

Digital Resale: Assessing the Impact of R.A. No. 10372 and the First Sale Doctrine on Digital Media Transactions in the Philippines

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I. INTRODUCTION

The first part of this Note will provide a brief overview regarding the role of the First Sale Doctrine¹ in a digital marketplace where intangible digital intellectual property is sold. From the beginning, it must be emphasized that the amendments introduced by Republic Act (R.A.) No. 10372² on the doctrine have yet to be interpreted and applied by our courts in an actual controversy. The void in jurisprudence is the concern that this Note seeks to address in order to afford consumers of digital media a measure of certainty as to what may be considered copyright-infringing acts or otherwise. Thus, the succeeding parts will discuss the following:

- (1) the legal issue to be addressed by this Note, which is whether or not the First Sale Doctrine may be used as an affirmative defense if a digital resale is alleged to be a copyright-infringing act under the Intellectual Property Code,³ as amended by R.A. No. 10372;

Cite as 60 ATENEO L.J. 241 (2015).

1. See BLACK'S LAW DICTIONARY 711 (9th ed. 2011) & World Intellectual Property Office (WIPO) Secretariat, Interface Between Exhaustion Of Intellectual Property Rights And Competition Law, (A Document Presented To The Fourth Session Of The Committee on Development and Intellectual Property (CDIP)) 4, available at http://www.wipo.int/edocs/mdocs/mdocs/en/cdip_4/cdip_4_4rev_study_inf_2.pdf (last accessed July 30, 2015) [hereinafter WIPO, Interface]. Generally defined, it is "the consumption of rights in intellectual property subject matter as a consequence of the legitimate transfer of the title in the tangible article that incorporates or bears the intellectual property asset in question." With regard to scope, it may operate at a national, regional, or international level. In copyright law, it is the rule that the purchaser of a physical copy of a copyright-protected work may sell the copy to a third party without fear of infringing the author's right of distribution. The author is considered to have exhausted his right to distribute the physical copy of his work after he releases it to the public at large. It may also be referred to as the exhaustion doctrine or the exhaustion right of the consumer. *Id.*
2. An Act Amending Certain Provisions of Republic Act No. 8293, Otherwise Known as the "Intellectual Property Code Of The Philippines," and for Other Purposes [INTELLECTUAL PROPERTY CODE OF THE PHILIPPINES], Republic Act No. 10372 (2012).
3. An Act Prescribing the Intellectual Property Code and Establishing the Intellectual Property Office, Providing for its Powers and Functions, and for

- (2) the objectives of the Note in order to address such issue;
- (3) the relevance of the Note to Philippine jurisdiction; and
- (4) the scope and limitations of the Note.

A. Statement of the Problem

The primary issue that this Note seeks to address is whether or not the digital resale of legitimately purchased digital media constitutes copyright infringement under the Intellectual Property Code, as amended by both R.A. No. 10372 and the e-Commerce Act.⁴ Corollary to this issue is whether or not the First Sale Doctrine may be utilized as an affirmative defense against allegations of infringements. Other jurisdictions have varied opinions on the matter. The case of *UsedSoft GmbH v. Oracle International Corp.*⁵ not only strengthened the First Sale Rights of consumers within the European Union, it also protected digital resellers from being liable for copyright infringement. The situation in the United States of America (US) is different, where *Vernor v. Autodesk, Inc.*⁶ took the opposite stance by denying the American consumer of the defense available under the First Sale Doctrine and upholding the enforceability of the software license agreement. In the Philippines, the Supreme Court has yet to take a position on this matter. Meanwhile, Filipino digital resellers are left in an uncertain situation and might find themselves liable under the e-Commerce Act for piracy or unauthorized transfer of legitimately purchased copies.

The second issue that this Note seeks to address is whether or not the amended Intellectual Property Code still imposes a specific regime of copyright exhaustion in national, regional, or international levels. The resolution of this issue will also determine whether copyright holders in the Philippines still have the exclusive right to prevent parallel importation of their works. Further, should it be determined that the First Sale Doctrine applies to protected digital works under the first issue of this Note, another question that need be resolved is whether or not the exhaustion doctrine will apply to the digital environment.

Finally, if the Supreme Court adopts any of the aforementioned exhaustion regimes, it is necessary to determine which exhaustion regime the

Other Purposes [INTELLECTUAL PROPERTY CODE], Republic Act No. 8293, as Amended (1997).

4. An Act Providing for the Recognition and Use of Electronic Commercial and Non-Commercial Transactions, Penalties for Unlawful Use Thereof and for Other Purposes [e-Commerce Act], Republic Act No. 8792 (2000).
5. *UsedSoft GmbH v. Oracle International Corp.*, Eur. Ct. J. C-128/11, Grand Chamber Judgment (July 3, 2012).
6. *Vernor v. Autodesk, Inc.*, 621 F.3d 1102 (9th Cir. 2010) (U.S.).

Philippines should adopt that will yield the greatest protection for digital copyright and resale rights.

B. Objectives

The primary objective of this Note is to determine if the First Sale Doctrine applies in the Philippines and if the same can be extended to the digital environment. In doing so, this Note will discuss whether or not the treaty obligations of the Philippines permit the First Sale Doctrine as a limitation on an author-owner's digital copyright. These treaties include the Berne Convention,⁷ the World Intellectual Property Organization (WIPO) Internet Treaties,⁸ and the Trade-Related Aspects of Intellectual Property Rights (TRIPS) Agreement.⁹ Should it be found that international copyright laws permit the operation of the exhaustion doctrine, this Note shall explore the rights of the author-owner under the same — which operate as an implication of the said doctrine. These “economic rights” or copyrights of an author shall be discussed as they are enshrined in International Copyright Law and Philippine Copyright Law. Consequently, the statutory basis of the First Sale Doctrine in the amended Intellectual Property Code shall be discussed and if the same may be invoked as an affirmative defense in case of alleged infringement.

The second objective of this Note is to determine what concept of the First Sale Doctrine is permissible under Philippine Copyright Law, in light of the changes made to the Intellectual Property Code by R.A. No. 10372. This Note will also resolve whether or not copyright still includes the exclusive right of importation and if the law still prohibits parallel imports.

Recognizing that Philippine jurisprudence is insufficient on the matter, the third objective of this Note is to interpret and clarify the provisions of the amended Intellectual Property Code on the applicability of the First Sale Doctrine on digital resale. This objective shall be met by turning to the American and European Union jurisprudence, which may serve as persuasive guides to interpret our own law. The most recent decisions from each jurisdiction involving digital copyright, resale, and the operation of the digital exhaustion doctrine shall be discussed.

7. Berne Convention for the Protection of Literary and Artistic Works, *ratified* Aug. 1, 1951, 1161 U.N.T.S. 30 [hereinafter Berne Convention].

8. WIPO Copyright Treaty, *ratified* Oct. 4, 2002, 36 I.L.M. 65 [hereinafter WCT] & WIPO Performances and Phonograms Treaty, *ratified* Oct. 4, 2002, 36 I.L.M. 76 [hereinafter WPPT] [both collectively known and hereinafter WIPO Internet Treaties].

9. Agreement on Trade-Related Aspects of Intellectual Property Rights, *ratified* Dec. 16, 1994, 1869 U.N.T.S. 299 [hereinafter TRIPS Agreement].

C. Significance of the Study

1. The Rise of Intangible Digital Intellectual Property

The evolution of the internet and technology has drastically changed the way people consume content. So drastic that Philippine law and jurisprudence often lag behind the emergence of new trends and technologies. Music, movies, games, and other media are now just a click away because of the internet and the constantly improving speed of internet service providers (ISPs) that are made available to consumers all over the world. Its evolution has been described as follows —

The Internet has evolved from a mere e-mail network for technically skilled users during its first decade into an e-mail or instant messaging communications network for some, a gaming network for others, a source of news for others, and a distribution channel for video and musical entertainment for others. For others still, it is the principal media for engaging with geographically dispersed communities of friends.¹⁰

A few decades ago, people had to go to stores to purchase or rent movies in Betamax format, music in compact cassette, and computer software in floppy disks. The advent of the optical disc and the widespread access to the internet through dial-up connections in the 1990s marked the gradual shift towards digital distribution.¹¹ By the end of that decade, file-sharing software appeared, catapulting the development of digital downloading of compressed files containing music, films, or software from the Internet to an individual's personal computer (PC). These downloaded files could, then, be stored in physical media by “burning” them into compact discs. Ironically, it was the unauthorized sharing of these files through peer-to-peer (P2P) networks, such as Napster, that laid the groundwork for future online sellers of digital content such as Apple Inc.'s iTunes.¹² Currently, iTunes carries 80% of the market share in the US and 70% of the market share of worldwide digital music sales.¹³ In 2011, 16 billion songs were downloaded from iTunes and 300 million iPods were sold.¹⁴ Its nearest competitor — Sony — sold only 220,000 Walkman

10. Shane Greenstein, *The Evolution of Internet Architecture: Glimmers and Signs of Innovative Health in the Commercial Internet*, 8 J. TELECOMM. & HIGH TECH. L. 25, 33 (2010).

11. Digitaldownloader, *The History of Digital Distribution*, available at <http://www.engadget.com/2011/10/04/apple-16-billion-itunes-songs-downloaded-300-million-ipods-sol/> (last accessed July 30, 2015).

12. *Id.*

13. *Id.*

14. Donald Melanson, *Apple: 16 billion iTunes songs downloaded, 300 million iPods sold*, available at <http://www.engadget.com/2011/10/04/apple-16->

cassette players over a span of 30 years.¹⁵ Today, digital distribution has spread out from music and videos to e-books, software, and video games with digital vendors emerging in the market, such as Steam and Amazon.

In 1994, there were less than 5,000 internet users in the Philippines.¹⁶ By 2004, there were an estimated six million users.¹⁷ The number of Filipino internet users is expected to rise up to an estimated 41 million by 2014.¹⁸ As of 2002, ₱3.66 billion was spent by Filipinos on online shopping.¹⁹ Online spending per person was pegged at ₱16,400.00 during the first half of that year.²⁰ Some of the top purchases made by Filipinos were physical and digital copies of computer software, music, videos, and books.²¹ A decade later, in 2012, the volume of e-commerce increased to approximately ₱5 billion, which consisted of online sales of physical and digital products.²² Despite these numbers, there exists no reliable industry figures on how exactly e-commerce is growing in the Philippines.²³ In the same year, Google estimated that there are over 33 million Filipinos who access the internet regularly to shop and create businesses, among other activities.²⁴ Google expects the number to double by 2016.²⁵ With the advent and increasing ubiquity of smartphones worldwide, an estimated 70 million mobile subscribers in the Philippines will have access to internet-enabled devices.²⁶ The Philippines is the fastest-growing smartphone market in South East Asia — with 30% of all mobile phones sold in the country being

billion-itunes-songs-downloaded-300-million-ipods-sol/ (last accessed July 30, 2015).

15. *Id.*

16. Janette Toral, *The Filipino Internet User Evolving, in PHILIPPINE INTERNET REVIEW: 10 YEARS OF INTERNET IN THE PHILIPPINES* (1994-2004) 35 (2009).

17. *Id.*

18. *Id.*

19. *Id.* at 40.

20. *Id.*

21. *Id.* at 43.

22. Toral, *supra* note 16, at 43.

23. Janette Toral, *The End of E-Commerce as we know it*, available at <http://digitalfilipino.com/the-end-of-e-commerce-as-we-know-it> (last accessed July 30, 2015).

24. TJ Dimacali, *Google Philippines launched, job openings announced*, available at <http://www.gmanetwork.com/news/story/291602/scitech/technology/google-philippines-launched-job-openings-announced> (last accessed July 30, 2015).

25. *Id.*

26. *Id.*

smartphones.²⁷ With these statistics, one can only imagine the actual amount of digital media purchased online by Filipinos.

Truly, the age of digital content distribution has arrived. Unfortunately, Philippine copyright laws have only begun to address this reality and our jurisprudence has not even explored this frontier. Inevitably, there shall be several questions over the right to ownership over the digital content purchased online. Do consumers own the digital media they download from the internet or are they mere licensees — forbidden to exercise acts of ownership over the same? Do consumers inadvertently waive their right to ownership by blindly clicking “Yes” on agreements when they hastily make their digital purchases or are these agreements contracts of adhesion that are not enforceable in the jurisdiction of the Philippines?

2. The Gap in Jurisprudence, the Lack of Regulation in Philippine e-Commerce, and the Danger of Infringement

It is also important to determine whether or not a gray market for digital products within our jurisdiction may come to exist under our intellectual property laws. There exists a need to explore the possible defenses a legitimate reseller may use should he or she decide to participate in it. Indeed, facilitating the regulation of a legitimate gray market, where copyright and consumer interests are both protected, is in line with public policy. The Intellectual Property Code provides that “[t]he use of intellectual property bears a social function. To this end, the State shall promote the diffusion of knowledge and information for the promotion of national development and progress and the common good.”²⁸ With this statutory declaration, the pressing need for the protection of intellectual property rights has come to the attention of the various branches of the Philippine Government. In recent years, the Government has turned much of its attention to preventing theft of intellectual property. Retired Supreme Court Justice Josue N. Bellosillo succinctly explains the Philippine milieu in his speech before the Judicial Workshops for Judges and Judicial Administrators on Intellectual Property —

The Intellectual Property Office, the Videogram Regulatory Board, the Department of Justice, the National Bureau of Investigation, the Philippine National Police, the Bureau of Customs, the Department of Trade and Industry [(DTI)], the education system, the media[,] and the intellectual property owners themselves have bonded together and are complementing

27. *Id.*

28. INTELLECTUAL PROPERTY CODE, § 2, ¶ 2.

each other *in formulating and adopting a more rational, viable[,] and effective response to the unmitigated violation of intellectual property rights.*²⁹

Although the e-Commerce Act granted authority to the DTI to direct and supervise the promotion and development of e-commerce in the country alongside other government agencies,³⁰ the online industry in the Philippines remains largely unregulated. A great contributor to the widespread unmitigated violation of intellectual property rights is perhaps due to the great confusion over which government agency exercises primary supervision of e-commerce in the Philippines.³¹ During the term of former President Gloria Macapagal-Arroyo, the Commission on Information and Communications Technology (CICT) was established with this mandate — “[t]he Commission shall be the primary policy, planning, coordinating, implementing, regulating, and administrative entity of the executive branch of Government that will promote, develop, and regulate integrated and strategic ICT systems and reliable and cost-efficient communication facilities and services.”³²

Perhaps realizing that the CICT had overlapping functions with DTI, it was eventually abolished by President Benigno C. Aquino III and reorganized into the Information and Communications Technology Office (ICTO).³³ It is now placed under the policy, technical, and administrative supervision of the Department of Science and Technology (DOST).³⁴ It is the DOST which now takes the lead in the implementation of the Government Information Systems Plan (also known as Philippine Government Online), which is a “framework and guide for the computerization of key frontline and common services and operations of the

29. Josue N. Bellosillo, *The Judiciary and the Protection of Intellectual Property Rights*, Judicial Workshops for Judges and Judicial Administrators on Intellectual Property (March 17, 2002) & Jorge R. Coquia, Annotation, *Growing National Consciousness of Intellectual Property Rights*, 378 SCRA 376 (2002) [hereinafter Coquia, *National Consciousness*] (emphasis supplied).

30. e-Commerce Act, § 29.

31. Janette Toral, *State of E-Finance and E-Payment in the Philippines*, available at <http://digitalfilipino.com/state-of-e-finance-and-e-payment-in-the-philippines> (last accessed July 30, 2015).

32. Office of the President, *Creating the Commission on Information and Communications Technology*, Executive Order No. 269 [E.O. No. 269], § 2 (Jan. 12, 2004).

33. *Id.*

34. Office of the President, *Reorganizing, Renaming and Transferring the Commission On Information And Communications Technology and Its Attached Agencies to the Department of Science And Technology, Directing the Implementation Thereof and For Other Purposes*, Executive Order No. 47 [E.O. No. 47], § 1 (June 23, 2011).

government to enhance overall governance and improve the efficiency and effectiveness of the bureaucracy.”³⁵ Today, it appears that this plan has been successfully achieved. A great majority of government agencies and instrumentalities, government owned and controlled corporations now have their own websites through which electronic transactions and information are made available to the public.³⁶

Despite these changes, the private sector remains in limbo. Confusion exists as to which government agency between DTI and ICTO is truly in charge of regulating e-commerce. This scenario potentially leaves prospective resellers of both legitimately-purchased and pirated digital intangible intellectual property to their own whims at the expense of the consumer and legitimate resellers. Moreover, the unregulated state of our e-commerce industry highlights the pressing need for scholarly work discussing the various legal issues. Indeed, for foreign media corporations, the largest area they find troublesome in the Philippines is copyright piracy, “particularly of musical recordings and audiovisual works” as well as the “unlicensed use of computer programs.”³⁷ This is largely due to the “ease of replication of digital copies in DVD or CD formats.”³⁸ Therefore, it becomes imperative to determine with certainty if the First Sale Doctrine may be used as an affirmative defense against allegations of infringement.

II. THE BASIS OF THE FIRST SALE DOCTRINE IN INTERNATIONAL COPYRIGHT LAW

The framework of Philippine intellectual property laws is largely influenced by our international treaty obligations. Consequently one cannot discuss the former without being familiar with the latter. This Chapter shall discuss several international instruments where the economic rights of copyright owners are enshrined — with a specific focus on the rights directly affected by the First Sale Doctrine. These are the copyright owner’s exclusive rights to reproduce copies of his work and to distribute such works to the public for the first time. This Chapter will ultimately show that international copyright laws permit exceptions to these economic rights — the exhaustion

35. Office of the President, Approving and Adopting the Government Information Systems Plan (GISP) as Framework and Guide For All Computerization Efforts in Government, Executive Order No. 265 [E.O. No. 265], § 2 (July 12, 2000).

36. Emmanuel C. Lallana et al., e-Government in the Philippines: Benchmarking Against Global Practices (An Unpublished Report Supported by Digital Philippines) 2, available at http://www.unapcict.org/ecohub/resources/e-government-in-the-philippines-benchmarking-against-global-best-practices/at_download/attachment1 (last accessed July 30, 2015).

37. VICENTE B. AMADOR, PHILIPPINE MULTIMEDIA LAW SOURCES: TREATIES, STATUTES & CASES 181 (2012).

38. *Id.*

right included. The following international instruments shall be discussed in the following order: the Berne Convention, WIPO Copyright Treaty, WIPO Performances and Phonograms Treaty (WPPT), and the TRIPS Agreement.

A. Promoting Intellectual Property Protection Worldwide: The World Intellectual Property Organization

The WIPO is the specialized agency responsible for the promotion of the protection of intellectual property throughout the world by ensuring administrative cooperation among states and in collaboration with other international organizations.³⁹ It was established as an organization under the United Nations (UN) and is the international organization tasked with monitoring the enforcement and the observance of intellectual property laws in the international community.⁴⁰ The WIPO functions as a forum where member states can “create and harmonize rules and practices to protect intellectual property rights.”⁴¹ Due to the developments in technology, the field of copyright and its related rights has expanded dramatically, with new ways of distributing and transmitting works globally becoming possible due to “satellite broadcasting, [CDs], DVDs, and the Internet.”⁴² It is precisely because of these developments that the WIPO has been greatly involved in the shaping of new standards to protect copyright in the digital environment.⁴³

Part of the WIPO’s functions is to administer international treaties, agreements, and conventions that concern intellectual property protection.⁴⁴ The WIPO administers the enforcement of the following treaties that concern copyright and related rights:

- (1) Berne Convention for the Protection of Literary and Artistic Works;
- (2) Brussels Convention Relating to the Distribution of Program-Carrying Signals Transmitted by Satellite;

39. Convention Establishing the World Intellectual Property Organization, art. 3, *ratified* July 14, 1980, 828 U.N.T.S. 3 [hereinafter WIPO Convention].

40. David Robert C. Aquino, Annotation, *Overview of Intellectual Property Protection in the Philippines*, 529 SCRA 822 (2007).

41. WIPO, Understanding Copyright and Related Rights (An Online Version Of WIPO Publication No. 909 (E)) 20, *available at* http://www.wipo.int/edocs/pubdocs/en/intproperty/909/wipo_pub_909.pdf (last accessed July 30, 2015) [hereinafter WIPO, Understanding Copyright].

42. *Id.*

43. *Id.*

44. WIPO Convention, *supra* note 39, art. 4.

- (3) Geneva Convention for the Protection of Producers of Phonograms Against Unauthorized Duplication of Their Phonograms;
- (4) Rome Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organizations;
- (5) WIPO Copyright Treaty (WCT); and
- (6) WIPO Performances and Phonograms Treaty (WPPT).⁴⁵

The Philippines is signatory to all these treaties, except the Brussels Convention.⁴⁶ As will be discussed, it is submitted that the most relevant international treaties to digital works are the Berne Convention, the WCT, and the WPPT. To facilitate the administrative cooperation of member-countries, it is also the function of the WIPO to develop measures “designed to facilitate the efficient protection of intellectual property throughout the world and to harmonize national legislation”⁴⁷ in the field of intellectual property law. The Philippines has been a member of the WIPO since 1980 and has been the beneficiary and host of several technical assistance activities ever since.⁴⁸

B. Foundation of International Copyright Law: The Berne Convention

Prior to the establishment of the WIPO, the Philippines became a party to several treaties, conventions, and international agreements on patents, trademark, and copyright — many of which are now being administered by the WIPO. In the field of copyright, the Philippines acceded to the Berne Convention on 1 August 1951.⁴⁹ The Berne Convention provides that literary and artistic works, whatever mode or form of expression,⁵⁰ shall enjoy protection in all signatory countries for the benefit of the author-owner and his successors in title.⁵¹ It guarantees authors-owners the rights granted by both their domestic law and the Berne Convention with the condition that protection in the country of origin should be governed by domestic law.⁵² The Berne Convention defines the term “country of origin” as follows —

45. WIPO, Understanding Copyright, *supra* note 41, at 21.

46. Aquino, *supra* note 40, at 826.

47. WIPO Convention, *supra* note 39, art. 4.

48. WIPO, Information by Country: Philippines, available at http://www.wipo.int/members/en/details.jsp?country_id=139 (last accessed July 30, 2015).

49. Jorge R. Coquia, Annotation, *The International Protection of the Intellectual and Industrial Property in the Philippines*, 336 SCRA 282, 284 (2000) [hereinafter Coquia, *International Protection of IP*].

50. Berne Convention, *supra* note 7, art. 2, ¶ 1.

51. *Id.* art. 2, ¶ 6.

52. *Id.* art. 5, ¶ 3.

- (a) in the case of *works first published in a country of the Union*, that country; in the case of *works published simultaneously in several countries of the Union*[,] which grant different terms of protection, *the country whose legislation grants the shortest term of protection*;
- (b) in the case of *works published simultaneously in a country outside the Union and in a country of the Union*, the latter country;
- (c) in the case of *unpublished works or of works first published in a country outside the Union, without simultaneous publication in a country of the Union, the country of the Union of which the author is a national*, provided that:
 - (1) *headquarters or his habitual residence in a country of the Union, the country of origin shall be that country, and*
 - (2) *when these are works of architecture erected in a country of the Union or other artistic works incorporated in a building or other structure located in a country of the Union, the country of origin shall be that country.*⁵³

Under the Berne Convention, a work is considered to have been “published simultaneously” if the same was published in two or more countries within 30 days of its first publication.⁵⁴

Based on the foregoing definitions, an author’s enjoyment and exercise of rights over his work shall not be subject to any formality — such as registration — and the extent of protection and means of redress for any infringement shall be governed by the country where protection is being claimed.⁵⁵ In addition to the guarantee of protection of an author’s rights over his works within signatory countries, the Berne Convention provides for the restriction of an author’s rights when such authors are nationals of countries that are not parties to the Berne Convention.⁵⁶ The rights of an author who is a national of such state may be restricted by the signatory country when his country fails to protect, in an adequate manner, the works of authors who are nationals of the country belonging to the Union.⁵⁷ In effect, it may be observed that the Berne Convention prescribes a minimum standard of protection, which all countries must accord to the works of authors within their jurisdiction, and the consequences of failure to provide such standard.

1. The Author’s Reproduction Right and the Three-Step Test

One of the most important rights discussed under the Berne Convention is the author’s exclusive right of reproducing his protected works and

53. *Id.* art. 5, ¶ 4 (emphasis supplied).

54. *Id.* art. 3, ¶ 4.

55. *Id.* art. 5, ¶ 2.

56. Berne Convention, *supra* note 7, art. 6, ¶ 1.

57. *Id.*

authorizing such reproduction in any manner or form.⁵⁸ The term “reproduction” covers any sound or visual recording.⁵⁹ As an exception to this exclusive right of reproduction, the Berne Convention allows for member countries to legislate permissible circumstances where reproduction may be made without the authorization of the author. However the reproduction must not conflict with the normal exploitation of the work nor may it unreasonably prejudice the legitimate interests of the author.⁶⁰ The rules allowing such an exception are collectively known as the “Three-Step Test,”⁶¹ which was first codified in the Berne Convention. Since then it has been repeated and included in various forms within the text of several international instruments concerning intellectual property. With regard to international copyright laws, the test can be found in different international agreements.

First, in Article 9 of the Berne Convention, which provides that

[i]t shall be *a matter for legislation in the countries of the Union* to permit the reproduction of such works in certain special cases, provided that such reproduction *does not conflict with a normal exploitation of the work and does not unreasonably prejudice the legitimate interests of the author.*⁶²

Secondly, Article 10 of the WCT, which adopts the provisions of the Berne Convention and extends their application to the digital environment, provides that

- (1) Contracting Parties may, *in their national legislation*, provide for limitations of or exceptions to the rights granted to authors of literary and artistic works under this Treaty *in certain special cases that do not conflict with a normal exploitation of the work and do not unreasonably prejudice the legitimate interests of the author.*
- (2) Contracting Parties shall, *when applying the Berne Convention*, confine any limitations of or exceptions to rights provided for therein *to certain special cases that do not conflict with a normal exploitation of the work and do not unreasonably prejudice the legitimate interests of the author.*⁶³

Third, Article 16 of the WPPT, which applies *mutatis mutandis* to the extension of Article 10 of the WCT to the digital space, provides that

- (1) Contracting Parties may, *in their national legislation*, provide for the same kinds of limitations or exceptions with regard to the protection of performers and producers of phonograms as they provide for, in their

58. *Id.* art. 9.

59. *Id.*

60. *Id.*

61. *Id.* ¶ 2.

62. Berne Convention, *supra* note 7, art. 9 (emphasis supplied).

63. WCT, *supra* note 8, art. 10 (emphasis supplied).

national legislation, *in connection with the protection of copyright in literary and artistic works.*

- (2) Contracting Parties shall confine any limitations of or exceptions to rights provided for in this Treaty to *certain special cases which do not conflict with a normal exploitation of the performance or phonogram and do not unreasonably prejudice the legitimate interests of the performer or of the producer of the phonogram.*⁶⁴

And last, Article 13 of the TRIPS Agreement, a treaty enforced by the World Trade Organization (WTO), provides that

[m]embers shall confine limitations or exceptions to exclusive rights to *certain special cases[,] which do not conflict with a normal exploitation of the work and do not unreasonably prejudice the legitimate interests of the right holder.*⁶⁵

From the foregoing enumeration, the essence of the Three-Step Test is the limitation of the exclusive rights of the copyright owner, provided that the following circumstances are present that:

- (1) the limitations are only in certain special cases;
- (2) such limitations do not conflict with the normal exploitation of the work; and
- (3) such limitations do not unreasonably prejudice the legitimate interests of the copyright owner.⁶⁶

On one hand, the Berne Convention that the Three-Step Test was introduced to specifically apply to an author's right of reproduction. The TRIPS Agreement, on the other hand, is worded in such a way that it encompasses all exclusive rights of a copyright owner and not just the reproduction right. The question, therefore, is whether or not the requisites for specific limitations under the Berne Convention are now rendered moot by Article 13 of the TRIPS Agreement.⁶⁷ This specifically applies to countries that are signatories of both international instruments, such as the Philippines, US, and members of the European Union.

To resolve this dilemma, it has been submitted that the Three-Step Test, as it specifically applies to the reproduction right, is still effective and that all other limitations on exclusive rights under the Berne Convention should also pass the Three-Step Test, in addition to their own corresponding

64. WPPT, *supra* note 8, art. 16 (emphasis supplied).

65. TRIPS Agreement, *supra* note 9, art. 13 (emphasis supplied).

66. Tobias Schonwetter, The three-step test within the copyright system, (A Paper Presented at the Fourth Pan-Commonwealth Forum on Open Learning, Ocho Rios, Jamaica), *available at* <http://pcf4.dec.uwi.edu/viewpaper.php?id=58> (last accessed July 30, 2015).

67. *Id.*

requirements.⁶⁸ The application of the test harmonizes the TRIPS Agreement and the WCT with the Berne Convention and simultaneously lends clarity to vague terms in the Berne Convention, such as “fair practice” under the requisites for fair use of broadcast works.⁶⁹ This contention is supported by the wording of Article 13 of the TRIPS Agreement, which speaks of “limitations or exceptions to exclusive rights” without qualification or limitation as to its scope and meaning.⁷⁰ Indeed, even the WTO has clarified the application of the TRIPS Agreement with respect to the Berne Convention. In a Panel Report adopted by the Dispute Settlement Board of the WTO concerning a dispute between the US and European Union concerning Section 110 (5) of the United States Copyright Act, the WTO had the opportunity to unequivocally state the applicability of Article 13, to wit —

We conclude that Article 13 of the TRIPS Agreement applies to Articles 11 [] (1) (iii) and 11 (1) (ii) of the Berne Convention (1971) as incorporated into the TRIPS Agreement, *given that neither the express wording nor the context of Article 13 or any other provision of the TRIPS Agreement supports the interpretation that the scope of application of Article 13 is limited to the exclusive rights newly introduced under the TRIPS Agreement.*⁷¹

To support this contention, the WIPO has also stated that “there is no conflict between the Berne Convention and the TRIPS Agreement as far as exceptions and limitations to exclusive rights are concerned.”⁷² This puts to rest any doubt regarding the applicability of the Three-Step Test, given that the WIPO is charged with enforcement of the Berne Convention.⁷³

68. *Id.* See Berne Convention, *supra* note 7, art. 10. It provides “free uses on quotations of published works” and “illustrations for teaching purposes” as long as the source and author are indicated; free uses of “articles published or broadcast works, works seen or heard in connection with current events.” *Id.*

69. *Id.*

70. Mihály J. Ficsor, The three-step test under the TRIPS Agreement and the specific exceptions and limitations permitted by the Berne Convention – Its role under the WIPO Copyright Treaty (WCT) and in the draft text of an instrument/treaty on exceptions or limitations for the visually impaired (An Unpublished Paper About the Balancing of Interests in the Field of Copyright) 4, *available at* http://www.copyrightseesaw.net/archive/?sw_10_item=33 (last accessed July 30, 2015).

71. *Id.* (emphasis supplied).

72. WIPO, Implications of the TRIPs Agreement on Treaties Administered by WIPO (An Online Version of WIPO Publication No. 464 (E) 23, *available at* http://www.wipo.int/edocs/pubdocs/en/intproperty/464/wipo_pub_464.pdf (last accessed July 30, 2015).

73. WIPO Convention, *supra* note 39, art. 4 (ii).

In summary, the Berne Convention clearly allows exceptions and limitations to the exclusive rights of an author, provided that such exceptions and limitations under the Convention pass the Three-Step Test as enshrined in the TRIPS Agreement. *It is therefore submitted that there is international recognition of the principle that the exclusive right of an author to reproduce his works is not absolute.* However, as discussed, the exceptions to such right must not be in conflict with the normal exploitation of the work and must not unreasonably prejudice the legitimate interests of the right holder.

2. The Berne Convention and the Rise of the Internet

The Berne Convention has been criticized as “highly restrictive, anachronistic[,] and inflexible” due to its “protectionist and trade distorting” effect on countries, which are predominantly copyright users rather than producers.⁷⁴ In particular, the Berne Convention was called anachronistic for it was created in an era when individual authors, not the large multi-national corporations such as the “copyright industries of the US and Europe[,]” were the principal rights holders.⁷⁵ The Berne Convention now exists in an era where the general rule that all unpaid uses are illegal and represent lost sales at the expense of the copyright owner and industry prevails.⁷⁶ Unlike the 19th Century, the age of digital distribution through the Internet has resulted in consequences, such as the absence of extra costs of production, distribution, or lost market opportunities for copyright holders.⁷⁷ Indeed, a recent study of the European Commission even proposes that pirated downloads in the Internet have positively influenced legitimate purchase downloads without displacing online sales.⁷⁸ In light of these issues, the WCT and WPPT (collectively known as the WIPO Internet Treaties) were created to better address the shortcomings of the Berne Convention. The WIPO Copyright Treaties are considered “special agreements,” as provided under Article 20⁷⁹ of the Berne Convention, which allows states to enter

74. Alan Story, Study on Intellectual Property Rights, the Internet, and Copyright (An Unpublished Paper Commissioned By The Commission on Intellectual Property Rights) 17, available at http://www.iprcommission.org/papers/pdfs/study_papers/sp5_story_study.pdf (last accessed July 30, 2015).

75. *Id.*

76. *Id.* at 18.

77. *Id.*

78. Luis Aguiar & Bertin Martens, Digital Music Consumption on the Internet: Evidence from Clickstream Data (A Working Paper By The Joint Research Centre of the European Commission) 16, available at <http://ftp.jrc.es/EURdoc/JRC79605.pdf> (last accessed July 30, 2015).

79. Berne Convention, *supra* note 7, art. 20.

into such agreements if these shall grant greater rights to authors or contain provisions, which do not contradict the Convention.⁸⁰

C. Analyzing the WIPO Internet Treaties: The WIPO Copyright Treaty

Realizing that the Berne Convention is ill-equipped to resolve copyright issues at present, the WCT was, thus, born. It was created in order to introduce new rules and to clarify the applicability of the Berne Convention in light of the profound impact of the development and convergence of information and communication technologies on the creation and use of literary and artistic works.⁸¹ The WCT specifically requires Parties to comply with Articles 1 to 21 and the Appendix of the Berne Convention.⁸² In addition, Articles 2 to 6 of the Berne Convention are to be applied *mutatis mutandis* by the Parties in respect of the protection provided by the WCT.⁸³ To elaborate further, the rights and principles discussed in these provisions shall be discussed hereinafter.

The WCT reiterates the principle that expressions, not ideas, of literary and artistic expression are covered by copyright protection.⁸⁴ In relation to this principle, the WCT now considers computer programs as literary works, protected under the Berne Convention regardless of the mode or form of their expression.⁸⁵ More importantly, the WCT introduced the codification of the following rights of an author in the digital environment:

- (1) distribution under Article 6;⁸⁶
- (2) rental under Article 7;⁸⁷ and
- (3) communication to the public under Article 8.⁸⁸

In addition to these rights, the right of reproduction and the permissible exceptions from it under the Berne Convention was declared to be fully applicable in the digital environment.⁸⁹ It was further agreed that “the storage of a protected work in digital form in an electronic medium

80. Ruth L. Okediji, *The Regulation of Creativity Under the WIPO Internet Treaties*, 77 *FORDHAM L. REV.* 2379, 2388 (2009).

81. WCT, *supra* note 8, pmb1.

82. *Id.* art. 1, ¶ 4.

83. *Id.* art. 3.

84. *Id.* art. 2.

85. *Id.* art. 4.

86. *Id.* art. 6.

87. WCT, *supra* note 8, art. 7.

88. *Id.* art. 8.

89. See WCT, *supra* note 8, art. 1, ¶ 4.

constitutes a reproduction within the meaning of Article 9 of the Berne Convention.”⁹⁰ These exclusive rights, which are very relevant to a digital version of the First Sale Doctrine, include exceptions that have also been adopted by the WCT. Each of these rights shall be discussed hereunder.

1. The Distribution Right and the Exhaustion Doctrine

Under this right, the author enjoys “the exclusive right of making available to the public of the original and copies of their works through sale or transfer of ownership.”⁹¹ The terms “copies” and “original and copies” are defined under the WCT as fixed copies that can be put into circulation as tangible objects.⁹² The purpose of such definition is to ensure that transient copies or reproductions, like those automatically created by the Random Access Memory (RAM) of computers, will not infringe the exclusive distribution or rental rights of the author.⁹³ As an exception to the distribution right, the WCT allows Parties to determine the conditions under which the exhaustion doctrine would apply after the first sale or transfer of the original — or a copy thereof — with the author’s consent.⁹⁴ Not only does Article 6 codify the ability of states to create limitations by means of legislation to the author’s distribution right, it also allows Parties to determine the specific regime of exhaustion they shall adopt — national, regional, or international.⁹⁵ However, it must be noted that the exhaustion doctrine is not absolute — it only concerns the rights of an author, which are “commercial” in nature or what is otherwise known as the author’s economic rights.⁹⁶

Furthermore, the exhaustion doctrine is limited by the geographic scope countries decide to confine it in. The right to determine the regime of exhaustion to be adopted by a country is not only found in the WCT. It can also be found in other multilateral treaties concerning intellectual property, which specifically provide for the operation of the exhaustion doctrine.⁹⁷ Under Article 6 of the TRIPS Agreement, it is provided that “[f]or the

90. *Id.*

91. WCT, *supra* note 8, art. 6, ¶ 1.

92. *See* WCT, *supra* note 8, arts. 6 & 7.

93. Okediji, *supra* note 80, at 2395.

94. WCT, *supra* note 8, art. 6, ¶ 2.

95. Mihály J. Ficsor, Former Assistant Director General of the WIPO, The WIPO Internet Treaties and Copyright in the Cloud, Speech at the ALAI Congress, Kyoto, Jap. (Oct. 18, 2012) (transcript available at <http://www.copyrightseesaw.net/data/documents/documents/9/b/7/9b71d73904fa7f5be19b2bc92e357db1.doc> (last accessed July 30, 2015)).

96. WIPO, Interface, *supra* note 1, at 4.

97. *Id.* at 5.

purposes of dispute settlement under this Agreement, subject to the provisions of Articles 3 and 4[,] nothing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights.”⁹⁸ The relevance of this provision to the exhaustion doctrine was further clarified in the Declaration on the TRIPS Agreement and Public Health, which states that “[t]he effect of the provisions in the TRIPS Agreement that are relevant to the exhaustion of intellectual property rights is to leave each Member free to establish its own regime for such exhaustion without challenge, subject to the []MFN and national treatment provisions of Articles 3 and 4.”⁹⁹ The WPPT, also, has similar provisions on exhaustion as a limitation to the distribution right of performers and producers of phonograms.¹⁰⁰

In light of these multilateral agreements and the WCT, the Philippines is still at liberty to continue the application of existing exceptions and limitations to an author’s economic rights as well as to create new exceptions and limitations, which it may deem appropriate.¹⁰¹ On the basis of these provisions alone, it is submitted that there is an international recognition of the principle that the distribution right of the author is not absolute and that the same may be limited by Congress through legislation.

2. The Right of Rental

Under the WCT, authors of computer programs, cinematographic works, and works embodied in phonograms — as determined by legislation — enjoy the exclusive right to authorize the commercial rental to the public of such works.¹⁰² Circumstances considered as an exception to this right are, with regard to computer programs, when the subject of rental is not the program itself and, in the case of cinematographic works, provided that there has been no widespread copying resulting in the material impairment of the author’s reproduction right.¹⁰³ These rules, unique to the WCT and not found under the Berne Convention, were made in response to the recent

98. TRIPS Agreement, *supra* note 9, art. 6. Articles 3 and 4 pertain to the two essential policies of the Agreement: the National Treatment and Most-Favored Nation Treatment policies. *Id.* arts. 3 & 4.

99. World Trade Organization (WTO), Declaration On The TRIPS Agreement and Public Health, WT/MIN/(01)/DEC/2 (2001) [hereinafter Declaration on the TRIPS Agreement] (emphasis supplied).

100. WPPT, *supra* note 8, arts. 8 & 12.

101. AMADOR, *supra* note 37, at 365 (citing Pamela Samuelson, *Intellectual Property and The Digital Economy: Why the Anti-Circumvention Regulations Need to Be Revised*, 14 BERKELEY TECH. L.J. 1 (1999)).

102. WCT, *supra* note 8, art. 7, ¶ 1.

103. *Id.* ¶ 2.

advances of technology, which made it easy for those customers of rental shops to abuse the author's exclusive right of reproduction.¹⁰⁴

3. The Right of Communication to the Public

Without prejudice to similar provisions in the Berne Convention, the WCT grants authors the right to communicate to the public their performance through any communication device which allows the reception of images or sounds beyond the origin of the transmission.¹⁰⁵ The WCT states that

authors of literary and artistic works shall enjoy the exclusive right of authorizing any communication to the public of their works, by wire or wireless means, including the making available to the public of their works in such a way that members of the public may access these works from a place and at a time individually chosen by them.¹⁰⁶

Under this Article, mere provision of physical facilities for enabling or making a communication is not equivalent to a communication under the Berne Convention or the WCT.¹⁰⁷ To elaborate, Vicente B. Amador distinguishes between transmission of the work and transmission of the performance of the work.¹⁰⁸ When the work is transmitted, for example an e-book, and the recipient uses a software to read the words or pictures therein, such transmission does not equate to a performance, even if the software reads aloud the text of the e-book.¹⁰⁹ The same principle applies to musical works such as compositions or pantomimes and choreographic works fixed in notation because such works are considered separate and distinct from their performance.¹¹⁰ Amador concludes that in order for there to be a performance by transmission, there must be a "transmission of the sounds or images of a performance of the work, rather than a transmission of the work itself."¹¹¹ The principle of protecting those who merely provide the technology or physical place to access digital content is largely due in part to the "strong presence of [ISPs], Online Service Providers (OSPs), and representatives of the telecommunications industry during the WIPO negotiations" who lobbied to ensure that their services would not infringe this right.¹¹²

104. WIPO, Understanding Copyright, *supra* note 41, at 8.

105. AMADOR, *supra* note 37, at 410.

106. WCT, *supra* note 8, art. 8.

107. *Id.*

108. AMADOR, *supra* note 37, at 411.

109. *Id.*

110. *Id.*

111. *Id.*

112. Okediji, *supra* note 80, at 2395.

Is unauthorized downloading of a copyrighted work resulting in the creation of a copy in the downloader's computer an infringement of the transmission right? Although an electronic transmission of the work is made through the internet, it is argued by Amador that what is actually infringed is the reproduction right of the author,¹¹³ because the download is made at the instance of the user. Consequently, the copy is made at the user's initiative.¹¹⁴ In such an instance, the right of distribution may also be violated by the downloader if he transmits the unauthorized copy to another or by the host of the unauthorized copy as long as he makes the same available for download.¹¹⁵

In summary, it is submitted that the WCT allows for the application of the First Sale Doctrine in the digital environment due to the exceptions and limitations on the rights of the author discussed earlier. The most relevant right to the digital resale of electronically transmitted goods is the distribution right of the author. As provided for by the WCT, the Philippines is free to legislate how exhaustion of rights over a copy is to take effect after the first sale or transfer of ownership with the consent of the author.¹¹⁶

D. Analyzing the WIPO Internet Treaties: The WIPO Phonograms and Performances Treaty

In contrast to the WCT, which focuses on the rights of authors of literary and artistic works, the WPPT focuses on the rights of the performers and producers of phonograms. Under the WPPT, performers are defined as "actors, singers, musicians, dancers, and other persons who act, sing, deliver, declaim, play in, interpret, or otherwise perform literary or artistic works or expressions of folklore."¹¹⁷ Conversely, producers of phonograms are defined as "the person, or the legal entity, who or which takes the initiative and has the responsibility for the first fixation of the sounds of a performance or other sounds, or the representations of sounds."¹¹⁸ A fixation is defined as "the embodiment of sounds, or of the representations thereof, from which they can be perceived, reproduced[,] or communicated through a device."¹¹⁹ Whereas the WCT is a development from the principles laid down in the Berne Convention, the WPPT is, however, a development from the Rome Convention for the Protection of Performers, Producers of Phonograms, and

113. AMADOR, *supra* note 37, at 430.

114. *Id.*

115. *Id.*

116. WCT, *supra* note 8, art. 6, ¶ 2.

117. WPPT, *supra* note 8, art. 2 (a).

118. *Id.* art. 2 (d).

119. *Id.* art. 2 (c).

Broadcasting Organizations.¹²⁰ Similar to the WCT, the WPPT was created in recognition of the profound impact of the development and convergence of information and communication technologies, albeit on the aspects of production and use of performances and phonograms.¹²¹ The WPPT also grants the rights of reproduction, distribution, and rental to performers and producers of phonograms the application of which are similar to the WCT.¹²² These economic rights are subject to the Three-Step Test clause discussed earlier, which allows for limitations to such rights. A reading of the provisions of the WPPT reveals that the exhaustion right only operates as to the performances, which are *fixed* in phonograms. The operation of the First Sale Doctrine in relation to the economic rights granted by these phonograms shall be discussed hereunder.

1. The Reproduction, Distribution, and Rental Rights

Under the WPPT, both the performer and the producer have the exclusive right to authorize the direct or indirect reproduction of their performances fixed in phonograms in any manner or form.¹²³ However, an exception to this exclusive right may be made by Parties as long as it passes the Three-Step Test under Article 13.¹²⁴ As to the application of the reproduction right and the exception under Article 13 in the digital environment, the WPPT provides for its full application, “in particular to the use of performances and phonograms in digital form.”¹²⁵

As to the distribution right of the performer and producer, these are similar to the distribution right granted to authors under the WCT. Consequently, the concepts earlier discussed are also applicable to the WPPT. The distribution right and the corresponding freedom of Parties to determine the conditions under which the First Sale Doctrine may operate are also present and identical to their counterpart provisions in the WCT.¹²⁶

With regard to the right of rental of the performer and producer, the provisions of WCT and WPPT slightly differ, in as much as the extent of the right is concerned. Performers and producers have the exclusive right to authorize the *commercial* rental of their phonograms to the public *even after* the

120. *Id.* art. I, ¶ I.

121. *Id.* pmb1.

122. WIPO, Summary of the WIPO Performances and Phonograms Treaty (WPPT) (1996) available at http://www.wipo.int/treaties/en/ip/wppt/summary_wppt.html (last accessed July 30, 2015).

123. WPPT, *supra* note 8, arts. 7 & 11.

124. *Id.* art. 16 (2).

125. See WPPT, *supra* note 8, arts. 7, 11, & 16.

126. WPPT, *supra* note 8, arts. 8 & 12.

authorized distribution of such phonograms to the public.¹²⁷ This is subject to the proviso that Parties, on 15 April 1994, had and continues to have in force a system, which adequately compensates performers and producers for such commercial rental and as long as such rental does not give rise to the material impairment of their right of reproduction.¹²⁸

2. The Right of Making Available of Phonograms

Under the WPPT, performers and producers enjoy the exclusive right to authorize the making available to the public performances fixed in phonograms “by wire or wireless means, in such a way that members of the public may access them from a place and at a time individually chosen by them.”¹²⁹ This is identical to the right of authors to communicate their works to the public discussed earlier. This right is touted by the phonographic industry as the international community’s recognition of dissemination of phonograms through digital networks as “a primary form of exploitation of music” and, therefore, should be under the control of the copyright owner in order to combat piracy and infringement of rights in the digital environment.¹³⁰ Furthermore, this right is considered fundamental to the promotion of e-commerce and new business models by the recording industry, which, in turn, will benefit consumers who will enjoy a wider range of content that are easily available through the internet.¹³¹

The right of “making available,” which was greatly lobbied for by the entertainment industry of the US, has been criticized as having granted “near-perfect control over copyright works without due regard for the consumers’ right of fair use.”¹³² Ironically, despite the WPPT’s recognition of the need to balance the rights of performers and producers with that of the larger public interest,¹³³ the WPPT now has the undesirable effect of upsetting such balance largely in favor of the entertainment industry.

127. *Id.* art. 6.

128. *Id.* arts. 9 & 13. The WCT has a similar provision regarding an author’s right to receive equitable remuneration for the rental of copies of their works. *Id.*

129. *Id.* arts. 10 & 14.

130. International Federation of the Phonographic Industry (IFPI), The WIPO Treaties: ‘Making Available’ Right (An Online Publication Of The IFPI Dated March 2003) 1, available at <http://www.ifpi.org/content/library/wipo-treaties-making-available-right.pdf> (last accessed July 30, 2015).

131. *Id.*

132. AMADOR, *supra* note 37, at 382.

133. WPPT, *supra* note 8, pmb1.

E. Overview of the TRIPS Agreement

Through the TRIPS Agreement, members of the WTO are required to “adhere to minimum standards of protection” provided by the Paris Convention, the Berne Convention, the Rome Convention, and the Treaty on Intellectual Property in Respect of Integrated Circuits.¹³⁴ The TRIPS Agreement covers the area of copyright and related rights under Section 1.¹³⁵ The three primary features of the TRIPS Agreement are: first, the provision of minimum standards of protection of intellectual property; second, the provision of guidelines for the domestic enforcement of intellectual property rights; and third, the provision of a dispute settlement mechanism through the WTO’s procedures.¹³⁶ The TRIPS Agreement is instrumental in linking the importance of intellectual property protection within the framework of trade and globalization under the WTO.¹³⁷ The role of the TRIPS Agreement in the enforcement of copyright in the digital environment shall be discussed hereunder.

1. Should Digital Resellers Seeking Protection under the Exhaustion Doctrine be Wary of the TRIPS Agreement?

Under the TRIPS Agreement, Members are obliged to “provide for criminal procedures and penalties to be applied *at least in cases of willful trademark counterfeiting or copyright piracy on a commercial scale.*”¹³⁸ Furthermore, the remedies, which shall be available to Members, include “imprisonment and/or monetary fines sufficient to provide a deterrent, [consistent] with the level of penalties applied for crimes of a corresponding gravity.”¹³⁹ In light of these provisions, it appears that what the TRIPS Agreement penalizes are acts of copyright infringement — like piracy — which have a significant commercial impact on the copyright owner and not when there has been a resale of a legitimately purchased copy.¹⁴⁰ As earlier discussed, the Declaration on the TRIPS Agreement leaves it to the discretion of its Members to establish their own regime of exhaustion of intellectual property rights.¹⁴¹ It is, therefore, submitted that should the Philippines apply the

134. Coquia, *International Protection of IP*, *supra* note 49, at 284.

135. TRIPS Agreement, *supra* note 9.

136. WTO, Overview: The TRIPS Agreement, *available at* http://www.wto.org/english/tratop_e/trips_e/intel2_e.htm (last accessed July 30, 2015).

137. International Intellectual Property Alliance (IIPA), Copyright Enforcement Under the TRIPS Agreement (A Paper Prepared By The IIPA) 1, *available at* http://www.iipa.com/rbi/2004_Oct19_TRIPS.pdf (last accessed July 30, 2015).

138. TRIPS Agreement, *supra* note 9, art. 61. (emphasis supplied).

139. *Id.*

140. IIPA, *supra* note 137, at 4.

141. Declaration on the TRIPS Agreement, *supra* note 99, ¶ 5 (a).

exhaustion doctrine to the field of copyright, digital resellers should have no fear of violating the piracy provisions of the TRIPS Agreement.¹⁴² Furthermore, the Three-Step Test found under Article 13 of the TRIPS Agreement also acts as a standard to balance the effective protection of copyright on one hand and the reasonable limits and fair exceptions thereto on the other.¹⁴³ The end-result in mind is that copyright holders will be able to commercially benefit from their works made available through the digital environment while retaining appropriate limitations and exceptions that will “continue to safeguard public interest uses” and benefit consumers, service providers, and national cultures and economies.¹⁴⁴ This is in line with the objectives of the TRIPS Agreement which states that

[t]he protection and enforcement of intellectual property rights should contribute to the promotion of technological innovation and to the transfer and dissemination of technology, to the mutual advantage of producers and users of technological knowledge and in a manner conducive to social and economic welfare, and to a balance of rights and obligations.¹⁴⁵

These objectives should also be read in light of Article 8 — the Principles of the TRIPS Agreement — which provides that “[a]ppropriate measures, provided that they are consistent with the provisions of this Agreement, may be needed to prevent the abuse of intellectual property rights by right holders or the resort to practices which unreasonably restrain trade or adversely affect the international transfer of technology.”¹⁴⁶ Taken together, these two Articles of the TRIPS Agreement appear to provide basis for a Member to implement a regime of selective international exhaustion, a regime, which allows a country to choose whether it will implement national or international exhaustion, depending on the product being considered.¹⁴⁷ This variant of the international concept of the First Sale Doctrine is essentially a hybrid of the national and international regimes.¹⁴⁸ For example, the Japanese Ministry of International Trade and Industry considered applying the regime by imposing a ban on parallel imports of industrial machinery and electrical goods while allowing the parallel

142. The difference between piracy and what constitutes a legitimate digital resale shall be discussed in the next Chapter.

143. AMADOR, *supra* note 37, at 375.

144. *Id.*

145. TRIPS Agreement, *supra* note 9, art. 7.

146. *Id.* art. 8, ¶ 2.

147. Theo Papadopoulos, *The First-Sale Doctrine in International Intellectual Property Law: Trade in Copyright Related Entertainment Products*, 2 ENT. LAW 40, 54 (2003).

148. *Id.* at 56.

importation of CDs and watches.¹⁴⁹ In any case, it is submitted that the TRIPS Agreement poses no obstacle for the application of the exhaustion doctrine in the Philippines — again reinforcing the defense of exhaustion in digital resale transactions.

2. Comparison with Other Copyright Treaties

With regard to the field of copyright, the TRIPS Agreement obliges Members to comply with the provisions of the Berne Convention in general. But an exception is made with regard to Article 6 concerning the moral rights of an author.¹⁵⁰ In addition, the TRIPS Agreement reiterates the principle that expressions are protected by copyright while ideas, procedures, methods of operation, or mathematical concepts are not covered by copyright protection.¹⁵¹ Like the WCT, it also regards computer programs, in source or object code, as literary works to be protected under the Berne Convention.¹⁵² The rental right — at least as far as cinematographic works and computer programs are concerned — is similar to the provisions of both the WCT and WPPT.¹⁵³ Indeed, even the exception to the exclusive rental right applies when the subject of the rental of a computer program is not the program itself — a provision also present in the WCT.¹⁵⁴ Likewise, Members are also obliged to secure such rental right when rental of cinematographic works “has led to widespread copying,” materially impairing the author’s reproduction right.¹⁵⁵ It is important to note that what the TRIPS Agreement punishes is piracy, or the unauthorized copying of works and distributing the same to the public, such that the commercial interests of the author are severely affected.¹⁵⁶ The WIPO Internet Treaties have been described as a “toothless tiger because of the absence of any effective enforcement powers”¹⁵⁷ and pales in comparison to the TRIPS Agreement, which allows the WTO to impose sanctions on Members who fail to adhere to its provisions.¹⁵⁸ To elaborate, the dispute settlement mechanism of the WTO gives an aggrieved country the means to impose punitive tariffs on the products of an infringing country, which fails

149. *Id.*

150. TRIPS Agreement, *supra* note 9, art. 9, ¶ 1.

151. *Id.* art. 9, ¶ 2.

152. *Id.* art. 10, ¶ 1.

153. *Id.* art. 11.

154. *Id.*

155. *Id.*

156. IIPA, *supra* note 137, at 4.

157. Papadopoulos, *supra* note 147, at 49.

158. *Id.*

to adhere to the minimum standards of copyright protection required by the TRIPS Agreement.¹⁵⁹

Unique to the TRIPS Agreement are the two policies of National Treatment¹⁶⁰ and Most Favored Nation Treatment.¹⁶¹ The National Treatment clause, on one hand, mandates “that each WTO member shall accord to nationals of other members treatment no less favorable than that which it accords to its own nationals with regard to the protection of intellectual property subject to certain exceptions.”¹⁶² On the other hand, the Most Favored Nation Treatment clause requires Members to grant “any advantage, favor, privilege, or immunity granted by a member to the nationals of any other country” to the nationals of all the Members to the TRIPS Agreement immediately and unconditionally, subject to certain exceptions.¹⁶³ In addition, the policy of “reverse reciprocity of foreign laws” applies.¹⁶⁴ The operation of this policy results in consequences, to wit —

Any condition, restriction, limitation, diminution, requirement, penalty[,] or any similar burden imposed by the law of a foreign country on a Philippine national seeking protection of intellectual property rights in that country [] shall reciprocally be enforceable upon nationals of said country within Philippine jurisdiction.¹⁶⁵

This policy serves as a measure not only to ensure the compliance of Members with the Most Favored Nation and National Treatment clauses but also to temper the passage of municipal legislation, which may unequally impose the said limitations. It is, therefore, submitted that these clauses, as reminded by the Declaration on the TRIPS Agreement, are always to be taken into consideration by our courts should they apply the First Sale Doctrine.

F. International Copyright Law Principles Upholding the Digital Exhaustion Right

To summarize, the economic rights of an author, performer, or producer, which are recognized in international copyright law, are their reproduction right, distribution right, rental right, and transmission right. Because of the passage of the WIPO Internet treaties, the recognition of these rights and the exceptions thereto has now been applied to the digital space. In addition to these rights, the protection of copyrighted works now extends to the digital

159. *Id.* at 55.

160. TRIPS Agreement, *supra* note 9, art. 3.

161. *Id.* art. 4.

162. Aquino, *supra* note 40, at 826.

163. *Id.*

164. *Id.*

165. *Id.*

environment. It is submitted that the Philippines' international treaty obligations do not preclude the adoption of the Digital First Sale Doctrine. In fact, as the discussion above reflects, these treaties even encourage it. These internationally recognized rights and limitations, by virtue of the incorporation clause under the Constitution¹⁶⁶ and their counterparts in the Intellectual Property Code, are deemed part of Philippine law.

The exclusive right to import — while not specifically provided for in any of the previously discussed treaties — may be made available by municipal legislation. However, as will be discussed in the next Chapter, such right only arises if the country decides to adopt the concept of the First Sale Doctrine. In this regard, the TRIPS Agreement does not mandate which form of exhaustion a country must adopt. Ultimately, the discretion is left to Congress. With the amendments to the Intellectual Property Code by R.A. No. 10372, it appears that Congress has already made known its legislative intention.

III. THE STATUTORY BASIS OF THE FIRST SALE DOCTRINE IN THE INTELLECTUAL PROPERTY CODE

This Chapter shall discuss the origins of our copyright law and the current Intellectual Property Code along with the e-Commerce Act. It will provide a general overview of copyright protection in the Philippines and how the same extends to the digital space. After having established the basis of the First Sale Doctrine in international copyright laws, this Chapter shall now establish the doctrine's statutory basis in Philippine copyright laws. Moreover, the significant amendments made by R.A. No. 10372 to the Intellectual Property Code and its consequences to the operation and territorial scope of the First Sale Doctrine shall be discussed. Finally, this Chapter will identify the specific economic rights of an author, which will be affected by the doctrine, and the ways it may be limited by law.

A. Overview of the Intellectual Property Code and Copyright Protection in the Philippines

The heavy influence of American and European copyright laws in our jurisdiction may be easily observed by reviewing the various intellectual property laws governing the country since the Spanish colonial era. Prior to the establishment of the Philippine Republic, the Philippines was already governed by both the Law on Intellectual Property¹⁶⁷ of 10 January 1879 and

166. PHIL. CONST. art. 2, § 2. This provision states that the Philippines “adopts the generally accepted principles of international law as part of the law of the land.” PHIL. CONST. art. 2, § 2.

167. WIPO, Spain: Reglamento para la ejecución de la ley de 10 de enero de 1879 sobre Propiedad Intelectual (aprobado por el Real Decreto de 3 de septiembre

the Spanish Copyright Law¹⁶⁸ when the country was still under Spanish rule.¹⁶⁹ When Spain ceded the Philippines to the US through Treaty of Paris, the US Copyright Law was momentarily enforced in our jurisdiction until the passage of Act No. 3134 of 1924 by the Philippine Legislature, which was patterned after the American copyright law.¹⁷⁰ This would eventually be repealed by Presidential Decree (P.D.) No. 49,¹⁷¹ otherwise known as the Decree on Intellectual Property, enacted during the Martial Law era on 15 December 1972.¹⁷² P.D. 49 — a law intended to regulate copyright¹⁷³ — was described “to be more comprehensive and unquestionably modern in scope and in applicability, yet [] the provisions are not a total departure from the old law.”¹⁷⁴ At present, foreign decisions interpreting copyright laws are not binding on our courts — “at most they may be simply persuasive, or at least[,] may act as guides to [improve] decisions.”¹⁷⁵ But given the dire lack of jurisprudence involving digital copyright, it is submitted that the American and European decisions on the matter should be considered by our courts in the interpretation of our copyright laws. Consequently, the courts should not hesitate to resort to the wisdom of foreign jurisprudence on the First Sale Doctrine. After all, the purpose of copyright law protection is to grant only a limited monopoly to the author over his works through the “incorporeal right to print and publish, and *independent of and detached from the corporeal property out of which it arises.*”¹⁷⁶

Three decades after the passage of P.D. No. 49, R.A. No. 8293 — the Intellectual Property Code of the Philippines — took effect on 1 January

de 1880), available at http://www.wipo.int/wipolex/en/text.jsp?file_id=126639 (last accessed July 30, 2015).

168. *United States v. Yam Tung Way.*, 21 Phil. 67, 69 (1911). This case cites the Royal Decree on Spanish Copyright Law promulgated on 5 May 1887. *Id.*

169. Milagros Santos-Ong, Chief of the Supreme Court of the Philippines Library Services, Copyright Laws, Issues, Concerns and Cases, Remarks at the Seminar-Workshop on Research in Librarianship, Challenges, Competencies and Strategies, Laguna, Phil. (Oct. 10, 2007) (transcript available at <https://paarl.wikispaces.com/file/view/Copyright+Challenges.doc> (last accessed July 30, 2015)).

170. *Id.*

171. *Id.*

172. *Id.*

173. Coquia, *International Protection of IE*, *supra* note 49, at 283.

174. Lohel A. Martinez, Annotation, *The Copyright Law: A Crucible for Fuller Protection of Intellectual Property*, 83 SCRA 18 (1978).

175. *Id.* at 25.

176. *Id.* at 22 (emphasis supplied).

1998. It incorporated the provisions of the Berne Convention, the TRIPS Agreement, the WIPO Geneva Protocol,¹⁷⁷ and an Exchange of Notes with the US regarding the protection and enforcement of intellectual property rights.¹⁷⁸ Thereafter, the e-Commerce Act was signed into law on 14 June 2000.¹⁷⁹ Although the law is not primarily concerned with copyright alone, the e-Commerce Act has become an instrumental law in promoting international e-commerce.¹⁸⁰ The e-Commerce Act was essentially patterned on the Model Law on Electronic Commerce by the UN Commission on International Trade Law.¹⁸¹ The model was intended by the UN as a means to “maintain uniformity and harmony” between member-states with regard to “international coordination and harmonization of the government policies affecting electronic commerce.”¹⁸² The e-Commerce Act protects copyright over digital works and the public at large by penalizing hacking and piracy under Section 88.¹⁸³ With regard to the offense of piracy, the provision covers all types of intellectual property that may be found online.¹⁸⁴

Recently, R.A. No. 10372¹⁸⁵ amended the Intellectual Property Code and made substantial changes, which may potentially affect e-commerce and digital resale on a significant scale. Some of these changes include:

- (1) considering temporary and permanent copies as a reproduction,¹⁸⁶
- (2) stating that licensing of copyright does not necessarily imply the licensing of the material object subject to the copyright,¹⁸⁷ and
- (3) the removal of the copyright holder’s exclusive right of importation with regard to his works sold abroad.¹⁸⁸

177. Santos-Ong, *supra* note 169. Known as the WIPO Geneva Protocol, the WCT (along with the WPPT) would eventually be ratified by Congress in 2002. *Id.*

178. *Id.*

179. See e-Commerce Act of 2000.

180. *Id.* § 3.

181. Joan M. Padilla, *The Electronic Commerce Act (R.A. 8792): An Overview of IT’s (Information Technology) Impact on the Philippine Legal System*, 50 U.S.T. L. REV. 191, 192 (2006).

182. *Id.*

183. e-Commerce Act, § 88.

184. JESUS M. DISINI, *THE ELECTRONIC COMMERCE ACT AND ITS IMPLEMENTING RULES AND REGULATIONS* 37 (2000).

185. R.A. No. 10372.

186. INTELLECTUAL PROPERTY CODE, § 171.9.

187. *Id.* § 181.

1. The Public Interest Aspect of Copyright Protection

The policy towards intellectual property can be found in Section 13 of Article XIV of the Constitution,¹⁸⁹ which provides that the “State shall protect and secure the exclusive rights of scientists, inventors, artists, and other gifted citizens to their intellectual property and creations, particularly when beneficial to the people, for such period as may be provided by law.”¹⁹⁰ In the Intellectual Property Code, this constitutional policy is echoed in Section 2.¹⁹¹ In particular, the Intellectual Property Code pledges to “protect and secure the exclusive rights of scientists, inventors, artists[,] and other gifted citizens to their intellectual property and creations, particularly when beneficial to the people, for such periods as provided in this Act.”¹⁹²

The law further provides that the “use of intellectual property bears a social function. To this end, the State shall promote the diffusion of knowledge and information for the promotion of national development and progress and the common good.”¹⁹³ It is argued that the social function of the use of intellectual property involves the objectives of providing the incentive of just rewards for individuals to produce intellectual creations and ensuring that the community will reap the greatest benefits in these creations.¹⁹⁴ Therefore, the pursuit of copyright is not necessarily to reward the labor of authors; rather, the primary objective that underlies copyright is the promotion of progress in the sciences and useful arts.¹⁹⁵

The principle driving this policy is called the “idea-expression or fact-expression dichotomy,”¹⁹⁶ which allows other individuals the freedom to improve or build upon the information or knowledge conveyed by a work.¹⁹⁷ However, the law protects the author’s copyright by granting him the means to prevent the unauthorized copying, adaptation, or alteration of

188. *Id.* § 190.3.

189. Coquia, *National Consciousness*, *supra* note 29, at 379.

190. PHIL. CONST. art.14, § 13.

191. INTELLECTUAL PROPERTY CODE, § 2.

192. *Id.* ¶ 1.

193. *Id.*

194. Martinez, *supra* note 174, at 22.

195. AMADOR, *supra* note 37, at 247.

196. *Id.*

197. *Id.*

his work.¹⁹⁸ Essentially, copyright is the power to prevent third persons from doing something and is thus described as a “negative right.”¹⁹⁹

2. Protected Works and the Inclusion of Digital Works

As a general rule, works are protected by copyright if they are the product of one’s own intellectual labor or are original.²⁰⁰ For a work to be considered original, it must meet the following requirements, namely:

- (1) first, it must have been “independently created by the author;” and
- (2) second, it must possess a “minimal degree of creativity.”²⁰¹

Therefore, a work is not required to pass the test of imaginativeness or inventiveness.²⁰² Thus, from the moment of creation, an artistic or literary work is protected by copyright.²⁰³ The Intellectual Property Code provides a list of the classes of works that are protected, to wit:

- (a) Books, pamphlets, articles, and other writings;
- (b) Periodicals and newspapers;
- (c) Lectures, sermons, addresses, dissertations prepared for oral delivery, whether or not reduced in writing or other material form;
- (d) Letters;
- (e) Dramatic or dramatico-musical compositions; choreographic works, or entertainment in dumb shows;
- (f) Musical compositions, with or without words;
- (g) Works of drawing, painting, architecture, sculpture, engraving[s], lithography[,] or other works of art; models or designs for works of art;
- (h) Original ornamental designs or models for articles of manufacture, whether or not [capable of registration] as an industrial design, and other works of applied art;
- (i) Illustrations, maps, plans, sketches, charts[,] and three-dimensional works relative to geography, topography, architecture[,] or science;
- (j) Drawings or plastic works of a scientific or technical character;

198. *Id.*

199. *Id.*

200. *Id.* at 249.

201. AMADOR, *supra* note 37, at 250 (citing *Feist Pubs., Inc. v. Rural Tel. Svc. Co., Inc.*, 499 U.S. 340, 345-47 (1991)).

202. AMADOR, *supra* note 37, at 249.

203. INTELLECTUAL PROPERTY CODE, § 172.1.

- (k) Photographic works[,] including works produced by a process analogous to photography; lantern slides;
- (l) Audiovisual works and cinematographic works[,] and works produced by a process analogous to cinematography or any process for making audio-visual recordings;
- (m) Pictorial illustrations and advertisements;
- (n) Computer programs; and
- (o) Other literary, scholarly, scientific, and artistic works.²⁰⁴

The issue to be resolved, therefore, is whether or not digital versions of these classes, except computer programs — which necessarily exist in the digital space — are protected under our copyright law. The basis for copyright protection of digital works can be found in Section 172.2 of the Intellectual Property Code, which states that “[w]orks are protected by the sole fact of their creation, *irrespective of their mode or form of expression*, as well as of their content, quality[,] and purpose.”²⁰⁵ Further basis of copyright protection can be found in the e-Commerce Act, which punishes piracy of “protected material” or “copyrighted works, including legally protected sound recordings, [] phonograms, or information material on protected works” through the internet.²⁰⁶

3. Ownership of Copyright and the Exclusive Rights of an Author

Although the field of copyright is governed by special laws — like the Intellectual Property Code — it is important to note that the Civil Code of the Philippines (Civil Code) recognizes intellectual creation as one of the modes of acquiring ownership.²⁰⁷ The Civil Code further states that the following persons acquire ownership over their works through intellectual creation:

- (a) The author with regard to his literary, dramatic, historical, legal, philosophical, scientific, or other work;
- (b) The composer; as to his musical composition;
- (c) The painter, sculptor, or other artist, with respect to the product of his art; [and]

204. *Id.*

205. *Id.* § 172.2 (emphasis supplied).

206. e-Commerce Act, § 33 (b).

207. An Act to Ordain and Institute the Civil Code of the Philippines [CIVIL CODE], Republic Act No. 386, as Amended, art. 721 (1950).

- (d) The scientist or technologist or any other person with regard to his discovery or invention.²⁰⁸

The general rule therefore is that an individual who creates an original artistic or literary work is its owner, at least in the first instance, subject to the exceptions, which may be provided by law.²⁰⁹ These exceptions are provided for by the Intellectual Property Code, among them:

- (1) in case of joint authorship, they shall be governed by the rules on co-ownership, unless the work consists of parts that may be used separately in which case each shall own the part he created;²¹⁰
- (2) in case of works created in the course of an employee's regularly assigned duties, the employer shall own it, unless there is an agreement to the contrary;²¹¹
- (3) in case of commissioned works, the person who commissioned such work will have ownership but copyright remains with the creator, unless there is a written stipulation to the contrary;²¹²
- (4) in case of audiovisual works, copyright "shall belong to the producer, the author of the scenario, the composer of the music, the film director, and the author of the work so adapted;"²¹³ and
- (5) in case of letters, copyright belongs to the writer²¹⁴ but the letter itself shall be owned by the person to whom it is addressed and delivered.²¹⁵

The holder of the copyright is granted by the Intellectual Property Code a "bundle of rights," which may be individually "licensed or assigned separately, and even subdivided."²¹⁶ These rights — collectively known as the "economic rights" — are enumerated under Section 177 of the Intellectual Property Code:

Subject to the provisions of Chapter VIII, copyright or economic rights shall consist of the exclusive right to carry out, authorize[,] or prevent the following acts:

208. *Id.*

209. AMADOR, *supra* note 37, at 266.

210. INTELLECTUAL PROPERTY CODE, § 178.2.

211. *Id.* § 178.3.

212. *Id.* § 178.4.

213. *Id.* § 178.5.

214. *Id.* § 178.6.

215. CIVIL CODE, art. 723.

216. AMADOR, *supra* note 37, at 270.

- [(1)] Reproduction of the work or substantial portion of the work;
- [(2)] Dramatization, translation, adaptation, abridgment, arrangement[,] or other transformation of the work;
- [(3)] The first public distribution of the original and each copy of the work by sale or other forms of transfer of ownership;
- [(4)] Rental of the original or a copy of an audiovisual or cinematographic work, a work embodied in a sound recording, a computer program, a compilation of data and other materials[,] or a musical work in graphic form, irrespective of the ownership of the original or the copy[,] which is the subject of the rental;
- [(5)] Public display of the original or a copy of the work;
- [(6)] Public performance of the work; and
- [(7)] Other communication to the public of the work.²¹⁷

Amador summarizes the exclusive economic rights of a copyright holder as “to *reproduce* the work in copies or phonorecords; to prepare *derivative works* based upon the copyrighted work; to *distribute copies* of phonorecords of the copyrighted work to the public; to *perform* the work publicly; to *display* the work publicly; and [to] *transmit* sound recordings digitally.”²¹⁸ It is submitted that out of all these rights, the most affected by a digital exhaustion doctrine are, first and foremost, the distribution right, and secondly, the reproduction right. These shall be discussed in the latter part of this Chapter.

Separate and independent from these economic rights are the author’s moral rights, which are enumerated in Section 193 of the Intellectual Property Code. These moral rights may be summarized as the right of attribution over one’s works,²¹⁹ the right to make alterations to the work prior to, or to withhold its publication,²²⁰ the right to object to the derogation of his work, if the same is prejudicial to his honor or reputation,²²¹ and the right to restrain the use of his name in works that he did not create or distorted his original work.²²² While they do not affect the operation of the exhaustion doctrine, moral rights are important because they exist in favor of the author of the work, regardless of who owns the copyright or the work itself. These moral rights can neither be assigned nor

217. INTELLECTUAL PROPERTY CODE, § 177.

218. AMADOR, *supra* note 37, at 318. (emphasis supplied).

219. INTELLECTUAL PROPERTY CODE, § 193.1.

220. *Id.* § 193.2.

221. *Id.* § 193.3.

222. *Id.* § 193.4.

can they be a subject of a license.²²³ A notable amendment made by R.A. No. 10372 to the Intellectual Property Code is the modification of the term or period over which the author can exercise said moral rights.²²⁴ With regard to the right to be attributed to one's works, the term has been extended to "the lifetime of the author and in perpetuity after his death."²²⁵ The term of the other three remaining moral rights are now *co-terminous* with the economic rights of an author.²²⁶ In light of this amendment, it is submitted that the exhaustion of economic rights — due to the operation of the First Sale Doctrine — now directly affects the aforementioned moral rights of an author.

Having discussed the totality of economic and moral rights of the author, the next Sub-Chapter shall now discuss how the First Sale Doctrine acts as a limitation on the economic right of distribution and reproduction.

B. Is the First Sale Doctrine Applicable in the Philippines?

The answer to this question depends on the field of intellectual property law being considered. Although the focus of this Note is primarily the field of copyright law, it is useful to briefly review how the doctrine is applicable with regard to patents and trademarks. The purpose of such review is to emphasize the existence of the exhaustion doctrine in the Philippines, to highlight the instances where the national concept of the First Sale Doctrine applies, and to identify when the international concept of the same may be applied.

1. First Sale Doctrine in Patent and Trademark Law

The First Sale Doctrine is explicitly worded as a limitation on patent rights under the Intellectual Property Code. To better understand how the doctrine operates, this provision definitively illustrates the operation of the exhaustion doctrine —

The owner of a patent has no right to prevent third parties from performing, without his authorization, the acts referred to in Section 71 hereof in the following circumstances:

Using a patented product *which has been put on the market in the Philippines by the owner of the product, or with his express consent, insofar as such use is performed after that product has been so put on the said market; Provided, [t]hat, with regard to drugs and medicines, the limitation on patent rights shall apply after a drug or medicine has been introduced in the Philippines or anywhere else in the world by the patent owner, or by any party*

223. *Id.* § 198.1 & R.A. No. 10372, § 17.

224. R.A. No. 10372, § 17.

225. *Id.*

226. *Id.*

authorized to use the invention: Provided]] further, [t]hat the right to import the drugs and medicines contemplated in this [S]ection shall be available to any government agency or any private third party.²²⁷

In the instance of the parallel importation of patented goods, this provision becomes important as it may be invoked as a defense against a claim of patent infringement. Parallel importation involves the sale of a good, which has been manufactured abroad, to compete with domestically-manufactured goods under the same patent or trademark.²²⁸ Under this provision of law, a third person may import, distribute, and sell patented goods in the country after the patent owner or his licensee imports the patented goods or any goods derived from the use of the patent into the country without fear of patent infringement. This is known as the national concept of the exhaustion doctrine.²²⁹

The rule is different, however, for patented pharmaceutical products due to the amendment made by the Cheaper Medicines Act to the Intellectual Property Code.²³⁰ It is observed that the amendment introduced the international concept of the exhaustion doctrine to Philippine intellectual property laws. The new provision now allows for the application of the exhaustion doctrine after the introduction of the patented pharmaceutical product by the patent owner or a party authorized by him anywhere in the world.²³¹ However, the doctrine may not be used as a defense in cases of parallel importation of a generic version of a patented drug. A drug which has a valid and effective patent in the Philippines remains protected and the importation of such generic version is deemed an infringement by the law.²³²

Unlike patents, however, there is no express provision under the Intellectual Property Code incorporating the First Sale Doctrine as a limitation to trademark rights. The question as to whether or not the First Sale Doctrine applies to trademarks has not yet been resolved by our Supreme Court. It has been argued that a national concept of exhaustion

227. INTELLECTUAL PROPERTY CODE, § 72 (emphasis supplied).

228. BLACK'S LAW DICTIONARY 1004 (9th ed. 2009).

229. Ray Anthony Pinoy, *Is There a Place for the First Sale Doctrine in the Philippines?*, 86 PHIL. L.J. 341, 342 (2012).

230. *See* An Act Providing for Cheaper and Quality Medicines, Amending for the Purpose Republic Act No. 8293 or the Intellectual Property Code, Republic Act No. 6675 or the Generics Act Of 1988, and Republic Act No. 5921 or the Pharmacy Law, and For Other Purposes [Universally Accessible Cheaper and Quality Medicines Act], Republic Act No. 9502, § 7 (2008).

231. Pinoy, *supra* note 229, at 342.

232. *Id.*

may apply in Philippine jurisdiction with respect to trademarks.²³³ The statutory basis of this argument may be found in Section 87 of the Intellectual Property Code. The provision prohibits technology transfer arrangements — also considered as license contracts — from including clauses “that prohibit the licensee to export the licensed product[,] unless justified for the protection of the legitimate interest of the licensor[,] *such as exports to countries where exclusive licenses to manufacture and/or distribute the licensed product(s) have already been granted.*”²³⁴ This appears to suggest that the Philippines recognizes the principle of national exhaustion with regard to trademarks.²³⁵

2. First Sale Doctrine in Copyright Law

Having examined the application of the exhaustion doctrine in patents and trademarks, it is now prudent to resolve whether or not the same is applicable under copyright law.

The answer to this issue is definitely in the affirmative. The statutory basis for the application of such a doctrine can be found in Section 177.3 of the Intellectual Property Code, which grants the author the exclusive right over the “*first public distribution of the original and each copy of the work by sale or other forms of transfer of ownership.*”²³⁶ This provision covers the author’s distribution right. In relation to such right, the First Sale Doctrine operates by exhausting the copyright owner’s right over the goods after its first sale to the public. In other words, a copyright-protected work, or a copy thereof, which has been initially distributed to the public with the consent of the copyright owner, is no longer subject to his control thereafter. That being the case, the work may be subsequently redistributed by the public through lease or sale without fear of copyright infringement.²³⁷ The exhaustion

233. *Id.* (citing *Yu v. Court of Appeals*, 217 SCRA 328 (1993)). The basis of this submission is a case where the Supreme Court ruled that a local exclusive distributor of “House of Mayfair wall covering products” had the right to exclude a former dealer who imported the same goods for sale within the Philippines. Although the decision was based on the concepts of unfair competition and tortious interference under the Civil Code, it is submitted that had the former dealer not made it appear that he had any relationship with the trademark owner through sponsorship or approval — like the exclusive distributor — he would have had a valid defense against trademark infringement. In addition, the defense under the national concept of exhaustion may be invoked so long as the parallel importer did not materially alter the product. *Id.*

234. INTELLECTUAL PROPERTY CODE, § 87.8 (emphasis supplied).

235. Pinoy, *supra* note 229, at 353.

236. INTELLECTUAL PROPERTY CODE, § 177.3 (emphasis supplied).

237. AMADOR, *supra* note 37, at 324.

doctrine similarly applies to the exclusive rights of performers, as provided by Section 203.3 of the Intellectual Property Code, which states that performers have “the right of authorizing *the first public distribution* of the original and copies of their performance fixed in sound recordings or audiovisual works or fixations *through sale or rental or other forms of transfer of ownership.*”²³⁸ Finally, the distribution right of producers over sound recordings is also subject to the exhaustion doctrine under Section 208.2 of the Intellectual Property Code, which states that producers have the “right to authorize *the first public distribution* of the original and copies of their sound recordings through sale or rental or other forms of transferring ownership.”²³⁹ On the basis of these provisions, it is submitted that the First Sale Doctrine applies to all forms of digital copyrighted works.

A recent amendment to the Intellectual Property Code appears to have strengthened the applicability of the First Sale Doctrine to digital copyright-protected works, even if authors attempt to evade the consequences of a sale through shrinkwrap²⁴⁰ or clickwrap²⁴¹ agreements. R.A. 10372 amended the provision, which pertains to the distinct character of the copyright from the material object subject to it.²⁴² The said amendment now includes licensing, which was previously not considered by the old provision —

The copyright is distinct from the property in the material object subject to it. Consequently, the transfer, assignment, or *licensing* of the copyright shall not[,] itself[,] constitute a transfer of the material object. *Nor shall a transfer or assignment of the sole copy or of one or several copies of the work imply transfer, assignment[,] or licensing of the copyright.*²⁴³

238. INTELLECTUAL PROPERTY CODE, § 203.3 (emphasis supplied).

239. *Id.* § 208.2 (emphasis supplied).

240. This is usually found printed on the packaging of a boxed copy of software. Such a license serves as a notice to buyers that upon opening the package, they become legally bound by the terms of the license. The purposes of such licenses are: (1) to prohibit users from making unauthorized copies of the software; (2) to prevent modifications to such software; (3) to inform the users that the use of such software is limited to a certain number of computers; (4) to limit the liability of the manufacturer; and (5) disclaim warranties. BLACK'S LAW DICTIONARY 1004 (9th ed. 2009).

241. It is considered as the electronic version of a shrinkwrap license. A user agrees to the terms of an electronically displayed agreement — such as those found prior to the installation of software — by pointing to a particular location thereon (usually the “Accept or I Agree” button) and then clicking the same. Unless clicked, the application or program installation will not continue or will, sometimes, even close, depending on the software. It may also be referred to as a clickwrap agreement or End User License Agreement. *Id.* at 1275.

242. INTELLECTUAL PROPERTY CODE, § 181.

243. *Id.* (emphasis supplied).

Stated elsewhere, this provision means that the transfer of ownership of any material object, such as the original work or its copies, does not imply the transfer of ownership or licensing of the copyright. The term “material object” has not been defined under Philippine law or jurisprudence. It is, therefore, not settled whether or not the term embraces digital copies, such as Moving Picture Experts Group audio layer-3 (MP3) files and the like.

There are two submissions, which support the contention that digital works fall under the classification as a material object. First, the Intellectual Property Code protects works by the sole fact that they are created, “irrespective of their mode or form of expression.”²⁴⁴ Further reference may be made to *Advanced Computer Services v. MAI Systems Corporation*,²⁴⁵ which interpreted the term “material object” from the US Copyright Law provision from which our own Intellectual Property Code is heavily patterned after. According to the case, absolute permanence is not required for the creation of a copy.²⁴⁶ It is sufficient that the digital copy be permanent or stable enough to permit it to be perceived, reproduced, or otherwise communicated for a period of more than transitory duration.²⁴⁷ *Advanced Computer Services* further stated that the law extended protection to all original works, which “can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device.”²⁴⁸

Second, it is submitted that due to the amendments made by R.A. No. 10372 to the Intellectual Property Code, the same interpretation can now be applied to a digital copy. The law now defines reproduction as “the making of one or more copies, *temporary or permanent*, in whole or in part, of a work or a sound *recording in any manner or form*.”²⁴⁹ Due to the phrase “temporary or permanent,” it is submitted that digital copies fall under the term “material object,” whether stored in an external storage device, the RAM, or the hard disk of a computer.

244. *Id.* § 172.2.

245. *Advanced Computer Services v. MAI Systems Corp*, 845 F. Supp. 356, (E.D. Virg. 1994) (U.S.).

246. *Id.* at 362.

247. *Id.*

248. *Id.* at 363. This case involved the determination of whether or not the transfer of a computer program from a storage device, whether an external or hard disk, to the Random Access Memory (RAM) of a computer constitutes a copy for purposes of copyright law. The court ruled in the affirmative, stating that even though the RAM representation of the program disappears the instant the computer is turned off, “a copyrighted program[,] which is loaded into RAM and maintained there for minutes or longer,” it becomes sufficiently fixed to constitute a copy under the law. *Id.*

249. INTELLECTUAL PROPERTY CODE, § 171.9 (emphasis supplied).

In addition, the e-Commerce Act also supports the contention that a digital copy is a material object separate from the copyright. The said law penalizes the pirating or unauthorized copying of copyright-protected works through the use of telecommunication networks, such as the internet.²⁵⁰ It is submitted that the *corpus delicti* of such an offense is the unauthorized digital copy made by the act of piracy, the existence of which is proof that copyright infringement was committed. This submission is bolstered by the essence of the author's reproduction right — “creating any tangible object[,] which duplicates or embodies the work.”²⁵¹ It is therefore submitted that the aforementioned provision of the Intellectual Property Code, separating the copyright from the material object subject thereto, may be used by an unwitting consumer who was led to assume that the object of a digital transaction was a sale instead of a license agreement. It is further submitted that in cases of digital media transactions, where the transaction is actually a sale, the same provision can be used in conjunction with the First Sale Doctrine as a defense against copyright infringement.

3. Concept of the Exhaustion Right: National, Regional, or International?

The wording of Section 177 of the Intellectual Property Code does not definitively answer whether the Philippines adheres to the national or the international concept of exhaustion. In this regard, the WIPO Copyright Treaties give the Philippines the liberty to determine the conditions, or lack thereof, for the exhaustion doctrine to operate after the authorized first sale or other transfer of ownership of the original or copy of the work.²⁵² However, Congress has yet to specify whether the national or international concept of exhaustion controls the Intellectual Property Code. House Bill (H.B.) No. 267 initially proposed that the law be amended to reflect the national concept by granting the author “the right to exclusive importation into the Philippines and the first public distribution within the Philippines” of the work.²⁵³ However this was substituted by then H.B. No. 3841 — which became the present R.A. No. 10372²⁵⁴ — and the provision specifying such amendment was dropped. Neither is there an agreement nor treaty in place to facilitate the operation of exhaustion right at the regional level. At present, the Association of Southeast Asian Nations (ASEAN) is still undertaking initiatives focusing on improving the efficiency of intellectual property rights administration, protection, and enforcement within the

250. e-Commerce Act, § 33.

251. AMADOR, *supra* note 37, at 287.

252. WCT, *supra* note 8, art. 6.

253. H.B. No. 267, § 2, 15th Cong., 1st Reg. Sess. (2010).

254. H.B. No. 3841, 15th Cong., 3d Reg. Sess. (2012).

region — in pursuit of eventual economic integration by 2015.²⁵⁵ Therefore, the issue of whether or not the Philippines should apply the national, regional, or international concept remains a debatable question.

In support of the international concept of exhaustion, Amador argues that adopting the same would be perfectly consistent with the State's policy to "promote the diffusion of knowledge and information for the promotion of national development and progress and the common good"²⁵⁶ so that works, which have been publicly distributed anywhere around the world, may be lawfully acquired and subsequently redistributed by Filipinos.²⁵⁷ The Intellectual Property Code provides that works susceptible of copyright protection fall under the protection of the Code once they are first published abroad and in the Philippines within the period of 30 days, irrespective of the author's nationality or residence.²⁵⁸ Amador argues that once a work has been distributed elsewhere, the subsequent importation by third persons into the Philippines triggers the element of local publication.²⁵⁹ It is submitted that the publication of a work through the use of the internet already triggers the publication element in this provision due to the accessibility of the work both abroad and the Philippines. Indeed, authors who intentionally distribute the work through the internet for sale or licensing are arguably presumed to be aware of how the technology operates and that they consent to such transaction by granting a copy or license to the buyer once the latter pays the requisite fee.²⁶⁰

4. Barring the First Sale Doctrine through the Author's Right of Importation

As a counter-argument to his submission, Amador is of the opinion that the provision of the e-Commerce Act, which penalizes the unauthorized importation of digital copyright-protected works through the internet, clouded the applicability of the Intellectual Property Code to digital works and effectively created an inexhaustible right of importation of such works for authors.²⁶¹ An author who seeks to avoid triggering the publication effect of the Intellectual Property Code to preserve his inexhaustible right of importation can simply opt to avoid dissemination of physical copies and

255. ASSOCIATION OF SOUTHEAST ASIAN NATIONS (ASEAN) WORKING GROUP ON INTELLECTUAL PROPERTY COOPERATION, ASEAN INTELLECTUAL PROPERTY RIGHTS ACTION PLAN 2011-2015 4 (2011).

256. AMADOR, *supra* note 37, at 987 (citing INTELLECTUAL PROPERTY CODE, § 2).

257. *Id.*

258. INTELLECTUAL PROPERTY CODE, § 221.1 (e).

259. AMADOR, *supra* note 37, at 987.

260. Santos-Ong, *supra* note 169.

261. AMADOR, *supra* note 37, at 988.

make his works exclusively available in digital format.²⁶² Thereafter, the right of importation cannot be rendered ineffective by a national, regional, or international regime of exhaustion.²⁶³ This is further complicated by the circumstance where even the importation of genuine digital copies may not be done — this would still violate the author's right of exclusive importation. Although this argument highlights the undesirable consequences of the e-Commerce Act to the implementation of the exhaustion principle,²⁶⁴ it must be borne in mind that the Intellectual Property Code provisions limiting the importation of protected works have now been deleted by R.A. No. 10372, possibly rendering the arguments of Amador moot. These provisions guarded the importation right of the copyright owner and enumerated limited circumstances wherein importation by third parties may be allowed without the former's consent.

Prior to the enactment of R.A. No. 10372, the Intellectual Property Code used to impose stringent limitations on the importation of copyright-protected works even if the same was done for personal purposes. While the authorization of the author or copyright holder was not required, the importation of works was only limited to two sets of circumstances, namely: when copies were not available in the Philippines; and when copies are part of libraries or personal luggage belonging to persons or families returning from abroad.²⁶⁵

Under the first circumstance, private individuals may import only one copy at a time and it was strictly for individual use only.²⁶⁶ For incorporated or registered religious, charitable, or educational societies or institutions, not more than three copies or likenesses in any one invoice may be imported, provided that it is only for their use and not for sale.²⁶⁷ The same rule applies for importations made by any state school, college, university, or free public library in the country, or for importing works which are intended for the encouragement of the fine arts.²⁶⁸ Only the Philippine Government, by its authority and for its use, had no limitations on the number of copies, which may be imported.²⁶⁹

Under the second circumstance, the limitation of three copies applies to returning individuals or families and the prohibition of selling the same

262. *Id.*

263. *Id.* at 989.

264. *Id.* at 988.

265. INTELLECTUAL PROPERTY CODE, § 190.1. *See also* R.A. No. 10372, § 14.

266. INTELLECTUAL PROPERTY CODE, § 190.1 (a) (i).

267. *Id.* (iii).

268. *Id.*

269. *Id.* (ii).

within the country.²⁷⁰ In addition to all of these requirements, a prohibition was reiterated forbidding the use of allowable imported copies to violate, annul, or limit in any way the protection granted by the Intellectual Property Code to such works.²⁷¹ Such unauthorized use was deemed as infringement — punishable under the law and without prejudice to the copyright owner's right of action.²⁷²

5. R.A. No. 10372: Paving the Way for the International Concept of Exhaustion

An analysis of the aforementioned provisions reveal the intent of the law to guard and secure the right of the author to exclusively import his own works created and sold abroad when there are no copies of the same are available in the Philippines. This is in line with the right of first public distribution of the author under Section 177 of the Intellectual Property Code,²⁷³ which also implies that the law used to operate under the national concept of the First Sale Doctrine. The purpose of the importation right is to allow copyright owners “to partition the global market into national segments, setting price according to the price elasticity of demand in each segment, and[,] thereby[,] extracting monopoly profits.”²⁷⁴

However, now that R.A. No. 10372 deleted all the aforementioned limitations on importation of copyright-protected works in their entirety, the application of the international or regional concept of exhaustion is now possible in our jurisdiction. The only provision left affecting the importation of copyrighted works and their copies now pertains to infringing materials

Subject to the approval of the Secretary of Finance, the Commissioner of Customs is hereby empowered to make rules and regulations for preventing the *importation or exportation of infringing articles prohibited under Part IV of this Act and under relevant treaties and conventions to which the Philippines may be a party* and for seizing and condemning and disposing of the same in case they are discovered after they have been imported or before they are exported.²⁷⁵

A notable addition to the law is the inclusion of the exportation of infringing articles. Therefore, the only prohibited importation or exportation

270. *Id.* § 190.1 (b).

271. *Id.* § 190.2.

272. INTELLECTUAL PROPERTY CODE, § 190.2.

273. It provides that the author has the exclusive right to carry out, authorize, or prevent the “first public distribution of the original and each copy of the work by sale or other forms of transfer of ownership. *Id.* § 177.3.

274. Papadopoulos, *supra* note 147, at 51.

275. INTELLECTUAL PROPERTY CODE, § 190 (emphasis supplied).

are those which are pirated or infringing materials under the Intellectual Property Code or the e-Commerce Act. Filipino consumers are now free to import into the country as many original works — or their copies — that they desire, provided that the same were legally acquired.²⁷⁶ They are also free to export such works and copies, subject to the copyright or economic rights of authors and regulations of the Bureau of Customs.²⁷⁷

Because of this amendment, it is submitted that the copyright owner's inexhaustible right to import his works has now been removed. Accordingly, it can now be limited under the First Sale Doctrine, regardless of the regime of exhaustion, which may be applicable in our jurisdiction — be it national, international, or regional. Furthermore, a consumer who legitimately acquires an original or a genuine digital copy of the work created and sold abroad and imports the same into the Philippines by downloading it from the internet will no longer be considered in violation of the e-Commerce Act because the Intellectual Property Code no longer requires the authority of the copyright owner for such importation. Under the e-Commerce Act, the unauthorized importation of “protected material, electronic signature, or copyrighted works including legally protected sound recordings or phonograms or information material on protected works, through the use of telecommunication networks, such as, but not limited to, the internet, in a manner that infringes intellectual property rights” was punishable on the same level as piracy.²⁷⁸ The e-Commerce Act provision was even criticized for being contrary to the principles of international copyright law, in particular the TRIPS Agreement, which states that only *willful* copyright piracy on a commercial scale shall be penalized proportionate to the gravity of the offense.²⁷⁹ Even the importation of genuine copies was penalized if the same was done without the authorization of the author. A further criticism of the old provision was that it penalized piracy alongside unauthorized importation; the former pertains to infringing materials, the latter to either.²⁸⁰ It is, therefore, submitted that with the passage of R.A. No. 10372, the author no longer has an inexhaustible right of importation, consequently bringing the copyright law of the Philippines in full compliance with its treaty obligations.

276. Official Gazette Online, FAQs on the amendments to the Intellectual Property Code of the Philippines, *available at* <http://www.gov.ph/2013/03/08/faqs-on-the-amendments-to-the-intellectual-property-code-of-the-philippines/> (last accessed July 30, 2015).

277. *Id.*

278. e-Commerce Act, § 33 (b).

279. TRIPS Agreement, *supra* note 9, art. 61.

280. AMADOR, *supra* note 37, at 989.

More importantly, the Philippines is now free to adopt the following variants of international exhaustion, namely: (1) international exhaustion; (2) selective international exhaustion by product class; and (3) the “Rule of Reason” exhaustion model.²⁸¹ With the first two of these variants having already been discussed in previous sections as allowable under the TRIPS Agreement and WCT, it is timely to discuss the third. The Rule of Reason model applies the international exhaustion model by default, but allows copyright owners the opportunity to prove that existing circumstances warrant the non-exhaustion of their economic rights over a copy of their work.²⁸² It is argued that this model simultaneously protects copyright while promoting the free trade and movement of goods.²⁸³ This regime will necessarily require “consistent rulings in determining the validity of [exceptions] to the rule[.]” which might result in ambiguities and consequently, protracted litigation.²⁸⁴ Like its other variant international exhaustion regimes, the Rule of Reason regime is permissible under the TRIPS Agreement.²⁸⁵

6. R.A. No. 10372 Now Allows for Parallel Importation of Works

As a consequence of the R.A. No. 10372 amendments, which favor the application of an international exhaustion right in the Philippines, it is submitted that Philippine copyright laws have effectively removed the exclusive importation right of the author over his works. It must be noted that the rationale for international exhaustion is that “the copyright owner, having sold the product, has obtained the benefit of exclusive commercial exploitation rights bestowed by [intellectual property rights laws] and should no longer control its distribution beyond the first sale.”²⁸⁶ As discussed earlier, R.A. No. 10372 has already removed the limitation on the number of copies a person may import into the country, so long as they are purchased legitimately. Therefore, the ban on parallel importation, which used to be enforced by the deleted provisions of the Intellectual Property Code, has now been lifted. A parallel importer is defined in Philippine jurisprudence as one who “imports, distributes, and sells genuine products in the market, *independently of an exclusive distributorship or agency agreement with the manufacturer.*”²⁸⁷ Parallel importers of legitimately purchased copyright-

281. Papadopoulos, *supra* note 147, at 56.

282. *Id.*

283. *Id.*

284. *Id.*

285. Declaration on the TRIPS Agreement, *supra* note 99, ¶ 5 (a).

286. Papadopoulos, *supra* note 147, at 50.

287. *Solid Triangle Sales Corporation v. The Sheriff of RTC QC*, Br. 93, 370 SCRA 491, 498 (2001) (emphasis supplied).

protected goods should not fear prosecution for copyright infringement since the law no longer requires such person to obtain the authorization of the copyright owner. It is submitted that this development should be considered an incentive for consumers — without unduly impairing the economic right of the author over his works in the digital environment. Indeed, it has been argued that the importation right “may enable copyright owners and their licensees to extract monopoly profits from a specific territory at the expense of domestic consumers.”²⁸⁸

With parallel importation of goods now permissible in Philippine jurisdiction, it is submitted that Filipinos should now be able to perform commercial distribution of copyrighted works, provided that they were legitimately purchased abroad, without fear of prosecution for copyright infringement. It is further submitted that as to digital media sold in the internet by an online merchant located outside the Philippines, the removal of the ban actually supports digital resale. Should the Supreme Court decide to interpret the Intellectual Property Code as granting a regime of international exhaustion, it is submitted that the first public distribution of digital media through the internet will, consequently, result in the exhaustion of the distribution right upon purchase by a Filipino consumer.

C. Problem Areas for Digital Resale and how the Fair Use Doctrine is an Enabler of the First Sale Doctrine

Should the First Sale Doctrine be upheld as being applicable to the digital environment, it is submitted that economic rights of distribution and reproduction of the author pose a significant obstacle to the legality of reselling digital media. While the former is extinguished by the First Sale Doctrine, the latter remains unaffected and is, therefore, a possible area for copyright infringement. To avoid this pitfall, this is where the Fair Use defense²⁸⁹ will begin to play a significant part in digital resale. Indeed, without this defense, the usefulness of a digital first sale doctrine will be insignificant if there is no permission to reproduce a transient copy at the very least.²⁹⁰

1. The Distribution Right

288. Papadopoulos, *supra* note 147, at 54.

289. Fair use is a defense used in an infringement claim by considering the following factors: (1) the purpose and character of the use, (2) the nature of the copyrighted work, (3) the amount and substantiality of the portion used, and (4) the effect of the use upon the potential market for or value of the copyrighted work. 17 U.S.C.A. § 107 (1976).

290. Jennifer Lahm, *Buying A Digital Download? You May Not Own The Copy You Purchase*, 28 TOURO L. REV. 211, 242 (2012).

The distribution right under the Intellectual Property Code is an essential provision allowing the author to create “a profitable marketing program” for his works by distributing the same to the general public by selling, licensing the use of a copy, lending, or renting it out commercially.²⁹¹ The distribution right also allows a copyright owner to protect himself from the unauthorized distribution of his works or its copies to the public, regardless of their lawful or unlawful manufacture.²⁹² However, this right is extinguished after the “first public distribution”²⁹³ by the author or his agent. The exhaustion of the distribution right necessarily entails a transaction, which is in the nature of a sale or a transfer of ownership over the original work or its copy.²⁹⁴ Should the transfer of ownership be in the nature of a donation — a transfer that is not necessarily commercial in nature — it is possible for the copyright owner donating such original or copy to “impose downstream restrictions on the use and disposal of the article by the person in whose favor the donation was made.”²⁹⁵ Therefore, an author who sells a digital work without any restriction is divested of any control over the subsequent sale by the purchaser.²⁹⁶ The author may no longer control the price at which it is to be resold nor can he control future retail sales; hence, his right of distribution over the material object sold ceases to exist.²⁹⁷ This is affirmed not only by the First Sale Doctrine under Section 177.3²⁹⁸ of the Intellectual Property Code but also by the principle under Section 181, which states that “copyright is distinct from the property in the material object subject to it.”²⁹⁹

In order to preserve his distribution right and to defeat the operation of the exhaustion doctrine in the digital environment, copyright owners often opt for licensing agreements for the use of the copy rather than enter into sales contracts.³⁰⁰ Shrinkwrap licensing agreements — originally used for physical copies — made the transition to the digital space in the form of clickwrap licensing agreements.³⁰¹ Should the copyright owner successfully prove the validity and enforceability of such an agreement, the reseller may consequently be sued for copyright infringement as the distribution right was

291. AMADOR, *supra* note 37, at 322.

292. *Id.* at 274.

293. INTELLECTUAL PROPERTY CODE, § 177.3.

294. AMADOR, *supra* note 37, at 275.

295. WIPO Secretariat, *supra* note 1, at 4.

296. AMADOR, *supra* note 37, at 275.

297. *Id.*

298. INTELLECTUAL PROPERTY CODE, § 177.3.

299. *Id.* at § 181.

300. AMADOR, *supra* note 37, at 323.

301. *Id.* at 324.

never extinguished.³⁰² However, shrinkwrap and clickwrap agreements have not been always upheld in foreign jurisdictions, thereby making the applicability of the exhaustion doctrine on digital goods “a subject of intense interest to online providers and the public.”³⁰³

In sum, if the Supreme Court encounters a case involving digital resale of a copyright-protected good, it is essential to determine if the distribution right of the author has been exhausted. The Supreme Court may either acquit an alleged copyright infringer under the First Sale Doctrine under Section 177.3 of the Intellectual Property Code or adjudge him guilty of copyright infringement under both the Intellectual Property Code and e-Commerce Act. In any case, it is important to note that the First Sale Doctrine “exhausts only the distribution right” and the person who legitimately acquires an original work or copy “may not reproduce it or create a derivative work from it.”³⁰⁴ Should the First Sale Doctrine in cases of digital media be applied, it is necessary to show that the reproduction right of the author is not infringed.

2. The Reproduction Right and the Fair Use Doctrine

Avoiding the infringement of the author’s reproduction right is a problematic area for prospective digital resellers. The copyright owner’s “reproduction right is implicated by each reproduction of a work in computer memory” either in one’s personal computer or an online server.³⁰⁵ R.A. No. 10372 seems to further aggravate the problem because, as discussed earlier, the Intellectual Property Code now considers the term reproduction to include even temporary copies.³⁰⁶

To avoid infringement and facilitate the operation of the exhaustion doctrine, a compromise may be found in allowing the recipient to resell his own digital copy, provided that he destroys it after the buyer possesses his own copy. To illustrate this digital transaction, the reseller would electronically transmit the digital copy to the buyer and then subsequently delete the copy he used to make the transmission.³⁰⁷ It is hereby submitted that such a transaction falls under the defense of “Fair Use” under our Intellectual Property Code. After all, “the reproduction right, as other exclusive rights, is subject to the Fair Use defense.”³⁰⁸ Since such a

302. *Id.*

303. *Id.* at 358.

304. *Id.* at 986.

305. *Id.* at 404.

306. See INTELLECTUAL PROPERTY CODE, § 171.9.

307. AMADOR, *supra* note 37, at 408.

308. *Id.* at 288.

transaction is not one of the statutorily recognized limitations on copyright under Section 184, the determination of whether it constitutes fair use relies on the factors provided by Section 185.1, namely:

- (a) The purpose and character of the use, including whether such use is of a commercial nature or is for non-profit educational purposes;
- (b) The nature of the copyrighted work;
- (c) The amount and substantiality of the portion used in relation to the copyrighted work as a whole; and
- (d) The effect of the use upon the potential market for or value of the copyrighted work.³⁰⁹

To better analyze the Fair Use defense, it is helpful to review the case of *A&M Records v. Napster, Inc.*,³¹⁰ which involved a P2P application that facilitated the widespread sharing or reproduction of digital copyright-protected goods, such as MP3 files.³¹¹ The defendant, Napster, “designed and [operated] a system[,] which [permitted] the transmission and retention of sound recordings [by] employing digital technology.”³¹² Essentially, Napster facilitated the transmission of MP3 files between users through P2P file sharing through its own network of servers and software.³¹³ Charged with copyright infringement, Napster raised the defense of Fair Use for itself and the users of its program.³¹⁴ Although Napster eventually lost, the way the 9th Circuit of the US Courts of Appeals interpreted the Fair Use factors may be persuasive since the provisions of our law are virtually identical with theirs.³¹⁵

The first factor of the Fair Use Doctrine essentially asks “whether the new work merely replaces the object of the original creation or instead adds a further purpose or different character.”³¹⁶ In the case of a digital media transaction — where the transmitted file is thereafter deleted — it is submitted that such a transaction is not repugnant to this factor because, unlike the system employed by Napster, where the sender and recipient retain their copies thereby infringing the author’s reproduction right, *only one copy shall exist at the end of a non-copyright infringing resale transaction*. The first factor also asks if “the allegedly infringing use is commercial or

309. INTELLECTUAL PROPERTY CODE, § 185.1 (emphasis supplied).

310. *A&M Records, Inc. v. Napster, Inc.*, 239 F.3d 1009 (9th Cir. 2001) (U.S.).

311. *Id.*

312. *Id.* at 1011.

313. *Id.*

314. *Id.*

315. 17 U.S.C.A § 107 (1976).

316. *A&M Records, Inc.*, 239 F.3d at 1015.

noncommercial.”³¹⁷ According to the case, “commercial use weighs against a finding of fair use but is not conclusive on the issue.”³¹⁸ Thus even if the resale was for profit, it is submitted that the act of transmitting a copy is not immediately deemed an infringement.

As for the second factor, the doctrine seeks to inquire into the nature of the use of the work.³¹⁹ The case stated that works, which are creative in nature, such as musical recordings, are “closer to the core of intended copyright protection” and, thus, the preference would be against the application of Fair Use against these works.³²⁰ However, it is respectfully submitted that the main question that need be answered in relation to the Fair Use is whether or not copyright will be eroded or defeated despite the work being expressly mentioned as protected? In other words, will this discourage authors from creating works through their intellectual labor due to the fear of their right to a just reward being revoked?

The third factor seeks to determine the portion of the work that was used by the alleged infringement.³²¹ In this regard, the case said that “under certain circumstances, a court will conclude that a use is fair even when the protected work is copied in its entirety.”³²² It is, therefore, submitted that the deletion of a copy at the end of a digital resale transaction passes this factor since the originating copy has been removed; thus, respecting the author’s reproduction right, albeit after the fact.

Finally, the fourth factor under the Fair Use Doctrine asks whether the use will “materially impair the marketability of the work which is copied.”³²³ The chief consideration, therefore, is whether or not the copying of the digital work harms the market for such product. It is submitted that, on the contrary, digital resale encourages the creation of secondary markets for these digital goods. Indeed, “markets for second-hand goods encourage retail price competition.”³²⁴ Additionally, the existence of such a market “could benefit distributors and copyright holders by promoting increased sales in the primary market.”³²⁵ The consumer is, therefore, confident of the

317. *Id.*

318. *Id.*

319. *Id.* at 1016.

320. *Id.*

321. *Id.*

322. *A&M Records, Inc.*, 239 F.3d at 1016.

323. *Id.*

324. Michael R. Mattioli, *Cooling Off & Secondary Markets: Consumer Choice in the Digital Domain*, 15 VA. J. L. & TECH. 227, 239 (2010).

325. *Id.*

fact that he may liquidate his digital media purchase in a future resale should he lose interest in the digital good and lose the desire to keep it.³²⁶

It is important to note that the Fair Use Doctrine even benefits those who are deemed to be licensees of clickwrap agreements. “[O]ne who is a licensee or merely in possession of the copy without owning it may raise this defense.”³²⁷ However, their rights are necessarily restricted by the licensing agreement; should the First Sale defense be accepted, the licensee who resells his copy would not be liable for copyright infringement.³²⁸ Rather, the licensee would be liable for breaching the license agreement, making his liability contractual in nature.³²⁹ It is submitted that licensees and owners of digital media copies alike should be able to use the Fair Use defense to make temporary copies to facilitate a digital resale transaction, provided that the copies be deleted after. It is further submitted that any liability for breaching a clickwrap agreement may be limited to contractual liability, should the Fair Use Doctrine be successfully invoked but the First Sale Doctrine fail.

In conclusion, the First Sale Doctrine and the Fair Use Doctrine are statutorily recognized limitations on the distribution and reproduction rights, respectively. If correctly invoked, these doctrines may be used as potentially effective defenses against copyright infringement. These doctrines, as enshrined under the Intellectual Property Code, along with the removal of the ban on parallel importation of works by R.A. No. 10372, should be considered a victory for Filipino digital media consumers and digital resellers. Should our Supreme Court determine that our laws provide for an international regime of exhaustion, it is submitted that this is perfectly in line with the public policy regarding intellectual property — “the diffusion of knowledge and information for the promotion of national development and progress and the common good.”³³⁰

IV. APPLICATION OF THE FIRST SALE DOCTRINE IN FOREIGN JURISDICTIONS

After having covered the general principles of international copyright laws and the provisions of the amended Intellectual Property Code, it is now wise to look at the decisions rendered by foreign courts interpreting these principles. These decisions are submitted to be persuasive to the interpretation of Philippine laws because of the similarity between foreign laws and the Intellectual Property Code and also because these jurisdictions

326. *Id.*

327. Lahm, *supra* note 291, at 245.

328. *Id.* at 242.

329. *Id.*

330. INTELLECTUAL PROPERTY CODE OF THE PHILIPPINES, § 2.

are bound under the same international agreements on copyright as the Philippines is.

A. American Jurisdiction

An interesting development in the US is that manufacturers of goods have turned to copyright laws as means of preventing gray market goods from abroad from entering the country,³³¹ invoking their distribution right under the Copyright Act — which states that the copyright owner “has the exclusive rights[] to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending.”³³² These gray market goods are the same as “parallel imports,” which is a term used by the European Union.³³³ It can be observed that, unlike the Philippines, the US retains a ban on parallel imports because of the distribution right. The distribution right is limited by the First Sale Doctrine under Section 109 (a) of the Copyright Act, which provides that “the owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord.”³³⁴ In this legal context, the clash is between copyright owners, who desire to control distribution of their products, and consumers, who are attracted to the gray market “because it offers identical goods at lower prices and encourages price competition.”³³⁵ How these doctrines were recently applied by US courts both in the digital and analog environment shall be the subject of discussion hereunder.

1. *Vernor*: Resale of Boxed Software is Infringement Due to Shrinkwrap Agreement

In addition to the defense provided by the First Sale Doctrine, there is another limitation on copyright under the Copyright Act known as the “Essential Step Doctrine.”³³⁶ This doctrine applies to the creation of an additional copy or adaptation by one who owns a copy of a computer program without infringement of copyright if “it is created as an essential step in the utilization of the computer program in conjunction with a

331. Brandon Leahy, *Supreme Indecision: Copyright's First Sale Doctrine in the Gray Aftermath of Costco v. Omega*, 16 INTELL. PROP. L. BULL. 45, 47 (2011).

332. 17 U.S.C.A. § 106 (1976).

333. Leahy, *supra* note 332, at 47.

334. 17 U.S.C.A. § 109 (a) (1976).

335. Leahy, *supra* note 332, at 47 (citing Lawrence M. Friedman, *Business and Legal Strategies for Combating Grey-Market Imports*, 32 INT'L L. 27 (1998)).

336. 17 U.S.C.A. § 117 (a) (1) (1976).

machine and that it is used in no other manner.”³³⁷ This doctrine has a counterpart under our Intellectual Property Code in Section 189.³³⁸ These doctrines were tackled in *Vernor*. In that case, Vernor³³⁹ purchased several boxed copies of Autodesk’s AutoCAD Release 14 software from one of Autodesk’s direct customers and he resold these on eBay.³⁴⁰ *Vernor* essentially involves an infringement suit between a software copyright holder, who alleges copyright infringement, and a licensee, who seeks protection under the First Sale and Essential Step Doctrines in order to be declared an owner of the software copy he seeks to resell.³⁴¹ In resolving the issue, the court relied on several precedents in the interpretation of the First Sale Doctrine, such as the precedent set by the case of *United States v. Wise*³⁴² —

337. *Id.*

338. INTELLECTUAL PROPERTY CODE, § 189.1. This Section states that

the reproduction in one (1) back-up copy or adaptation of a computer program shall be permitted, without the authorization of the author of, or other owner of copyright in, a computer program, by the lawful owner of that computer program: Provided, That the copy or adaptation is necessary for:

- (1) The use of the computer program in conjunction with a computer for the purpose, and to the extent, for which the computer program has been obtained; and
- (2) Archival purposes, and, for the replacement of the lawfully owned copy of the computer program in the event that the lawfully obtained copy of the computer program is lost, destroyed, or rendered unusable.

Id.

339. Vernor was an American citizen registered in eBay as a “PowerSeller,” while Autodesk was an American multinational corporation, which developed the software. When Autodesk saw Vernor’s auction on eBay, the former responded by filing a Digital Millennium Copyright Act (DMCA) take-down notice with eBay. Autodesk claimed that it conveyed its software copies pursuant to non-transferable licenses and that Vernor’s resale constituted copyright infringement. Vernor filed a counter-notice with eBay, but Autodesk did not respond, leading to the reinstatement of his auctions. Vernor, then, represented on his online auction that the software being sold was not currently installed on any computer. The DMCA process ensued, with Autodesk not replying to the counter-notice. This process was repeated four times. Eventually, Vernor brought a declaratory action against Autodesk to establish that his resale of the boxed copies were protected under the first-sale doctrine and did not constitute copyright infringement. *Vernor*, 621 F.3d. at 1104.

340. *Id.*

341. *Id.*

342. *United States v. Wise*, 550 F.2d 1180 (9th Cir. 1977) (U.S.).

Specifically, we considered whether the agreement[:] (a) was labeled a license[:] (b) provided that the copyright owner retained title to the prints[:] (c) required the return or destruction of the prints[:] (d) forbade duplication of prints[:] or (e) required the transferee to maintain possession of the prints for the agreement's duration.³⁴³

In that decision, the court “did not hold that the copyright owner’s retention of title itself established the absence of a first sale or that a transferee’s right to indefinite possession itself established a first sale.”³⁴⁴ Years after the precedent laid down in *Wise*, the considerations as to whether or not a purchaser of a copy of software was a licensee or an owner was further refined in what would be collectively known as the *MAI trio* of cases³⁴⁵ and was synthesized by the court in the following manner — “First, we consider whether the copyright owner specifies that a user is granted a license. Second, we consider whether the copyright owner significantly restricts the user’s ability to transfer the software. Finally, we consider whether the copyright owner imposes notable use restrictions.”³⁴⁶

It was on the basis of these considerations that the court upheld the software licensing agreement — or shrinkwrap agreement — stating that Vernor’s resale infringed Autodesk’s right of distribution, and that Vernor’s customers could not avail of the defense under the Essential Step Doctrine since title over the copies of software sold did not pass to them.³⁴⁷ As opposed to clickwrap agreements, the court ruled that the purchaser is deemed to agree to shrinkwrap agreements the moment they open the box after their purchase.³⁴⁸ The troubling fact in *Vernor* is that the used boxed copies were never opened by Vernor in the first place.³⁴⁹

Although not favorable for licensees desiring to assert ownership over their digital purchases, *Vernor* included policy considerations that are worthy of observation and aptly illustrates the clashing interests of copyright holders and consumers. The following policy arguments were raised on the side of licensing by Autodesk, the Software & Information Industry Association (SIIA), and the Motion Picture Association of America (MPAA).³⁵⁰

343. *Vernor*, 621 F.3d at 1108 (citing *Wise*, 550 F.2d at 1180).

344. *Id.* at 1109.

345. *Id.* (citing *MAI Systems Corp. v. Peak Computer, Inc.*, 991 F.2d 511 (9th Cir. 1993) (U.S.); *Triad Systems Corp. v. Southeastern Express Co.*, 64 F.3d 1330 (9th Cir. 1995); & *Wall Data, Inc. v. Los Angeles County Sheriff’s Dep’t*, 447 F.3d 769 (9th Cir. 2006) (U.S.)).

346. *Vernor*, 621 F.3d at 1111.

347. *Id.* at 1112.

348. *Id.*

349. *Id.* at 1111.

350. *Id.* at 1114.

Autodesk's argument raises the following public policy considerations in favor of upholding licensing agreements:

- (1) allows for tiered pricing for different software markets, such as reduced pricing for students or educational institutions;
- (2) increases software companies' sales;
- (3) lowers prices for all consumers by spreading costs among a large number of purchasers; and
- (4) reduces the incidence of piracy by allowing copyright owners to bring infringement actions against unauthorized resellers.³⁵¹

The SIIA raised the following arguments regarding the enforceability of a license agreement when a purchaser of software —

- (1) receives his copy of the work after making a single payment and (2) can indefinitely possess a software copy, because it is the software code and associated rights that are valuable rather than the inexpensive discs on which the code may be stored.³⁵²

Finally, the MPAA argued that the indefinite possession of a software copy “should not compel a finding of a first sale, because there is often no practically feasible way for a consumer to return a copy to the copyright owner.”³⁵³ From the aforementioned considerations, it may be gathered that the primary consideration of these parties is the maximization of economic returns on their copyrighted goods, whether they be digital or analog in nature.

In contrast to these policy submissions, Vernor, eBay Inc., and the American Library Association (ALA) presented arguments generally favoring the First Sale Doctrine as a limitation on digital copyright in favor of consumers. Vernor opposed the court's decision because it —

- (1) does not vindicate the law's aversion to restraints on alienation of personal property; (2) may force everyone purchasing copyrighted property to trace the chain of title to ensure that a first sale occurred; and (3) ignores the economic realities of the relevant transactions, in which the copyright owner permanently released software copies into the stream of commerce without expectation of return in exchange for upfront payment of the full software price.³⁵⁴

In support of creating a gray market or secondary market through an expanded interpretation of the First Sale Doctrine by the court, eBay argued that these markets promote public interest by: “(1) giving consumers

351. *Id.* at 1114-15.

352. *Vernor*, 621 F.3d at 1114-15.

353. *Id.*

354. *Id.* at 1115.

additional opportunities to purchase and sell copyrighted works, often at below-retail prices; (2) allowing consumers to obtain copies of works after a copyright owner has ceased distribution; and (3) allowing the proliferation of businesses.”³⁵⁵ Perhaps the strongest of all policy considerations discussed came from the ALA —

[J]udicial enforcement of software license agreements, which are often contracts of adhesion, could eliminate the software resale market, require used computer sellers to delete legitimate software prior to sale, and increase prices for consumers by reducing price competition for software vendors.³⁵⁶

The clash of public policy considerations reveals the ongoing debate as regards whether or not the First Sale Doctrine can transform licensees into owners of the digital copies they possess. American jurisprudence on the issue is hardly settled on the matter even as to *physical* media, as *UMG Recordings, Inc. v. Augusto*³⁵⁷ will reveal.

2. *UMG Recordings, Inc.*: Promotional CDs May Be Resold Despite Licensing Agreement

UMG Records is one of the world’s largest music companies and is engaged in the business of “creation, manufacture, and sale of recorded music, or phonorecords,”³⁵⁸ consequently being the copyright owner of such works.³⁵⁹ As part of its marketing strategy, UMG sent promotional CDs containing their music “to a large group of individuals (recipients), such as music critics and radio programmers[.]”³⁶⁰ These recipients, who received the unsolicited CDs, were informed of a licensing agreement in the form of a shrinkwrap agreement on the case of the CD³⁶¹ stating to the effect that

[t]his 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.³⁶²

Augusto, who was not part of the recipients who initially acquired possession of the CDs, was able to acquire these and, subsequently,

355. *Id.*

356. *Id.*

357. *UMG Recordings, Inc. v. Augusto*, 628 F.3d 1175 (9th Cir. 2011) (U.S.).

358. *Id.* at 1176.

359. *Id.* at 1177.

360. *Id.*

361. *Id.* at 1178.

362. *Id.*

auctioned them off on the internet through eBay.com — advertising them as “rare industry editions” and referred to them as “Promo CDs.”³⁶³ Similar to *Vernor*, UMG repeatedly attempted to take down the auctions and, when it was unable to do so, filed a complaint against Augusto — alleging that UMG retains the exclusive right of distribution over the eight promotional CDs he had sold.³⁶⁴ However, the court decided that the manner of UMG’s distribution — unsolicited, therefore in the nature of “unordered merchandise” — resulted in the transfer of title over the CDs to the recipients, thus, exhausting its distribution right.³⁶⁵ There being no indication that there was any prior arrangement with the recipients, there was “no evidence to support a conclusion that licenses were established under the terms of the promotional statement.”³⁶⁶ The court, while applying the considerations in *Wise*, differentiated *UMG Recordings, Inc.* from *Vernor* by stating that “software users who order and pay to acquire copies are in a very different position from that held by the recipients of UMG’s promotional CDs.”³⁶⁷ This was due to UMG’s lack of control over the distributed CDs, with “no assurance that any recipient has assented or will assent to the creation of any license or accept its limitations.”³⁶⁸

Interestingly, the court characterized the unsolicited distribution of promotional CDs by UMG as having “effected a gift or sale within the meaning of the [F]irst [S]ale [D]octrine.”³⁶⁹ This was based on two findings made by the district court. First, UMG’s act of giving away the promotional CDs to the recipients, who are music industry insiders, meant that there was no intent on its part to enter into a license agreement and, therefore, “absence of this intent is strong evidence that the product was sold.”³⁷⁰ That being the case, there was no indication on the packaging requiring the return of the CDs to UMG and neither did UMG monitor those who received it in order to ensure their return.³⁷¹ This was again reaffirmed by the court on appeal, even citing *Wise*, where the lack of a “return provision” meant that “permanent possession was granted to the recipient.”³⁷² Second, the court stated that while “licenses provide recurring benefits for the copyright

363. *UMG Recordings, Inc.*, 628 F.3d at 1178.

364. *Id.*

365. *Id.* at 1180-81.

366. *Id.* at 1182.

367. *Id.* at 1183.

368. *Id.*

369. *UMG Recordings, Inc.*, 628 F.3d at 1183.

370. *UMG Recordings, Inc. v. Augusto*, 558 F. Supp. 2d 1055, 1061 (C.D. Cal. 2008) (U.S.).

371. *Id.*

372. *UMG Recordings, Inc.*, 628 F.3d at 1183.

owner,” UMG’s only benefit was to restrain the subsequent transfer of its CDs.³⁷³ To distance itself from software licenses, the court stated that a license was needed because software needed to be copied into computers to be able to function, while “music CDs are not normally subject to licensing.”³⁷⁴ Therefore, the grant of perpetual possession of the CD to the recipients was characterized as a gift or sale made by UMG.³⁷⁵

It is submitted that the discussion above bears an apparent contradiction with the court’s attempt to distance itself from *Vernor* and software, considering that at the analog or physical level, a huge media conglomerate is able to distribute thousands of promotional CDs just to market its products. In the digital environment, is it not true that once a purchase is made, persons who download digital media arguably have perpetual possession of their copies as well? Moreover, how is it even possible to return a digital copy? Thus, it is submitted that aside from being contracts of adhesion,³⁷⁶ clickwrap agreements are merely there to restrain the subsequent transfer of copyright-protected goods, avoid exhaustion, and maximize commercial gains from such products.³⁷⁷

3. *Capitol Records, LLC v. ReDigi Inc.*: The First Online Market Place for Digital Used Music is Illegal Because Users Own Their “Particular” Digital Copies

*Capitol Records, LLC*³⁷⁸ is significant for it is the first time that an American court would pass over the issue of “whether the unauthorized transfer of a digital music file over the internet — where only one file exists before and after the transfer — constitutes reproduction within the meaning of the Copyright Act.”³⁷⁹

Capitol Records, LLC sued ReDigi Inc., a twenty-first century technology company that touts itself as a “virtual” marketplace for “pre-owned” digital music.³⁸⁰ Acting as an online secondary market where used digital media is sold, ReDigi’s website invites users to “sell their legally

373. *Augusto*, 558 F. Supp. 2d at 1061–62.

374. *Id.*

375. *Id.*

376. *Vernor*, 621 F.3d at 1115.

377. Joshua W. Newman, *Selling the Right to License: Examination of the First Sale Doctrine Through the Lens of UMG Recordings & Quanta Computer*, 35 J. CORP. L. 849, 857 (2010).

378. *Capitol Records, LLC v. ReDigi Inc.*, 934 F.Supp.2d 640 (S.D. N.Y. 2013) (U.S.).

379. *Id.* at 649.

380. *Id.*

acquired digital music files, and buy used digital music from others at a fraction of the price currently available on iTunes.”³⁸¹ This is done through ReDigi’s “Media Manager,” which is downloaded on a user’s computer. This program scans for digital music files eligible for reselling in ReDigi’s market place.³⁸² To be eligible, the file must have been purchased on Apple Inc.’s iTunes or from other ReDigi users.³⁸³ Should the Media Manager detect in the user’s computer eligible music files that have already been resold through its service, the program will prompt the user to delete the file.³⁸⁴ Since there is no automatic deletion of such copies, ReDigi’s policy is to suspend the accounts of users who refuse to comply.³⁸⁵ Eligible files are uploaded to the company’s “Cloud Locker,” a remote server in Arizona.³⁸⁶ Once the file has been uploaded to the cloud, the file on the user’s computer is deleted and, should it be resold in the market place, the file in the cloud shall be deleted as well.³⁸⁷ The access to the file in the cloud is “transferred to the new owner at the time of purchase,” thus, allowing the new owner to “stream it, sell it, or download it to her computer and other devices.”³⁸⁸ Interestingly, there is no money involved in the transaction; a virtual currency is used, “purchased from ReDigi or acquired from other sales.”³⁸⁹ This virtual currency, termed “credits” may not be exchanged for real currency and can only be applied to future music purchases in the ReDigi market place.³⁹⁰ Through this setup, “ReDigi earns a fee for every transaction” and retained a percentage for royalties to be paid to copyright holders.³⁹¹

Capitol owns the copyright of a number of the recordings sold on ReDigi’s website and alleged that ReDigi has committed copyright infringement.³⁹² In particular, Capitol claimed that ReDigi has violated its exclusive right of reproduction and distribution through its online service.³⁹³

381. *Id.*

382. *Id.*

383. *Id.*

384. *Capitol Records, LLC*, 934 F.Supp.2d at 648.

385. *Id.*

386. *Id.*

387. *Id.*

388. *Id.* at 649.

389. *Id.*

390. *Capitol Records, LLC*, 934 F.Supp.2d at 649.

391. *Id.*

392. *Id.* at 650.

393. *Id.*

Unfortunately for ReDigi, the court held that there was an unauthorized reproduction on its part, reasoning that

[b]ecause the reproduction right is necessarily implicated when a copyrighted work is embodied in a new material object, and *because digital music files must be embodied in a new material object following their transfer over the Internet*, the [c]ourt determines that the *embodiment of a digital music file on a new hard disk is a reproduction* within the meaning of the Copyright Act.

*This finding holds regardless of whether one or multiple copies of the file exist.*³⁹⁴

The court reasoned that the essence of the reproduction right is the “creation of a *new* material object and not an *additional* material object.”³⁹⁵ The court also found that ReDigi violated Capitol’s exclusive right of distribution, finding that ReDigi’s invocation of the First Sale and Fair Use Doctrines to be without any basis.³⁹⁶ Applying the statutory factors³⁹⁷ to determine if ReDigi’s storing of files in its Cloud Locker constitutes fair use, the court ruled against ReDigi stating that it

facilitates and profits from the sale of [copyright-protected] commercial recordings, transferred in their entirety, with a likely detrimental impact on the primary market for these goods. Accordingly, the [c]ourt concludes that the [F]air [U]se defense does not permit ReDigi’s users to upload and download files to and from the Cloud Locker incident to sale.³⁹⁸

Because the Fair Use defense of ReDigi was not upheld by the court, the exclusive reproduction right of Capitol remains unexhausted — rendering ReDigi’s reliance on the First Sale Doctrine useless. Because the reproduction of the music file in the cloud was not “lawfully made” under the Copyright Act, there could have been no valid First Sale on the part of the user because it was “impossible for the user to sell her ‘particular’ phonorecord on ReDigi.”³⁹⁹ As a result, ReDigi infringed the distribution right of Capitol because the files uploaded to and distributed through the Cloud Locker were “*reproductions* of the copyrighted code embedded in new material objects, namely the ReDigi server in Arizona and its users’ hard drives.”⁴⁰⁰ The court reasoned further that even the US Copyright Office, in its report on the Digital Millennium Copyright Act (DMCA), believed that “the justifications for the [F]irst [S]ale [D]octrine in the physical world could

394. *Id.* at 649 (emphasis supplied).

395. *Id.*

396. *Capitol Records, LLC*, 934 F.Supp.2d at 648

397. 17 U.S.C.A. §§ 106-07 (1976).

398. *Capitol Records, LLC*, 934 F.Supp.2d at 653.

399. *Id.*

400. *Id.*

not be imported into the digital domain.”⁴⁰¹ Unlike analog copyright-protected works, digital media “[do] not degrade, and can be reproduced perfectly on a recipient’s computer,”⁴⁰² and that since digital copies may be sent “instantaneously anywhere in the world with minimal effort and negligible cost[,]” the impact on the copyright owner’s market could be greatly detrimental.⁴⁰³

The ruling has two material implications on digital ownership. First, the ruling expressly recognized the ownership of users over their iTunes music purchases, notwithstanding the clickwrap terms of the iTunes Store.⁴⁰⁴ Indeed, the court explicitly stated that the “ReDigi user owns the phonorecord that was created when she purchased and downloaded a song from iTunes to her hard disk.”⁴⁰⁵ The court referred to such phonorecord as a “particular record,” because that specific file, which the user downloaded, is owned by the user.⁴⁰⁶ Second, and as a consequence of the first implication, nothing precludes the user from selling the particular copy she owns by alienating the very storage device it was downloaded to.⁴⁰⁷ The court reasoned that the Copyright Act “still protects a lawful owner’s sale of her ‘particular’ phonorecord, be it a computer hard disk, iPod, or other memory device onto which the file was originally downloaded.”⁴⁰⁸ Indeed, a reading of the ruling shows the court’s great hesitation in applying the First Sale Doctrine to purely digital transactions and yet, in the same breath, the court upheld the resale of a digital copy so long as the transaction is utilized through analog means. It is submitted that the very evils the court used as a justification for its decision — non-degradation of digital copies and the impact on the copyright owner’s market — still subsist and that the only evil, if it can even be considered one, that is prevented is the “near instantaneous” transfer of data anywhere around the globe.⁴⁰⁹

B. The European Union

401. *Id.* at 656 (citing USCO, Library of Cong., DMCA Section 104 Report (2001)).

402. *Id.*

403. *Id.*

404. See Apple Inc., Terms and Conditions available at <http://www.apple.com/legal/internet-services/itunes/us/terms.html#SERVICE> (last accessed July 30, 2015). The terms of the iTunes store consider users as licensees rather than owners of the content they purchased. *Id.*

405. *Capitol Records, LLC*, 934 F.Supp.2d at 656.

406. *Id.*

407. *Id.*

408. *Id.* (emphasis supplied).

409. *Id.*

The digital First Sale Doctrine in the European Community's legislation may be found under Article 4 (2) of Directive 2009/24,⁴¹⁰ which states that

[t]he first sale in the Community of a copy of a program by the right holder or with his consent shall exhaust the distribution right within the Community of that copy, with the exception of the right to control further rental of the program or a copy thereof.⁴¹¹

As may be observed from the provision, the European Union employs the regional concept of exhaustion. However, the Directive also prescribes certain restricted acts under Article 4 (1), which contains the exclusive reproduction and distribution rights of the software copyright owner.⁴¹² As a limitation to these rights — thereby strengthening the application of the exhaustion doctrine, Article 5 (1) provides an exception to the aforementioned exclusive rights —

*In the absence of specific contractual provisions, the acts referred to in points (a) and (b) of Article 4 (1) shall not require authori[z]ation by the right holder where they are necessary for the use of the computer program by the lawful acquirer in accordance with its intended purpose, including for error correction.*⁴¹³

This exception, the Essential Step Doctrine of European Union copyright law, enabled the resale of used software licenses in *UsedSoft GmbH* notwithstanding the argument that there was a clickwrap license agreement prohibiting the transfer of the program. This is in stark contrast with the decision in *Vernor*, where the shrinkwrap license agreement was upheld — thereby barring the operation of the Essential Step Doctrine.⁴¹⁴

1. *UsedSoft GmbH*

The factual backdrop of this case involves Oracle, a developer and distributor of databank software, otherwise known as “client-server-software,”⁴¹⁵ and

410. Council Directive 2009/24/EC on the Legal Protection of Computer Programs, [2009] OJ L 111/16 [hereinafter Computer Programs Directive].

411. *Id.* (emphasis supplied).

412. *Id.* art. 4 (1).

413. *Id.* art. 5 (1). (emphasis supplied).

414. *Vernor*, 621 F.3d at 1112.

415. Oracle distributes software via the internet and compels customers to agree to a licensing agreement. Once they agree by clicking through the pertinent agreement, the customer is granted the right to download unlimited copies of the databank software and then may install as many copies as the agreement allows. *UsedSoft*, on the other hand, markets used software licenses, including user licenses for the Oracle programs, which is the subject of contention in this case. Oracle argues that its customers are mere licensees since they agreed to the licensing agreement which customers initially click through and agree to when they first make a purchase online. In essence, Oracle is trying to retain its

UsedSoft, a company, which resells used software licenses including those of Oracle.⁴¹⁶ UsedSoft sold Oracle software licenses in an “Oracle Special Offer” sale, advertising that “the maintenance agreement concluded between the original license holder and Oracle was still in force, and that the lawfulness of the original sale was confirmed by a notarial certificate.”⁴¹⁷ Purchasers of such used licenses may either download a copy of the software from Oracle’s website or replicate their own existing copies should they desire to purchase more licenses for use in other computers.⁴¹⁸ It was at this point that Oracle initiated court proceedings in the German Regional Court to have UsedSoft stop its resale.⁴¹⁹ The case reached the German Federal Court of Justice, which ruled that UsedSoft and its customers infringed Oracle’s exclusive right of permanent or temporary reproduction under the Computer Programs Directive.⁴²⁰ The court ruled on the basis of Oracle’s license agreement, stating that the original acquirer of the license “[is] not [,] therefore[,] entitled to transfer to third parties the right of reproduction of those programs.”⁴²¹

When the decision was referred to the European Court of Justice for preliminary ruling, the following issues were referred by the German Federal Court to wit:

- (a) Is the person[,] who can rely on exhaustion of the right to distribute a copy of a computer program[,] a “lawful acquirer” within the meaning of Article 5 (1) of Directive 2009/24?
- (b) If the reply to the first question is in the affirmative[,] is the right to distribute a copy of a computer program exhausted in accordance with the first half-sentence of Article 4 (2) of Directive 2009/24 when the acquirer has made the copy with the right[-]holder’s consent by downloading the program from the internet onto a data carrier?
- (c) If the reply to the second question is also in the affirmative[,] can a person who has acquired a “used” software [license] for generating a program copy as “lawful acquirer” under Article 5 (1) and the first half-sentence of Article 4 (2) of Directive 2009/24 also rely on exhaustion of the right to distribute the copy of the computer program made by the first acquirer with the right holder’s consent by

distribution right over the software by claiming that no sales were made in the first place. See *UsedSoft GmbH*, Eur. Ct. J., C-128/11.

⁴¹⁶ *Id.*

⁴¹⁷ *Id.*

⁴¹⁸ *Id.*

⁴¹⁹ *Id.*

⁴²⁰ *Id.*

⁴²¹ *UsedSoft GmbH*, Eur. Ct. J., C-128/11.

downloading the program from the internet onto a data carrier if the first acquirer has erased his program copy or no longer uses it?⁴²²

The European Court of Justice first resolved the second question, stating that a sale existed between Oracle and those who originally acquired the licenses based on the nature of their transactions.⁴²³ Despite Oracle's argument that it sells licenses to use its software rather than the software itself, the court observed that the downloading of a copy from Oracle's website "and the conclusion of a user license agreement for that copy form an indivisible whole."⁴²⁴ Furthermore, the conclusion of such agreement allowed the customer to use the program permanently "in return for payment of a fee designed to enable the copyright holder to obtain a remuneration corresponding to the economic value of the copy of the work of which it is the proprietor."⁴²⁵ It was because of these observations that the court considered the entirety of the transaction as a sale, giving rise to the exhaustion of Oracle's distribution right.⁴²⁶ The court further reasoned that it makes no difference if the copy of the software was made available either digitally or through physical media because both circumstances require the creation of a copy on the user's computer and that of a license in order to be able to use the program perpetually after paying a fee.⁴²⁷ Even Article 4 (2) of Directive 2009/24 does not specify if the computer program should be embodied in a digital or analog form.⁴²⁸ It is interesting to note that the European Court of Justice's considerations at this point are very similar to *UMG Recordings, Inc.*, where an American court considered the absence of a provision requiring the return of the copyrighted good an indicator of UMG's intent to grant permanent possession to the recipient.⁴²⁹ Thus, the European Court of Justice deemed Oracle's sale of licenses as falling under the commonly accepted definition of a sale being "an agreement by which a person, in return for payment, transfers to another person his rights of ownership in an item of tangible or intangible property belonging to him."⁴³⁰ The European Court of Justice further cited the opinion of the Advocate General saying that not giving the term sale a broad interpretation would otherwise allow copyright owners to circumvent the exhaustion doctrine under Article 4 (2) of Directive 2009/24 by simply calling a contract

422. *Id.*

423. *Id.*

424. *Id.*

425. *Id.*

426. *Id.*

427. *UsedSoft GmbH*, Eur. Ct. J., C-128/11.

428. *Id.*

429. *UMG Recordings, Inc.*, 628 F.3d at 1183.

430. *UsedSoft GmbH*, Eur. Ct. J., C-128/11.

a license.⁴³¹ As a compromise and in order to prevent the abuse of the exhaustion doctrine, the court laid down this condition —

An original acquirer who resells a tangible or intangible copy of a computer program for which the copyright holder's right of distribution is exhausted in accordance with Article 4 (2) of Directive 2009/24 must, in order to avoid infringing the exclusive right of reproduction of a computer program[,] which belongs to its author, laid down in Article 4 (1) (a) of Directive 2009/24, make his own copy unusable at the time of its resale.⁴³²

The first and third issues above relate to the conditions under which a buyer of used licenses for computer programs may be considered a “lawful acquirer,”⁴³³ allowing him to utilize a reproduction of the software and “in order to enable him to use the program in accordance with its intended purpose.”⁴³⁴ Because the distribution right of Oracle was already exhausted by its initial sale to the first acquirer, the latter can resell it to a third party, who becomes a “lawful acquirer” even over the objection of Oracle.⁴³⁵ The court stated that

the second acquirer of the [license], as well as any subsequent acquirer of it, will be able to rely on the exhaustion of the distribution right under Article 4 (2) of [] [Directive 2009/24] and[,] hence[,] be regarded as lawful acquirers of a copy of a computer program within the meaning of Article 5 (1) of [] [Directive 2009/24] and benefit from the right of reproduction provided for in that provision.⁴³⁶

The decision concludes with UsedSoft being deemed a lawful acquirer of used licenses and was protected by the Exhaustion Doctrine.

2. The Philippine Intellectual Property Code Allows for a Wider Interpretation of Digital First Sale than *UsedSoft GmbH*

It is interesting to note that Article 5 (1) of the Computer Programs Directive has a counterpart provision under the Intellectual Property Code. On the reproduction of computer programs, Section 189 states that notwithstanding the exclusive economic rights of the author over his work,

the reproduction in one [] back-up copy or adaptation of a computer program shall be permitted, without the authorization of the author of, or other owner of copyright in, a computer program, *by the lawful owner of that computer program*[:] Provided, [t]hat the copy or adaptation is necessary for:

431. *Id.*

432. *Id.*

433. Computer Programs Directive, *supra* note 413, art. 5 (1).

434. *UsedSoft GmbH*, Eur. Ct. J., C-128/11.

435. *Id.*

436. *Id.*

- (a) *The use of the computer program in conjunction with a computer for the purpose, and to the extent, for which the computer program has been obtained; and*
- (b) Archival purposes, and, for the replacement of the lawfully owned copy of the computer program in the event that the lawfully obtained copy of the computer program is lost, destroyed, or rendered unusable.⁴³⁷

It is therefore submitted that Section 189 (a) strengthens the First Sale Doctrine under Section 177.3 of the Intellectual Property Code more than their European counterpart provisions because Philippine law does not have the proviso, which limits the same “in the absence of specific contractual provisions,”⁴³⁸ qualifying the reproduction of a computer program without the copyright owner’s consent. It appears that the right to make a back-up copy of a computer program is an absolute limitation on the right of reproduction of an author. Taking into consideration the expanded definition introduced by R.A. No. 10372 of what constitutes a reproduction, a temporary copy may be made by a user for purposes of digital resale.⁴³⁹ It is, therefore, submitted that should Philippine courts consider a license agreement to be actually a sale, the prospective reseller may create one back-up software copy in the computer of the prospective buyer then delete his copy at the conclusion of the transaction — similar to the setup in *Capitol Records, LLC*.⁴⁴⁰ Having parted ownership over the digital media at that point, his subsequent destruction or rendering useless of his own copy is in accord with Section 189.2 of the Intellectual Property Code, which provides — “No copy or adaptation mentioned in this Section shall be used for any purpose other than the ones determined in this Section, and any such copy or adaptation shall be destroyed in the event that continued possession of the copy of the computer program ceases to be lawful.”⁴⁴¹

It is further submitted that *UsedSoft GmbH* may be applied by the Philippine Supreme Court because the statutory basis under Section 189 of the Intellectual Property Code can be used to declare digital resellers as “lawful owners” in the same vein as “lawful acquirers.” Indeed, the Fair Use Doctrine may even be invoked as a defense if the copy made under Section 189.2 be alleged as an infringing copy. Section 189.3 allows for the application of the doctrine “whenever appropriate.”⁴⁴² However, it is important to remember that this Section applies exclusively to computer

437. INTELLECTUAL PROPERTY CODE, § 189 (emphasis supplied).

438. Computer Programs Directive, *supra* note 413, art. 5 (1).

439. INTELLECTUAL PROPERTY CODE, § 171.9.

440. *Capitol Records, LLC*, 934 F.Supp.2d at 640.

441. INTELLECTUAL PROPERTY CODE, § 189.2.

442. *Id.* §189.3.

programs only. Those seeking to resell their digital music and videos will still have to rely under the Fair Use Doctrine to be able to defeat the exclusive reproduction right of the copyright holder while relying on the First Sale Doctrine and successfully allege that the “licensing agreement” was actually a sale.⁴⁴³

3. The Civil Code Provisions on Sales and the Interpretation of Contracts are Compatible with the Reasoning of *UsedSoft GmbH*

The Civil Code provides that “[o]bligations arising from contracts have the force of law between the contracting parties and should be complied with in good faith.”⁴⁴⁴ In order for Philippine courts to determine that a licensing agreement is actually a sale, they may resort to the terms of the clickwrap agreement and determine if the same grants the perpetual use of the copy after paying the copyright owner the requisite fee as was found in *UMG Recordings, Inc.*⁴⁴⁵ and in *UsedSoft GmbH*.⁴⁴⁶ If there is no intent in the clickwrap agreement for the consumer to return his digital copy and if the contract’s only economic recurring benefit is to prevent the subsequent transfer of the copyrighted good,⁴⁴⁷ then it should be deemed a sale. For even if the license agreement is upheld but there is actually no intent for such digital copy to be returned, the copyright owner is effectively parting possession with the digital copy. Therefore, while the title of the contract may be named a license agreement, its contents may actually establish the existence of a sale provided that the following are present —

The essential elements of a contract of sale are[;] (1) consent or meeting of the minds, that is, to transfer ownership in exchange for the price[;] (2) object certain[;] which is the subject matter of the contract[;] and (3) cause of the obligation[;] which is established.⁴⁴⁸

At this juncture, the only element to be discussed is the first since the second and third are already present. In determining that Oracle conveyed ownership of the digital copy of its program, the court in *UsedSoft GmbH* found that Oracle effectively had no intention to retain the ownership of the digital copy for it allowed anyone to download the same on their website.⁴⁴⁹ The other half of the transaction consisted of the payment of a fee for the

443. See discussion in Chapter III, regarding the Fair Use Doctrine as a means of defeating the author’s reproduction right.

444. CIVIL CODE, art. 1159.

445. *Augusto*, 558 F. Supp. 2d at 1061-62.

446. *UsedSoft GmbH*, Eur. Ct. J., C-128/11.

447. *Augusto*, 558 F. Supp. 2d at 1061-62.

448. *MCC Industrial Sales Corporation v. Ssangyong Corporation*, 536 SCRA 408, 456 (2007).

449. *UsedSoft GmbH*, Eur. Ct. J., C-128/11.

grant of a license to be able to use such program perpetually.⁴⁵⁰ Since the court considered these two events as part of an indivisible transaction, it deemed the entire transaction a sale.⁴⁵¹ Again, it bears reiterating that the Intellectual Property Code does not consider the transfer or conveyance of a material object — the digital copy — to consequently mean that any of the author's economic rights were licensed.⁴⁵²

Indeed, even the Civil Code supports this finding since “[i]n order to judge the intention of the contracting parties, their contemporaneous and subsequent acts shall be principally considered.”⁴⁵³ The law further states that “[i]f the words appear to be contrary to the evident intention of the parties, the latter shall prevail over the former.”⁴⁵⁴ It is, therefore, submitted that the reasons behind *UsedSoft GmbH* — that a license agreement was actually a sale — may similarly be supported by Philippine Civil Code provisions on contracts.

V. SYNTHESIS AND RECOMMENDATIONS

To conclude this Note, this Chapter will serve as a nexus for all the concepts previously discussed and will operate from the following premises: first, that the Intellectual Property Code protects and limits copyright in the digital space; second, that Philippine treaty obligations permit Congress to legislate the limitations and exceptions to digital copyright and specify the conditions under which they shall operate; third, that the Intellectual Property Code allows the application of the First Sale, Fair Use, and Necessary Step Doctrines as limitations to digital copyright; and fourth, that there is no bar for licensing agreements to be interpreted as contracts of sale if they satisfy the requirements under the Civil Code. With these premises in mind, the following recommendations and the justifications are submitted.

A. *The Philippines Should Adopt the International Regime of Exhaustion*

Adopting the international regime of exhaustion is feasible because R.A. No. 10372 has removed the exclusive right of importation of a copyright owner.⁴⁵⁵ With parallel importation now allowed, the amendment of the law is in conformity with the realities surrounding internet use, in particular how it facilitates “nearly effortless transactions between buyers and sellers across the globe.”⁴⁵⁶ As opposed to a national regime of exhaustion, utilizing

450. *Id.*

451. *Id.*

452. INTELLECTUAL PROPERTY CODE, § 181.

453. CIVIL CODE, art. 1371.

454. *Id.* art. 1370.

455. INTELLECTUAL PROPERTY CODE, § 190.3.

456. Mattioli, *supra* note 326, at 229.

the international regime upholds the public policy behind the Intellectual Property Code, which is “the diffusion of knowledge and information for the promotion of national development and progress and the common good.”⁴⁵⁷ Furthermore, such a regime will “promote free and liberal trade,” especially with regard to the European Union due to its “inability to use a national exhaustion regime.”⁴⁵⁸ It is submitted that should this regime be adopted, consensus on the international framework upon which it shall function will best be reached and enforced through the WTO and the TRIPS Agreement — due, partly, to the enforcement measures the WTO may employ against non-compliant members.⁴⁵⁹

Also, an international regime of exhaustion shall be beneficial for consumers because the side effect of encouraging parallel importation is that it also “encourages competition” and it “limits the scope of intellectual property rights.”⁴⁶⁰ The exhaustion of copyright will now operate at a global level, thereby allowing parallel imports into the Philippines — hastening the emergence of secondary or gray markets for digital goods. At this point, it is worthy to revisit the policy argument made by eBay in *Vernor* regarding the benefit of secondary markets: “(1) giving consumers additional opportunities to purchase and sell copyrighted works, often at below-retail prices; (2) allowing consumers to obtain copies of works after a copyright owner has ceased distribution; and (3) allowing the proliferation of businesses.”⁴⁶¹

In conclusion, the Philippines, not being precluded by its treaty obligations from adopting the international concept of the First Sale Doctrine, should do so on the basis of its declared public policy towards intellectual property rights.

B. Avoiding Copyright Infringement in Digital Resale

The following scenarios are presented where digital resale may be performed and the defenses against copyright infringement may be invoked to avoid liability under the Intellectual Property Code and the e-Commerce Act. In all these scenarios, the economic rights that will always be implicated by a digital resale and that are sought to be limited or exhausted are the author’s exclusive right to reproduce and distribute his work.

457. INTELLECTUAL PROPERTY CODE, § 2, ¶ 2.

458. Ryan L. Vinelli, *Bringing Down the Walls: How Technology Is Being Used To Thwart Parallel Importers Amid The International Confusion Concerning Exhaustion Of Rights*, 17 CARDOZO J. INT’L & COMP. L. 135, 162 (2009).

459. *Id.* at 165.

460. *Id.* at 149.

461. *Vernor*, 621 F.3d at 1115.

1. If Reselling Digital Copyrighted Goods in General, Utilize Fair Use and First Sale Doctrines as Affirmative Defenses

The digital goods referred to under this scenario are all the digital versions of all the artistic and literary works,⁴⁶² fixed performances,⁴⁶³ and sound recordings⁴⁶⁴ enumerated by the Intellectual Property Code. Because the First Sale Doctrine does not exhaust the reproduction right of the author, performer, or producer of these goods, it is necessary that the reproduction of a transient copy, or a copy which, is electronically transmitted to the buyer to be deemed fair use under the factors prescribed by the Intellectual Property Code.⁴⁶⁵ Should the Fair Use Doctrine be found applicable, consequently, a limitation on the author's reproduction right is imposed — thereby allowing the reseller to create a transient digital copy of the work, provided that it is subsequently deleted after the transaction. Such a regime would be similar to the scheme and arguments in *Capitol Records, LLC*, except that in this scenario, the file is not uploaded to a third party cloud server or service.⁴⁶⁶ This avoids the pitfall of having the Fair Use Doctrine denied application due to the multiple reproductions of the work created and stored in the server of a secondary market place such as what happened in *Capitol Records, LLC*.⁴⁶⁷

For the initial purchase or first sale made before a legitimate resale may exist, it is submitted that the factors considered in *UMG Recordings, Inc.* be made applicable, such as the lack of a provision in a purported licensing clickwrap agreement for the return or destruction of the digital copy as amounting to a grant of perpetual use and renders the same as a sale.⁴⁶⁸ To further strengthen the argument that the contract was a sale, the statements of the court in *Capitol Records, LLC* regarding the ownership of iTunes music purchases and the “particular record” theory may be resorted to.⁴⁶⁹

2. If Reselling Computer Program, Utilize First Sale Doctrine and Section 189 of the Intellectual Property Code as Affirmative Defenses

The resale of computer programs is different because, unlike the other classes of literary and artistic works, computer programs often include a clickwrap agreement before they are even copied into the computer for use. It is,

462. INTELLECTUAL PROPERTY CODE, § 172.1.

463. *Id.* § 203.3.

464. *Id.* § 208.2.

465. *Id.* § 185.1.

466. *Capitol Records, LLC*, 934 F.Supp.2d at 640.

467. *Id.* at 654.

468. *Augusto*, 558 F. Supp.2d at 1061-62.

469. *Capitol Records, LLC*, 934 F.Supp.2d at 654.

therefore, imperative for the prospective reseller to successfully prove that there has been a sale, rather than a licensing agreement, as was found in *UsedSoft GmbH*.⁴⁷⁰ It should be proved that, as in the first scenario above, the perpetual use of the software was granted “in return for payment of a fee designed to enable the copyright holder to obtain a remuneration corresponding to the economic value of the copy of the work of which it is the proprietor.”⁴⁷¹ As long as the transaction is proven to include the elements of a contract of sale, the distribution right of the copyright holder is, consequently, exhausted by virtue of the operation of the First Sale Doctrine. How shall the resale be facilitated after, then? Being the lawful owner of the digital copy of the computer program, the reseller is granted by the Intellectual Property Code the right to reproduce at least one copy of the computer program and then transmit the same to the prospective buyer of used software.⁴⁷² Thereafter, the reseller should delete his copy pursuant to the limitation on the First Sale Doctrine prescribed by *UsedSoft GmbH*⁴⁷³ and in compliance with the Intellectual Property Code provision requiring the destruction of copies of computer software where “continued possession of the copy of the computer program ceases to be lawful.”⁴⁷⁴

C. Conclusion

Philippine courts should always be aware that copyright is a limited monopoly, not perpetual.⁴⁷⁵ Philippine courts should not hesitate to apply the doctrines of First Sale, Fair Use, and Necessary Step as limitations on copyright for the same was never intended to be absolute and perpetual. Even in international copyright laws, recognized exceptions and limitations to copyright exist. Copyright holders should not be allowed to circumvent the exhaustion doctrine through the use of clickwrap licensing agreements, since the transfer or transmission of a digital copy to the buyer already constitutes a transfer of ownership over such copy. The digital environment is perhaps the best place where the law’s policy of promoting the diffusion of knowledge and culture may be best attained due to the possibilities a digital gray market for literary and artistic goods — allowing for competitive pricing and business models. The aim of the law will be frustrated if licensing agreements — just by the fact that they are named and worded as such — are upheld on that basis alone. The inevitable result from such an

470. *UsedSoft GmbH*, Eur. Ct. J., C-128/11.

471. *Id.* at 45.

472. INTELLECTUAL PROPERTY CODE, § 189.

473. *UsedSoft GmbH*, Eur. Ct. J., C-128/11.

474. INTELLECTUAL PROPERTY CODE, § 189.2.

475. Martinez, *supra* note 174, at 22.

interpretation is digital copyright monopoly without any limitation whatsoever.

That the First Sale Doctrine will eventually be encountered by our courts is inevitable. The hope is that when that time comes, it will strike an even balance between equitable compensation for authors for their creative labor and a grant of beneficial ownership unto consumers over the digital copyright-protected goods they have purchased.