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December 2012

# Free-for-resale of software licenses?

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The Court of Justice of the European Union ("ECJ") has by a ruling on July 3 this year (case no. C-128/11) ruled that a licensor who grants a perpetual licensee may not through the license agreement prohibit the resale of copies of the software. This article presents the main features of the ECJ's judgment and the practical consequences the decision could have for the sale and licensing of software.

## Background of the case

Oracle develops and markets computer software and accordingly holds the copyright to these software programs. In the present case the software that Oracle provided was a so-called Client Server Software which was conceded to customers through downloading from the web and the simultaneous signing of a license agreement. Each license included 25 users. Through the license agreement, which the customer needed to sign in order to download the software, the customer received "*exclusively for its internal business purposes an indefinite, non-transferable, royalty-free and non-exclusive right to use the program.*"

UsedSoft, a German company, pursued in turn trade with used software and user licenses from Oracle's software by purchasing unused user licenses from Oracle's customers in order to resell them to new customers.

UsedSoft was in both first and second instance of the national courts in Germany held liable for infringement of Oracle's rights. UsedSoft appealed, however, to the Bundesgerichtshof, which in turn requested a preliminary ruling from the ECJ in order to clarify how Article 4 and 5 of Directive 2009/24 (the "Directive") shall be incorporated under German law.

## ECJ judgment and application of the exhaustion principle

UsedSoft argued in support of its claim that Oracle's right to restrict the resale was no longer valid with reference to the so-called exhaustion principle set out in Article 4 of the Directive. The exhaustion principle is a principle under intellectual property law which stipulates that the right holder's right to limit the spread of copies of material protected by intellectual property law cannot be enforced after the specimen is put on the market with the right holder's consent. The right holder's right to control the resale of the specimen is thus exhausted after the first sale of the specimen.

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Oracle asserted for its part that the exhaustion principle applies only to physical goods and copies and that the principle cannot be applied when signing a license agreement and subsequent downloading of software. This would imply that Oracle's exclusive right to control the resale of the specimen would remain, which would mean that the license condition "non-transferable" set out in Oracle's license agreement would prohibit UsedSoft's resale of Oracle's software. In support of the opinion that the exhaustion principle applies only for physical copies it was stated, inter alia, that the tenure of software and sales/leasing of the current software cannot involve a transfer of ownership, but only a license right to use the software, which cannot be consumed.

In an overall assessment of the transaction of Oracle's sales of the software ECJ, however, ruled to UsedSoft's favor, that the license granted by Oracle would be deemed to be equivalent to a sale of a copy of the software on a physical medium. Since the customer had received a perpetual right to use the copy of the software and the financial compensation paid by the customer was equal to the economic value of the copy, ECJ held that the sale of the license would involve a transfer of ownership of the copy. Based on the fact that the sale of the license would be treated as a transfer of ownership of a copy of the software, ECJ held that the exhaustion principle set out in Article 4.2 of the Directive would apply to Oracle's sales of licenses. Accordingly UsedSoft's resale of licenses was deemed allowed, even though the license terms set out that the software was "non-transferable".

The decision implies an extension of the exhaustion principle since the court has created a new model for how a digital product can be equated with a physical copy. Listed below are some of the consequences that we believe the judgment could have on the sale and licensing of software in practice.

**Plausible increase of time-limited licenses**

The ECJ has based the judgment of the transfer of ownership to the license on the fact that the license was granted for an unlimited period. It can accordingly be concluded that the user rights granted for an indefinite period, with or without updates and service, can be resold without restriction and without the rights holder prevention of such resale. Users who no longer have need of the software may consequently sell the license even if the license terms stipulate that such resale is prohibited.

A relatively simple measure in order to avoid the "hit" of the exhaustion principle is to issue licenses which are limited in time since the sale will then, according to the court's judgment, not be considered to imply a transfer of ownership of the license. However, it can reasonably be assumed that the time limitation in such case should be sufficiently short in order to have a relevant impact on the buying decision, and not only a theoretical time limit which lapses long after the use of the software would be presumed to have ceased. Otherwise, there is possibly a risk that the exhaustion principle still "hits" the sale of the license.

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Instead of adjusting the terms of the license, it may be more attractive to change the form of the transaction itself. A significant portion of the software market is today provided through cloud-based services, and since (as explicitly stated in the judgment) services cannot be subject to the exhaustion principle one solution could be to offer a software through a so called Software-As-A-Service ("SaaS"), where access to the software is offered online for each particular use, and no or very limited download occurs. Such change of the form of the transaction is more complex than only adjusting the license terms, and often involves a completely new business model with both confidentiality and privacy considerations and new contractual relationships as regards the cloud service.

In summary, our conclusion is that the already existing migration to cloud services and SaaS will accelerate for software such models are suitable for.

**Increased security measures**

Resale of the software requires that the software on the first user device is erased. Such deletion can of course be difficult for rights holders to monitor. To ensure that the resale takes place permissibly so that the software is deleted when the transfer is made, the software producers will probably need to review the ways to monitor the usage and/or activation of the sold licenses. Probably we will see that security measures, in the form of production keys, passwords and registration requirements for activation of each issued license will increase in order to restrain the increased opportunities for piracy since the judgment may pave the way for rogue actors.

**Handling of service and upgrade commitments**

ECJ asserted that service and upgrade commitments which are an integral part of the downloaded software does not constitute a barrier to the consumption in accordance with the exhaustion principle of the software itself. Notwithstanding the fact that the software has been adjusted and updated, and therefore do not necessarily represent the exact same software that was initially sold, the copy of the software shall be considered consumed and be allowed to resell. The court, however, is relatively vague in this part and we may be seeing some borderline problems as to whether upgrades and executed services shall be included in the consumption of the copy of the software or not.

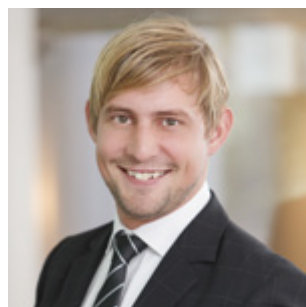
**New competition situation**

As a consequence of the judgment, consumers can now legally be offered to buy used software, probably including updates and adjustments. Accordingly, software producers may end up in a situation competing with other actors selling their own software, both as regards the same version of the software as competition between the different versions of the software. Software producers, who previously have been able to fully control their competition has now instead reason to keep abreast of the new prospective that customers may choose an older version, which may affect both the pricing of software as well as how and when new versions are launched onto the market.

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Up until now the prevailing view on the consumption of the exclusive distribution rights to intellectual property protected material was, in accordance with Oracle's argumentation above, built on the fact that a physical copy of the material was consumed. For example, the distribution right to the music that appears on a CD has been consumed when the CD has been set on the market with the right holder's consent, and then the CD can be freely resold. The music on the CD, however, may not be copied to a new medium, since the consumption is tied to the physical medium/specimen. Today's efficient Internet connections and new patterns of consumption online, however, allows more and more intangible objects to be sold and used without a physical medium. Physical copies rarely exists in the digital environment; music can be listened to through for example iTunes and Spotify instead of through physical copies of CD-records, books are read through the e-book readers and software is installed by downloads. The ECJ has through this judgment extended the intellectual property law exhaustion principle by stating that the distribution right can be consumed even without a physical medium and without transfer of a physical copy, which is a fundamental step that could have significant consequences. It should be noted that ECJ expressly states that the judgment only applies to the Directive and the court has thus limited the ruling to apply only to software. Accordingly the case should not be applied by analogy to all types of copyrighted materials appearing in digital format. But even if the court expressly states that it is a question of interpretation of "lex specialis", and only the application of the Directive, it is not irrelevant to reflect on what a similar interpretation would imply in other areas. For example, if music from iTunes, e-books from Amazon or audio books from Amazon would be allowed to be resold freely, this would have major implications for a large share of consumption online and how it will be designed in the future.



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