Kluwer Copyright Blog

Waiting for Tom Kabinet, a.k.a why EU copyright needs digital exhaustion, and how the CJEU can help with this – Part 2

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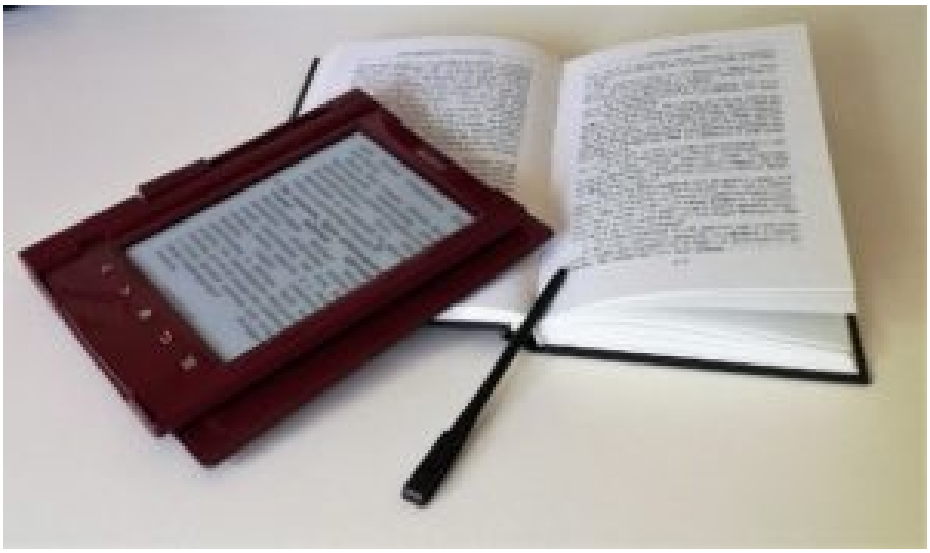

Part 1 of this post discussed the legislative history and significance of the CJEU referral in *Tom Kabinet.* This part will illustrate content and implications of the three classificatory dichotomies, explain why EU copyright law needs digital exhaustion, and propose interpretative solutions for the CJEU to help with this, leveraging the occasion offered by the *Tom Kabinet* referral.

Three classificatory dichotomies

Sale vs license. Licenses are generally excluded from the scope of Article 4(2) InfoSoc, for they do not entail a transfer of ownership, and their object is usually qualified as a service. In *UsedSoft*, the CJEU defined "sale" as an autonomous concept of EU law, adopting a functional interpretation according to which, regardless of the label used to classify the contract, sale is any agreement which allows the use, unlimited in time and scope, of an object in return for a payment that corresponds to its economic value. A narrower interpretation not including "all forms of product marketing" having sale-like characteristics was considered a threat to the effectiveness of exhaustion, for it would have left right-holders free to unduly control secondary markets and restrict fundamental freedoms beyond what is necessary to obtain an appropriate remuneration, that is to preserve the specific subject matter of copyright.

In Tom Kabinet. In order to avoid the frustration of the balancing aims underlying Article 4(2) InfoSoc and guarantee the adoption of a harmonized notion of sale across EU copyright law, the CJEU would need to apply the same reasoning to contracts labelled as "license" and having as object other types of digital works. The interpretative option is supported by strong contextual

arguments as the Software Directive II, and in fact the InfoSoc Directive as well, mentions the notion of sale without referring to national laws, and the recitals of both Directives point to the goals of striking a (fair) balance between copyright and conflicting rights and freedoms, and between the protection of right-holders' interests and the achievement of other Treaty objectives.

Distribution vs communication. The dichotomy matters because exhaustion is excluded for communication to the public – the category under which the online transfer of digital copies is generally classified. In *UsedSoft* the CJEU could avoid the definitory question by using the *lex specialis* argument to exclude the application of Article 3 InfoSoc to software products, and classify as a distribution any transfer of the work, regardless of its tangible/intangible nature. The Court, however, also added an important systematic clarification, ruling that Article 6(1) WCT does not distinguish the two rights on the basis of the nature of their objects, but rather on the type of transfer and use of the work, with "distribution" covering any conveyance of the copy – regardless of whether tangible or intangible – "communication" referring to any dematerialized transmission with no permanent retention of the work, and "making available" indicating the same transmission, but originating on-demand.

In *Tom Kabinet*. The Court could take advantage of the opportunity offered by the referral to finally bring systematic order and spell out the criteria to be applied when drawing the borders between the two rights. The swiftest option, which is to confirm the *UsedSoft* reading of Article 6(1) WCT, is contextually supported by (i) the saving clause of Article 8 WCT which, when listing the Berne Convention's provisions left untouched by the "new" umbrella solution, refers only to conduct entailing the transmission of the work (broadcasting, recitation, public performance etc); (ii) the decision of the EU legislator to classify the making available right as a sub-category of the right of communication to the public and not – as e.g. in the US – under the right of distribution, emphasizing their ontological distinction; and (iii) Recitals 23 and 24 InfoSoc, which qualify "transmission" as a key feature of the right protected under Article 3 InfoSoc. Compared to the rigid distinction derived by the Agreed Statement and grounded on the tangible/intangible nature of the support, this interpretation would also attribute the necessary relevance to the different economic value and significance of the acts of exploitation included under Articles 4 and 8 WCT – a difference which does not depend on the nature of the copy, but on the duration and extent of its availability for the user. It would also ensure a technologically neutral approach to the various economic operations, making sure that functionally similar transactions are treated equally, and increasing the adaptability of fast-to-obsolesce provisions to the evolution of copyright markets.

Goods vs services. The dichotomy became relevant when the EU legislator supplemented the WCT definition with the exclusion of services from the scope of exhaustion. The two notions are not defined in the Treaties, and only fragmentedly by secondary sources and case law. The CJEU qualifies as goods entities characterized by tangibility and tradability, and services as a residual category. Intangible products tend to be simplistically qualified as services for their immaterial nature, regardless of the contract of which they are object. The same approach is followed by the Database Directive (Recital 33, excluding exhaustion for online databases), the E-Commerce Directive (Recital 18, defining the online sale of goods as service), and the VAT Regulation (limiting supply of goods to "the transfer of the right to dispose of tangible property as owner").

To overcome the problems created by the frequent limitation of EU consumer protection measures to goods, the Consumer Rights Directive (CRD, 2011/83/EU) has opted for a new, hybrid classification of contracts for digital content not distributed on material supports, stating that they "should be classified (…) neither as sales contracts nor as service contracts". With the very same

tertium genus approach, the EU legislator has allowed Member States to equalize the VAT imposed on printed and electronic books for cultural policy goals, carving out e-books from the umbrella of services without classifying them as goods. Both interventions, however, are limited in scope as *lex specialis*. This fragmented background makes the use of the good-service dichotomy to define the scope of exhaustion (Recital 29 InfoSoc) a source of ambiguities, hardly justified in light of the objectives of the principle, for which what counts is the transfer of ownership, and not the nature of the copy.

In *Tom Kabinet.* With the largest copyright market now being online and digitized, the use of tangibility as a watershed to distinguish between goods and services would ultimately expunge exhaustion from the system. To avoid this risk, the CJEU should opt for a contextual and teleological interpretation of the dichotomy. On a contextual ground, the renewed scope of Articles 3 and 4 InfoSoc may help with linking distribution to goods and communication to the public to services, using a *tertium genus* approach for the immaterial transfer of digital content. On a teleological ground, the same conclusion would result from the consideration that excluding digital exhaustion because of a tangibility-oriented reading of the dichotomy would run against the goals and limits of the principle, as consolidated in the CJEU's case law – protecting fundamental freedoms, avoiding market fragmentation, and fostering competition, while preserving the specific subject matter/essential function of copyright, that is the right to obtain adequate remuneration. Classifying as service any digital work rules out digital exhaustion, leaving right-holders free to control secondary digital markets and request additional remuneration after each online sale of protected works in digital format, even when the first sale has already granted them an appropriate return. Adopting *a tertium genus* classification for the dematerialized transfer of digital content would bring the latter outside the scope of Recital 29 InfoSoc, casting away the distortions caused by the different treatment reserved for similar transactions simply due to the different nature of the support involved, and avoid undermining the effects of exhaustion in a large share of the copyright market.

Why EU copyright law needs digital exhaustion

By allowing digital exhaustion, the CJEU could solve several short-circuits that have emerged in its construction of EU copyright law. Aside from solving the three abovementioned classificatory dichotomies, the Court would (i) eliminate the need to resort to the *lex specialis* argument to limit the side-effects of the InfoSoc's tangible-intangible dichotomy, reducing the fragmentation and systematic chaos featuring its case law; (ii) provide a single autonomous notion of sale across EU copyright law, inspired by the interpretative principle of functional equivalence; and (iii) grant uniformity in the methods of interpretation applied to Article 4 InfoSoc, now split between the rigid literal interpretation of paragraph 2, and the flexible teleological approach to paragraph 1, which has expanded the right of distribution to also cover remote preparatory activities, even if not resulting in a sale. Admitting digital exhaustion would also ensure coherence in the teleological interpretation and implementation of legal solutions which largely share the same objectives (as is the case for Article 4(2) InfoSoc and Article 4(2) Software II), and the fulfillment of some of the InfoSoc goals, such as the implementation of the four freedoms and the non-distortion of competition.

Digital exhaustion is also supported by a range of economic arguments. Several studies have proven the functional equivalence of traditional and digital markets *vis-à-vis* the necessity of exhaustion, particularly to balance copyright enforcement and conflicting policy objectives such as access to and preservation of cultural products, privacy, and reduction of transaction costs. The

principle is also capable of realizing additional economic benefits, chiefly to bolster innovation and platform competition, with a consequent increase in quality and decrease in price of protected works.

How the CJEU can help

The seemingly insuperable obstacles that a literal reading of existing sources pose to digital exhaustion may be effectively overcome – should the CJEU wish to do so – with a teleological and contextual interpretation based on the example of the case law on Community exhaustion, where the Court directly applied Treaty provisions to protect fundamental freedoms and the internal market against the distortive effects of national exhaustion rules, while ensuring the preservation of the specific subject matter and essential function of copyright.

One barrier may lay in the fact that InfoSoc is a Directive of maximum harmonization (C-479/04, *Laserdisken*) – a circumstance that bans the horizontal application of the Treaty where the Directive has already introduced measures necessary to achieve specific Treaty objectives, unless it is ascertained that the measure itself falls short of fulfilling such goals. Article 4(2) InfoSoc and exhaustion seem to perfectly fit within this definition. However, the revolution in copyright markets has created a limbo where the exclusion of digital exhaustion leaves out a large – if not the largest – share of the market of protected works from the balance between copyright and other Treaty objectives struck by Article 4(2) InfoSoc. This gap demands a direct application of the Treaty, to the extent necessary to fulfill it and the Directive's goals, and *Tom Kabinet* may be the opportunity to proceed accordingly.

Using the same teleological arguments of *UsedSoft*, the obstacles posed by Recital 28 InfoSoc and the WCT can be circumvented upon two considerations. The first is that the WCT sets only a minimum standard of protection, which means that the tangible-only limitation set in the Agreed Statement should be understood as a lower and not upper edge of protection. Once a license akin to a sale is excluded from the scope of Article 3 InfoSoc for incompatibility, the need to "host" it under another right to effectively protect right-holders justifies a stretch of Article 4 InfoSoc to cover digital copies. The second is that a literal interpretation of existing sources may not guarantee that in the digital environment the Treaty provisions underlying the principle of exhaustion, from those that triggered its Community-wide introduction (freedom of circulation of goods and protection of competition in the internal market) to those setting specific cultural policy goals – achieved through a greater availability and affordability of protected works in secondary markets – and the respect of fundamental rights such as property (Article 17 CFREU) and privacy (Article 8 CFREU) of the buyer of the digital support, would be equally respected and fulfilled. This consideration may allow the horizontal application of the same Treaty rules to interpret secondary EU law in a manner that is conducive to the realization of their objectives, and thus to allow digital exhaustion to take place, provided that the first sale of the work is enough to ensure appropriate remuneration to right-holders, in order to preserve the specific subject matter/essential function of copyright.

Last, in the absence of a provision similar to Article 5 Software II in the InfoSoc Directive, the act of reproduction needed to effectively transfer a digital work in the context of a second-hand sale can be justified either under Article 5(1) InfoSoc, qualifying the transient reproduction as an essential part of a technological process whose sole purpose is to enable a lawful second-hand transfer of the work, or by applying the *FAPL* and *Ulmer* doctrine, which allows an extension of the scope of exceptions and limitations (and exhaustion may be characterized as a limitation to

copyright) when needed to ensure the achievement of their goals. In both instances, technological measures of protection should be put in place to ensure that the reproduction is only temporary, and that the seller's copy is deleted upon alienation (e.g. watermarking, forward-and-delete technologies etc).

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