continuous chain of title in the copyright of the routine, but the Second Circuit disagreed.

The routine was first performed in 1938 on the radio. It was also performed by Abbot and Costello in their 1940 *One Night in the Tropics* movie (*Tropics*) and in 1945 in their *Naughty Nineties* movie. As both the routine and the two movies were created before January 1, 1978, date of the entry into force of the 1976 Copyright Act, they are subject to the 1909 Copyright Act, which only protects published or registered works. A work was protected for twenty-eight years under the 1909 Copyright Act, if it was published with the required copyright notice. However, public performance of a work was not a publication under the 1909 Copyright Act, Silverman v. CBS Inc. (SDNY 1986), and therefore the routine was not first published in 1938, but in 1940. Unpublished and unregistered works were protected indefinitely by common law, but became automatically protected by copyright on January 1, 1978.

In November 1940, Abbot and Costello allegedly assigned their rights in the routine as performed in the two movies to Universal Pictures Company (UPC), which registered the copyright of *Tropics* in 1940 and of *The Naughty Nineties* in 1945, and timely renewed both copyrights. As the common law copyright of the routine as first performed in 1938 was never assigned, Abbot and Costello had retained it. They registered a copyright for "Abbott and Costello Baseball Routine" in 1944, but did not renew it and thus the work is in the public domain since 1972.

Plaintiff did not rely on the 1944 registration to claim they own the copyright, but rather in an agreement made in 1984 where UPC quitclaimed all of its rights in the performance of the routine to Abbott &Costello Enterprises (ACE), a general partnership formed by the comedians' heirs. ACE was later dissolved and copyrights' ownership were divided among Abbot and Costello heirs.

Defendants had argued that the routine was in the public domain because only Abbott and Costello could have renewed the copyright of the movies, but Plaintiffs argued that UPC had the authority to do it because the comedians had assigned ownership of their common law copyright in the routine to UPC, the routine had merged into *Tropics*, and the copyright was transferred to ACE by the quitclaim.

For Judge Daniels, the 1940 registration of the One Night movie by UPC in 1940 "extinguished whatever common law copyright Abbott and Costello had in the unpublished version of the [r]outine." However, the Second Circuit found that Abbott and Costello had merely intended to license the use of the routine to UPC, not to assign their common law copyright in it. The Second Circuit did not interpret the agreement as being a work-for-hire agreement either, because the routine had already been created in 1938 and thus could not have been created at UPC's "instance and expense" as required it to be a work for hire, Playboy Enters., v. Dumas (2d Cir. 1995). The routine had not merged in the movies either, as "authors of freestanding works that are incorporated into a film… may copyright these 'separate and independent works'", 16 Casa Duse, LLC v. Merkin (2d Cir. 2015) and the routine is such a freestanding work.

Intellectual property

United States

When is the output of a copyright-protected software program itself protected by copyright?

By Marie-Andrée Weiss

When is the output of a copyright-protected software program itself protected by copyright? This is a case of first impression for any court of appeals which is pending at the Ninth Circuit. The case *is Design Data Corporation v. Unigate Enterprise, Inc.*, 14-16701. On 17 October, 2016, counsels for both parties presented their arguments at the Ninth Circuit to a three-judge panel, composed of Judge Consuelo M. Callahan, Judge Michael Daly Hawkins and Judge Andrew D. Hurwitz.

Design Data Corporation (DDC) has created a computer aided design (CAD) steel detailing software, SDS/2, which can be used to draw 2-D and 3-D drawings and models of structural steel components. The designs can only be viewed through the SDS/2 software, the SDS/2 Viewer software, and in electronic images exported from SDS/2. Unigate Enterprise (UE) is a company which provides steel detailing CAD files to its clients in the U.S. It does not produce the files itself, but instead outsources their production to contractors in China.

DDC believed that UE had used the SDS/2 software illegally. Representatives of DDC visited UE's office in August 2012 and UE allowed the representatives to search UE's computers and copy some files. They found a folder containing installation files for SDS/2 and three patch files which can be used to circumvent SDS/2's licensing requirement. Defendants admitted during discovery that one of its co-owners downloaded a copy of SDS/2 to an external hard drive, but that she believed this copy to be a free demonstration copy of the software, and that she did not install the software, nor did she try to use it. UE admitted that SDS/2 had been used to create files and drawings in five of its projects, but argued that they were made by contractors in China.

DDC sued UE for direct copyright infringement, claiming it had illegally downloaded a copy of the software and also had copied files and images which are output of the SDS/2 software protected by copyright. It also sued UE for contributory copyright infringement claiming that UE imported from China infringing files and images generated by SDS/2 in violation of 17 U.S.C. §602.

UE moved for summary judgment, claiming that merely downloading a software program without installing or using is *de minimis* copying and that therefore not direct infringement. UE also argued that it cannot be held liable for contributory infringement, as "wholly extraterritorial acts of infringement cannot support a claim under the Copyright Act even when authorized by a party in the United States," quoting Subafilms, Ltd. v. MGM-Pathe Communications Co., 24 F.3d 1088, 1092, 1995 (9th Cir.1994).

On August 6, 2014, Judge William Orrick from the Northern District Court of California granted Defendants' motion for summary judgment both for contributory infringement and direct infringement. Defendants had correctly argued that they could not be sued for contributory infringement. Judge Orrick also found that downloading a copy of SDS/2 "without any evidence that the copy was installed or used… amount[ed] at most to a de minimis 'technical' violation that is not actionable as a matter of law."

DDC appealed to the Ninth Circuit, asking the Court to reverse summary judgment. DDC's counsel argued before the Ninth Circuit that UE did "consciously implement a business model… that was designed to exploit a breach in the copyright protection afforded to software developers by shifting its infringement of [Plaintiff's software] overseas." However, as UE cannot be sued for contributory infringement, DDC argued instead that UE directly infringed its copyright by downloading the software and by reproducing the output of the software program which is protected by copyright.

Direct infringement: did UE violate copyright law by copying DDC's software?

Judge Callahan and Judge Hurwitz were both troubled by the fact that UE had advertised on its site that it used the SDS/2 software. UE's counsel answered that UE was counting on contractors to use it, but admitted that UE had never asked DDC if it was indeed true that the contractors were legally using the software. UE admitted it had downloaded the software, and therefore copied it, but argued it had not used it and therefore this *de minimis* copying was not actionable. DDC argued that, by downloading the software, UE had copied the entire SDS/2software code and therefore the copying was not *de minimis*.

Judge Hurwitz asked UE's counsel whether the *de minimis* doctrine should apply each time someone copies a work protected by copyright, even if he does not use it, and the UE's counsel answered in the affirmative.

Direct infringement: is the output of the software protected by copyright?

DDC argued also that UE has directly infringed the SDS/2 software because it has copied the steel component designs which are a visual display of the software, and are as such output of the software also protected by copyright. For Judge Hurwitz, this is the "really interesting issue in this case." However, not every output of a software is protectable by copyright. The question of when the output of a computer program is protectable by copyright has not yet been answered by any court which makes it an issue of first impression.

Software's source code, which is human-readable, and its object code, which is machine-readable, are both protectable by copyright as literary works, if they are original and fixed in a tangible medium of expression. However, the functional elements of the software, such as its systems or procedures, are not protected by copyright since copyright law does not protect process, system, and method of operation. Judge Orrick had quoted *Altai* and found that the "job files" and the other documents produced by the SDS/2 software "are data not covered by copyright"

Courts often use the abstraction-filtration-comparison test, first coined by the Second Circuit in Computer Assocs. Int'l v. Altai, to assess which parts of a software program are protected by copyright. The Second Circuit specified that the decision "[did] not control infringement actions regarding categorically distinct works, such as… products of computer programs." There is no case where a court used the abstraction-filtration-comparison test to determine whether the output of a software has been infringed.

Judge Hurwitz asked DDC's counsel what makes in her view a particular output protectable by copyright. She offered a test: an output would be protected by copyright if one can tie some sort of creative expression that is included in that output as having emanated from the software. Judge Hurwitz asked her what percentage of creative expression would trigger copyright protection. What if 80% of the creative expression originates from the software user? She conceded that in this case the output would "probably not" be protected by copyright. Judge Callahan found this test too complicated.

UE's counsel then proposed another test. The output would be protected to the extent that it includes creative expression that has been fixed in the software and embodied in the output. However, if there is additional creative content added to the output by a user, and therefore the proportionality is too imbalanced and weights too heavily in favor of the user, it could be found under the abstract-filtration-comparison test not original and thus not protected. Judge Hurwitz said, that while there is no case addressing the issue, some seem to suggest that the output of a software program may be, in some instances, so substantially similar to the software program that it deserves protection. Judge Hurwitz noted, however, that plaintiff must show substantial similarity.

DDC's counsel argued that there is not only substantial similarity, but even identity, because, if one inputs the same data into the software, one gets the same design out of it, in an expression which is fixed. But Judge Callahan quoted paragraph 721.6 of the Compendium of U. S. Copyright Office Practice about the "Relationship Between a Computer Program and a Work Created with a Computer or a Computer Program," which explains that "ownership of the copyright in a work is distinct from ownership of any material object that may be used to create that work." Judge Callahan asked DDC's counsel whether this was relevant to the case and she answered that DDC owns the copyright in the software and also owns a copyright in "unnecessary creative expression that accompanies that." She specified that DDC is not arguing that it owns the copyright in the entire design of the component, only in the expression that accompanies it. DDC considers this to be direct infringement, as it is a derivative work of the component of the software image files.

On rebuttal, Judge Hurwitz asked again DDC's counsel to explain the relationship between both the creative input of the software and the creative input of its users, and how and when the ratio of these two creative inputs would trigger, or not, the copyright protection of the output. DDC's counsel answered that DDC is focused on expressive content that is not in the actual design of the component, such as the font or the colors used, the shape of a comment box, or the placement of certain components around the design which appear in the design file, but which are not the design itself. She argued that these elements must be identified using the abstraction-filtration-comparison test to find out whether some elements are protected by copyright, but conceded that there was not any computer software case which used this test.

Intellectual property
European Union

The exhaustion rule does not authorize the resale of the back-up copy of a computer program

By Marie-Andrée Weiss

The Court of Justice of the European Union (CJEU) ruled on 12 October 2016 that while the original acquirer of a software can resell his used copy of the program because the exclusive rights of the copyright holder have been exhausted by the first sale, reselling a back-up copy of the program is subject to the authorization of the rightsholder. The case is Ranks and Vasiļevičs, C-166/15.

Mr. Ranks and Mr. Vasiļevičs (Defendants) sold online, from 28 December 2001 to 22 December 2004, more than 3,000 back-up copies of Microsoft computer programs protected by copyright, for an amount evaluated at 264,514 euros. Defendants claimed to have bought these copies from the original owners. However, some of these programs were copies, which Defendants claimed had been legally made by the original owners after the original programs had been damaged, destroyed or lost.

Defendants were charged by a Latvian court for selling unlawfully objects protected by copyright and found guilty. On appeal, the Criminal Law Division of the Riga Regional Court requested a preliminary ruling from the CJEU, asking the Court (1) if the acquirer of a copy of a computer program stored on a non-original medium can resell this copy, in such a case that the original medium of the program has been damaged and the original acquirer has erased his copy or no longer uses it, because in such case the exclusive right of distribution of the right holder has been exhausted, and (2) if the person who bought the used copy in reliance of the exhaustion of the right to distribute can sell this program to a third person.

The Latvian court cited Directive 2009/24 in its request. However, as the facts took place before the Directive entered into force on 25 May 2009 and repealed Directive 91/250, the CJEU considered that these two questions had to be interpreted under the equivalent provisions of Directive 91/250, that is, its articles 4(c) about the first sale of computer program doctrine, and its articles 4(a), 5(1), and 5(2) about the exceptions to the exclusive right of reproduction of a computer program.

The exhaustion right protects the right of the original acquirer to resell his copy of the program

Article 4(a) of Directive 91/250 and Article 4.1(a) of Directive 2009/24 give the rightsholder the exclusive right to reproduce a computer program, by any means whatsoever, whether temporarily or permanently. That right is, however, exhausted, under Article 4(c) of Directive 91/250 and Article 4.2 of Directive 2009/24, if the copy of the program has been placed on the market in the European Union (EU) by the rightsholder or with her consent. The CJEU held in UsedSoft that the right of distributing a computer program is thus exhausted regardless of whether it is a tangible or an intangible copy of the program (*UsedSoft* paragraphs 55 and 61) and specified that "sale," within the meaning of Article 4(2) of Directive 2009/24, includes purchasing the right to use a copy of a computer program for an unlimited period (*UsedSoft*, paragraph 49).

The CJEU noted that "the holder of the copyright in a computer program who has sold, in the European Union, a copy of that program on a material medium, such as a CD-ROM or a DVD-ROM, accompanied by an unlimited licence for the use of that program, can no longer oppose the resale of that copy by the initial acquirer or subsequent acquirers of that copy, notwithstanding the existence of contractual terms prohibiting any further transfer" (*Ranks and Vasiļevič* paragraph 30).

Reselling a back-up copy of a computer program is subject to the authorization of the rightsholder

However, the issue in our case was not about the right of the original acquirer to resell his used copy of a computer program, but instead whether the right of exhaustion gives a person who acquired, either from the original acquirer or from a subsequent acquirer, a used copy of a computer program stored on a non-original material medium, the right to resell that copy.

Microsoft argued that a non-original copy of a computer program can never benefit from exhaustion of the right of distribution and thus cannot be sold by the user without the rightsholder's authorization. Defendants argued that even non-original copies benefit from the exhaustion right, if, as stated in *UsedSoft*, the right holder gave the acquirer of a program, in return for a fee corresponding to the economic value of the work, the right to use the copy for an unlimited period, and if the original acquirer had made every copy in his possession unusable at the time of the resale of the program.

Advocate General Saugmandsgaard wrote in his 1 June 2016 Opinion of the case that article 4(c) of Directive 91/250 must be interpreted as meaning that the right holder's exclusive right of distribution is infringed if the user makes a copy of the computer program and then sells it without the right holder's authorization, even if the original medium has been damaged and the seller makes all of his copies unusable (Opinion at 25 and 54). The CJEU followed the opinion of its AG.

While article 5(2) authorizes making a back-up copy of the computer program, it may only be done "to meet the sole needs of the person having the right to use that program" and, therefore, such copy cannot be made to resell the computer program to a third party, even if the original copy has been destroyed, damaged or lost (*Ranks* *and Vasiļevič* paragraph 43).

The CJEU had held in *UsedSoft* that the exclusive right of distribution of a computer program is exhausted after the first sale of the program in the EU. However, *UsedSoft* could be distinguished from this case as Mr. Ranks and Mr. Vasiļevič were not the original acquirer of the computer programs, and instead had been selling copies of computer programs "on non-original material media." There was "nothing to suggest that they initially purchased and downloaded those copies from the rightholders website"(*Ranks and Vasiļevič* paragraph 51).

A back-up copy of a computer program cannot be transferred to a new acquirer without the authorization of the copyright holder, even if the original copy has been damaged, destroyed or lost (*Ranks and Vasiļevič* paragraph 44). For the CJEU, Mr. Ranks and Mr. Vasiļevič thus indeed possessed infringing copies of a computer program, which is forbidden by article 7.1(b) of Directive 91/250 and Directive 2009/24, and sold them, which is forbidden by article 7.1.(a) of Directive 91/250 and Directive 2009/24.

This case restricts the scope of the digital resale market.

Intellectual property

European Union

McFadden vs. Sony Entertainment – ECJ prohibits anonymous open WLANs

By Maria Sturm

On 15 September 2016 the ECJ presented its judgement in the case Tobias McFadden vs. Sony Entertainment Germany. The judgement is interesting for two reasons: 1) it clarifies some questions about the liability of WLAN providers and 2) the judges deviated from the opinion of advocate general Szpunar, delivered on 16 March 2016.

In this case, the ECJ had to give a preliminary ruling according to Article 267 TFEU in a case brought before the district court I in Munich. Mr. McFadden operated an anonymous access to a wireless local area network (WLAN) free of charge in the vicinity of his business of selling and leasing lighting and sound systems. He did so, because he wanted to draw the attention of customers of the shops nearby. Through his open WLAN a musical work owned by Sony Entertainment Germany was made available to customers, but without Sony's consent.

The district court of Munich had several questions related to EU law which it could not answer without the prior interpretation of the ECJ. So it requested the Court to give a ruling according to Art. 267 TFEU. The most important explanations of the ECJ covered three areas:

1. Can a service free of charge still be an economic activity?

Making a network available to the general public free of charge can be an information society service according to Article 12 (1) of Directive 2000/31 (Directive on electronic commerce) if it is provided for purposes of advertising. In the case in question, Mr. McFadden offered the free WLAN to draw the attention of passers-by to his shop. This is important, because the relevant directives only cover economic activity. However, we talk about economic activity in the context of EU law only when the service provided is **not** free of charge. Here, the ECJ sees an indirect remuneration via advertising, and therefore held that this is economic activity.

2. How far goes the limitation of liability of access providers according to Directive 2000/31?

Article 12 (1) of Directive 2000/31 limits the liability of access providers. Therefore, if its preconditions are fulfilled, the provider does not have to compensate rightsholders for the infringement of their rights. That includes also reimbursement of the costs of giving formal notice and court costs. However, rightsholders may still claim injunctive relief against the continuation of the infringement against the provider. And in this case, they can also claim the costs of giving formal notice and court costs. Costs of giving formal notice and court costs are accessory claims. They can only be granted, if the main claim is successful. Without liability, no accessory claims to the liability claim exist. But if there is an injunctive relief claim, the accessory claims to the injunctive relief claim can be enforced. The ECJ made this clear distinction in interpreting Article 12 (1), because before how far the provider liability limitation extended was in dispute.

3. How can an equilibrium between the different basic rights with regard to the internet be achieved?

The ECJ had to decide about an equilibrium of three different basic rights affected in the case of the infringement of copyrights via the internet: first, there is the right to intellectual property of the rightsholder, second, the provider has a right to entrepreneurial freedom, and third, the user has a right to access free information. Closing internet access completely would of course protect the rightsholder's copyright most effectively, but would also excessively harm the two other rights. One could require the access provider to monitor all of the information transmitted. However, this measure would harm the access providers right to entrepreneurial freedom as it would require too much time and effort. Apart from that, this measure is already forbidden by Art. 15 (1) of Directive 2000/31. According to the advocate general, securing the WLAN with a password would harm the fair balance of the affected rights, too. In contrast, the ECJ decided that the only feasible measure would be to protect the WLAN via a password. This measure harms the entrepreneurial freedom and the right to free information to a smaller degree and offers at least some protection to the copyright, because the access is no longer anonymous and thus may deter possible infringers. However, concerning this last point we must keep in mind another consideration: the McFadden case was a preliminary ruling. This means that the ECJ only answered the questions the district court of Munich posed and the district court of Munich only asked, if the password solution was admitted by EU law. However, there are other technical measures, e.g. the blocking of certain ports[4], which might have the same effect and might offer an equilibrium between the affected rights, too.

[4] In the internet protocol suite, a port is an endpoint of communication in an operating system.