WILMERHALE

Is the Transfer of Software a License or a Sale?

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Unlike other copyrighted materials, such as books and videos, software is typically distributed to consumers under a license agreement. License agreements that accompany most off-the-shelf software contain a number of restrictions. These restrictions typically limit the number of users of the software, restrict the licensee's ability to transfer the software and prohibit reverse engineering. However, a recent case has cast doubt over the viability of these license arrangements.

In SoftMan Products Company, LLC v. Adobe Systems Inc., a federal district court in California held that when a software vendor transfers a copy of its software, that transfer should be viewed as a sale of goods rather than a license of intellectual property.

Adobe Systems is a major vendor of consumer software. Adobe's software is accompanied by an electronic copy of its shrinkwrap license agreement which, among other things, prohibits consumers from redistributing the software or selling it on a stand-alone basis. Any user who installs the software is presented with an electronic version of the agreement and must agree with its terms before installation is completed.

SoftMan Products, a discount software distributor, purchased bundled copies of multiple Adobe software products and then sold individual products from the bundles on a stand-alone basis. Adobe claimed that SoftMan infringed Adobe's copyright in these products (specifically Adobe's right to distribute and control distribution) and violated the terms of the shrinkwrap agreement that accompanied the Adobe software.

In denying Adobe's motion for preliminary injunction, the court first found that Adobe's restrictions on transferring copies of its software conflicted with the first sale doctrine under copyright law. The first sale doctrine states that if a customer purchases a lawfully-made copy of software, the customer is entitled to sell or dispose of that copy without the copyright owner's consent (but not to make subsequent unauthorized copies of such software). This principle is the same one that applies to copies of books, videos and other copyrighted works, and is not altered in the software context.

In addition, the court looked to the "economic realities" of the business environment and the specific circumstances of the transfer to determine that the transaction relating to Adobe's bundled software amounted to a transfer of title, rather than a license. In reaching this conclusion, the court focused

on the following facts:

- Purchasers of Adobe software obtained a single copy of the software for a single payment which was made at the time of the transfer;
- Because the term of the license was indefinite with no provisions for renewal, purchasers had perpetual possession of the copy;
- Distributors typically paid full value for large quantities of Adobe software and accepted the risk of loss of, or damage to, the software by agreeing to the terms of the distribution agreement with Adobe; and
- Subsequent distributors and ultimate consumers also paid full value for the product and accepted the risk of loss or damage.

The court distinguished two cases in which the first sale doctrine did not apply to a transfer of software. The court found that Microsoft Corp. v. Harmony Computers and Electronics Inc., 846 F. Supp. 208 (E.D.N.Y. 1994), was distinguishable because the retailer in that case distributed counterfeit copies of software which the reseller obtained from an unauthorized source, a clear copyright violation. The court also found that Adobe Systems Inc. v. One Stop Micro, Inc., 84 F. Supp. 2d 1086 (N.D. Cal. 2000), was distinguishable because the retailer in that case physically altered the packaging of the educational version of the Adobe software that it acquired from an authorized reseller by peeling and destroying “educational version” stickers on the software and then resold the altered package of software commercially at below retail prices. In addition, the court declined to adopt the Harmony and One-Stop courts’ analysis that retailers who purchase software from an authorized reseller are subject to the terms and restrictions of the license agreement to which the authorized reseller and the copyright owner are parties.

The court also declined to address the question of the general validity of shrinkwrap licenses. (See our March 22, 2000, April 9, 2001 and August 20, 2001 Internet Alerts concerning the enforceability of shrinkwrap, “click and accept” and “browse wrap” agreements.) The court found that even if a shrinkwrap license might be enforceable against an end-user, SoftMan was not bound by that agreement because a user could only agree to the terms of the Adobe End User License Agreement when it installed the program, and SoftMan never attempted to install the software that it sold. Although a notice on the software box indicated that a license agreement was contained on the software media, there was no hard copy of the agreement enclosed in the box. The court held that SoftMan's reading of the notice on the box did not itself amount to an assent to the terms of the license agreement, which were never presented to SoftMan.

The court distinguished its holding from that of the Seventh Circuit in ProCD v. Zeidenberg . In ProCD, the court held that the purchaser of a software program was prohibited by the shrinkwrap license from distributing additional copies over the Internet. (See our July 1996 Intellectual Property Bulletin for more on the ProCD v. Zeidenberg case.) Unlike SoftMan, however, the defendant in ProCD had multiple opportunities to read the shrinkwrap license agreement included with the software and assented to the terms of the license as a condition to his use of the software.

It is interesting to note that the Adobe court's holding is consistent with European Union directives and decisions. Under European Union law, a lump-sum license to use software for an indefinite

period of time is deemed to be a sale of goods, in which case the software vendors' restrictions on transfer of physical copies of that software will not be enforced.

The Adobe case is important because it emphasizes the importance of obtaining an affirmative assent to the terms of any license agreement that a software vendor wishes to enforce against its users. Like the court in Specht v. Netscape Communications, Inc., (see our August 20, 2001 Internet Alert), the Adobe court refused to enforce the terms of an agreement that the defendant did not manifestly agree with. These cases suggest that a software licensor should make its licensing terms plainly visible to any person who purchases a license of the software, either by including a copy in the box or on the packaging, in addition to including an electronic copy in the installation routine and elsewhere on the electronic media.

The Adobe court found it significant that: (1) the Adobe agreement was directed to end-users, and not resellers like the defendant; and (2) the terms of the Adobe agreement apparently stated that acceptance occurred on installation by a click and accept – a mechanism never utilized by the defendant. To avoid such problems in the future, software vendors need to establish a reasonable acceptance mechanism for their agreements which will be seen by all types of parties intended to be made subject to their agreements – both end-users and resellers. Including a hard copy of an end user-oriented agreement is unlikely to be sufficient if a distributor or reseller theoretically could read it without loading the software and without clicking and accepting on the agreement.

Moreover, the Adobe court has cast doubt on a software licensor's ability to restrict the transfer of the physical copies of software after those copies have been sold to a purchaser, even with a valid license agreement. While the court did not specifically address this issue, its emphasis of the importance of the first sale doctrine implies that software and hardware vendors who attempt to restrict the post-sale transfer of their products by means of a software license may have difficulty doing so.

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