10-1-2005

A Positive Externalities Approach to Copyright Law: Theory and Application

Jeffrey L. Harrison
University of Florida Levin College of Law, harrisonj@law.ufl.edu

Follow this and additional works at: http://scholarship.law.ufl.edu/facultypub
Part of the Intellectual Property Commons, and the Law and Economics Commons

Recommended Citation

This Article is brought to you for free and open access by the Faculty Scholarship at UF Law Scholarship Repository. It has been accepted for inclusion in Faculty Publications by an authorized administrator of UF Law Scholarship Repository. For more information, please contact outler@law.ufl.edu.
ARTICLES

A POSITIVE EXTERNALITIES APPROACH TO COPYRIGHT LAW: THEORY AND APPLICATION

Jeffrey L. Harrison*

TABLE OF CONTENTS

I. INTRODUCTION ............................................. 3

II. THE ECONOMICS OF NEGATIVE AND POSITIVE EXTERNALITIES ..... 8
    A. THE BASICS ............................................. 8
    B. THE TREATMENT OF NEGATIVE EXTERNALITIES ............... 11
    C. TRANSFERRING THE ANALYSIS TO POSITIVE EXTERNALITIES .... 13

III. MAKING THE RULES OPERATIONAL .............................. 15
    A. INTERNALIZATION OF POSITIVE EXTERNALITIES WILL BE
       FACILITATED AS LONG AS THE COST OF THE FACILITATION
       DOES NOT EXCEED THE SOCIAL BENEFITS OF THE WORK ......... 15
    B. NO COSTS BEYOND THE MINIMUM NECESSARY TO BRING
       COPYRIGHT-WORTHY WORKS INTO EXISTENCE SHOULD
       BE INCURRED ............................................. 16

IV. COPYRIGHT LAW AND POSITIVE EXTERNALITIES:
    THE THRESHOLD QUESTION .................................. 17
    A. ABSTRACTION, THINNING, AND EFFICIENCY .................... 19
    B. DERIVATIVE WORKS ........................................ 24

* Stephen C. O'Connell Professor of Law, University of Florida College of Law.
V. THE SECOND ISSUE: NO MORE COSTLY THAN NECESSARY ....... 27
   A. COPYRIGHT DURATION .................................... 28
   B. NEW USES .................................................. 31
      1. The Theory ............................................. 31
         a. Market Expansions .................................. 34
         b. Substitution Effects ................................ 36
         c. Expansion and Substitution Effects ............... 37
         d. A Suggested Approach ............................... 38
      2. The Cases .............................................. 39
   C. FAIR USE .................................................. 48

VI. SUMMARY .................................................. 58
I. INTRODUCTION

The basic goal of copyright law is, at a general level, fairly well understood, yet the law itself seems untethered to any consistent analytical approach designed to achieve that goal. Take, for example, White-Smith Music Co. v. Apollo Co., a copyright standard from 1908. The question was whether producing piano rolls that create the sound of preexisting compositions constituted "copying." The Supreme Court held that it did not, reasoning that one could not actually look at the holes in the rolls and see a version of the original composition. The import of the decision was short-lived; the 1909 Copyright Act extended copyright protection to the right to "reproduce mechanically the work."

Although the outcome was altered, the Court's approach has an aimless quality that persists. In this context, "aimless" is to be taken literally—one is hard pressed to discern whether the Court has a specific objective much less one that can be linked to the Constitutional enabling language that permits the enactment of laws protecting intellectual property in order "[t]o promote the Progress of Science and the Useful Arts." Most scholars agree that this language allows the creation of intellectual property laws as a means of increasing social welfare. Perhaps the best known and clearest statement is Justice Potter Stewart's observation:

The limited scope of the copyright holder's statutory monopoly, like the limited copyright duration required by the Constitution, reflects a balance of competing claims upon the public interest: Creative work is to be encouraged and rewarded, but private motivation must ultimately serve the cause of promoting broad public availability of literature, music and the other arts. The immediate effect of our copyright law is to secure a fair return for an "author's" creative labor. But the ultimate aim is, by this incentive, to stimulate artistic creativity for the general public good.

---

1 See infra note 4 and accompanying text.
2 209 U.S. 1 (1908).
4 Twentieth Century Music Corp. v. Aiken, 422 U.S. 151, 156, 186 U.S.P.Q. (BNA) 65, 67 (1975). See also Mazer v. Stein, 347 U.S. 201, 219, 100 U.S.P.Q. (BNA) 325, 333 (1954) ("The economic philosophy behind the clause empowering Congress to grant patents and copyrights is the conviction that encouragement of individual effort by personal gain is the best way to advance public welfare through the talents of authors and inventors in 'Science and useful Arts.'"); Fox Film v. Doyal, 286 U.S. 123, 127, 13 U.S.P.Q. (BNA) 243, 244 (1932) ("The sole interest of the United States ... in conferring [a copyright] lie[s] in the general benefits derived by the public from the
The approach called for is one that is economic in nature in that the social welfare gains and losses resulting from protecting a particular work should be the central concern of efforts to interpret intellectual property law. From an economic perspective, the focus is on which outcome advances social welfare; all the usual issues of copyright disputes and scholarship—What is copying? What is creative? Is there authorship? Is there substantial similarity, etc.—are simply means to that end. Yet, formalistic discussions, like the one found in White-Smith Music, of the proper standards for creativity, copying, and similar copyright issues appear to have no theoretical underpinning—economic or otherwise.

As a familiar example, consider the college student who downloads a song without permission. This is literally copying but, unless labeling the action copying has some social significance, it makes little sense to engage in a great deal of judicial and scholarly hand-wringing over the matter. If the student is impoverished and would not have paid for the music, the composer and other copyright-holders are no worse off and the student is better off. If anything, there is social gain for the student who has not in any way interfered with the ability of the composer or performer to sell his or her work to others. On the other hand, perhaps the student would have purchased the music, or maybe most student copiers would have purchased the music. If this is the case, it may be too

---


6 209 U.S. at 18. The Court does note that the creation of the rolls may mean that others may use the underlying composition without paying (and, therefore, discourage the promotion of science and the useful arts). *Id.*

7 The distinction between what is literally a violation and what is functionally a violation is familiar to those who study antitrust law. See *Broad. Music, Inc. v. Columbia Broad. Sys.*, 441 U.S. 1, 201 U.S.P.Q. (BNA) 497 (1979) (distinguishing "per se price fixing" from price fixing).

8 In fact, one could make the case that the copying results in a Pareto Superior outcome in that at least one party is better off and no one else is worse off.
expensive to distinguish among copiers who are too poor to purchase the music and those who are not, and a broad rule is the most efficient way to administer an economically sensible system of copyright even though the "wrong" decision may result in some cases. But the truth is, most decisions reveal little of this type of reasoning.

Justice Stewart's commentary suggests courts do seem to understand the economic logic. They either are unwilling to follow the logic or to do so expressly. In the Supreme Court's most recent copyright case, *Eldred v. Ashcroft*,

the analysis is confined to Congressional authority to retroactively extend the copyright term. The Court held that it did. The connection between retroactive term extension and promoting "the Progress of Science of the Useful Arts" is tenuous at best. And, although the Court addressed some economic concerns, the effort to do so is poorly reasoned and seems like an afterthought. What is especially puzzling is that, in other areas of law, rules have evolved that can be squared with efficiency even though there is no Constitutional or statutory mandate. Copyright, even with Constitutional direction that is squarely utilitarian in nature, seems adrift.

This Article has two goals. The first is to explain in some detail what copyright law might look like if it reflected economic reasoning. The second is to put to the test the question of whether copyright law is as far out of sync with economic guidelines as cases ranging from *White-Smith Music* to *Eldred* suggest. Although this introduction has stressed the economic irrationality of copyright law, could it actually be that within copyright decisions there is an implicit economic sensibility?

In order to understand the economic approach and the inconsistency of copyright law, as well as the thesis of this article, it is necessary to understand the concepts of "externalities" and "public goods." Externalities can be negative or positive. In the context of actions that impose costs on others, the key concept is "negative externalities"—the harm to others resulting from the activity of another. There are good economic reasons for requiring those responsible for "negative externalities" to *internalize* (pay for) these costs, and the law reflects this reasoning. Thus, a careless driver must pay for the harm to the property of another. When it comes to copyright, the key concept is "positive externality"—the benefits to others resulting from the activity of another. There

---

9 *See supra* note 4.


11 The Court sweeps aside an argument that one cannot motivate someone to create something that already exists with reasoning that is flawed and inconsistent with other copyright limitations. *See infra* text accompanying notes 89-98.

12 *See discussion infra* at notes 89-98.
are also good economic reasons to permit those who create positive externalities to be compensated by those who enjoy the benefits of those efforts. Thus, the composer of a song that is performed by others is permitted to recover. This, too, is internalization. In fact, intellectual property law, including its Constitutional authorization, has internalization as its principal focus.

The underlying thesis of this Article is that positive and negative externalities are complements, and it is important to treat them similarly. Legal scholarship tends to address negative externalities disproportionately—in the interests of “allocative efficiency.” Allocative efficiency is not likely to be achieved, though, by only treating one side of the externality problem. In the context of resource allocation, this is the equivalent of exercising half of one’s body or tuning half of an automobile engine.

The analysis below begins, in Section A, with a more detailed discussion of externalities. The key is to describe how the methods of treating negative externalities can be converted to copyright law and positive externalities. In Section B, the theory of positive externalities is presented as two operational rules. The first is to protect only works that create more social benefit than social cost. These are labeled “copyright-worthy.” The second is to incur no greater social cost than necessary to encourage the production of copyright-worthy works. These two operational rules are refined throughout the Article in the context of discussions of various copyright doctrines.

Section C examines copyright decisions in order to determine whether an economic approach—either overt, implicit or intuitive—consistent with the first

---

13 See sources cited supra note 4.

14 Allocative efficiency is said to occur as long as the resources used to produce an output are less valued to society than the benefits from that output.


16 Social costs are a combination of private and public costs. In copyright, these costs include the costs of exclusion, the public costs of administering a copyright system, and the private costs of transactions and litigation resulting from a work being copyrighted.

17 The importance of viewing the economic task as including two steps can be understood by comparing the view of one treatise writer that “the purpose of copyright is to stimulate the production of the widest possible variety of creative goods at the lowest possible cost.” Paul Goldstein, International Copyright Law 3 (2001). This view is quite different from the one taken here and the one that would maximize social welfare. A system like that described in the quote would be one that encourages all creativity, even that without much value, as long as whatever creativity emerged was at the lowest cost.

18 For a similar evaluation of the common law, see Richard A. Posner, Economic Analysis
rule has evolved. The finding of the analysis is that, on balance, copyright opinions can be squared with an approach to positive externalities similar to that applied to negative externalities. In Section D, the analysis turns to whether the reasoning found in copyright decisions is consistent with the second rule. The focus is on analysis as opposed to the outcomes of specific cases. Cases involving duration, "new use," and "fair use" compose the universe of this analysis. Here, the finding is that courts generally do not have an economically sound method of minimizing the social costs of works that warrant protection. Sometimes courts appear to be interested in goals other than maximizing social welfare, and, in others, there appear to be no particular guiding principles.

Before continuing, two qualifications are in order. First, it is important to note the obvious fact that law is not interpreted simply to advance economic ends, and this Article does not make the claim that it should be. Nevertheless, there is near-universal agreement that intellectual property law in the United States is centered around bringing forth the production of creative people. In this context, more consciousness of positive externalities and how they mesh with negative externalities is essential. In addition, even if one is uncomfortable with the goals of efficiency or wealth maximization, it still makes sense to assess whether copyright does, in fact, track these interests.

Second, this Article focuses on judicial holdings and opinions and the question of whether these opinions are consistent with a theory of positive externalities. The point has been made that both the common law and antitrust law (also a form of common law) arguably evolved to conform to standards of economic efficiency. One may argue that despite uniform agreement that United States copyright law is utilitarian in nature with the bottom line purpose to maximize social welfare, the Act itself makes it impossible to adopt an economic approach to positive externalities. It is true that the Act, reflecting powerful political interests, is at times less about maximizing social welfare than it is about determining how the profits from protected works are divided. On the other
hand, there are many issues left sufficiently open for courts to adopt a sound economically-oriented approach and to allow an analysis of whether this tendency is present.\textsuperscript{25}

II. THE ECONOMICS OF NEGATIVE AND POSITIVE EXTERNALITIES

A. THE BASICS\textsuperscript{26}

Most people familiar with legal analysis know that a negative externality arises when an activity by one party imposes a cost on another. Less attention has been paid to the difference in the economic and legal consequences of positive externalities. Suppose you make a living growing and selling apples. The cost to you is $10 a bushel and you sell them for $12 a bushel, which is the measure of the value buyers attribute to your apples. Periodically, you fertilize, and the run-off from your field goes into an adjoining stream. People downstream who would otherwise use the water find that they must use wells and bottled water instead. The cost to them is $300 a year over what it would be if they could use the stream. The cost to downstream residents is an externality. Suppose, if you were required to pay this cost, the cost of apples per bushel would be $14. You would have to charge at least that much and, consequently, you would not be in the apple business. The key idea here is that it costs $14 to produce something that society says is worth $12. Yet you will produce the apples because you are able to shift $4 of the production cost to others.

No one questions whether an externality is involved here. That is a different issue from the legal reaction. The law may or may not require you to internalize the cost. It does this by declaring that the downstream residents have a right to use the water. You can compensate the people downstream or attempt to find a way to curb the run-off. The idea is that law complements economics here by requiring the orchard owner to make decisions based on all the costs of production as opposed to just those incurred directly.

\textsuperscript{25} Although certainly subject to debate, the Act tends to be less precise and more open to judicial interpretation in those areas that deal with what intellectual property is and what rights authors have. These are the matters that concern this Article. The Act is more detailed and less subject to judicial interpretation when addressing distributive matters.

\textsuperscript{26} Readers familiar with the economics of negative and positive externalities may want to skip this section.
While externalities abound, the decision—perhaps the only relevant one—about when to require compensation and internalization is a difficult one, and not every person causing a negative externality is required to make compensation. In addition, even when compensation is required, it may not be equal to the full amount of the externality. The issues of establishing that a negative externality is compensable and to what extent are the key to the analysis that follows—but first a look at the complementary notion of positive externalities.

In the context of positive externalities, it is also important to separate the economic reality from the legal action. Suppose you are an industrious and imaginative gardener. Your yard is a magnificent English garden that people come from miles around to see. They drive down your street and marvel at the beauty of your garden. They would pay to see the garden, but it is in plain view and there is no way for you to close the public street and charge admission. As an economic matter, there is no question that this is a positive externality. In effect, your gardening is a "public good" and those looking but not paying are "free-riders."

Your yard is actually smaller than it could be because, in order to support yourself, you spend your time working as a salesperson in a tire store where you earn $20,000 a year. In another town, a garden similar to yours can be found in a secluded area that people must pay to enter. They happily pay $5.00 per viewing and the total receipts are enough to provide a salary of $30,000. The point is that your efforts as a landscaper would be more valuable to society than your efforts as a salesperson in a tire store. It is because of your inability to internalize the external benefits of your efforts that you do not work full-time in the more productive and valued activity.

As with negative externalities, this is where the issue of a legal reaction arises. The fact that a positive externality is in play does not mean that the law will declare that the producer has a "right" to the benefits by collecting payments from those who enjoy those benefits. Most of the time, these benefits remain free—hence the term "free-riding." The free-riding in this case means you are forever in a less productive occupation. In some instances, most notably intellectual property, law attempts to complement economics. For example, if the law permitted you to block your street and charge admission to your garden, you would have an opportunity to test the market to see if you are more valued as a

---

27 Public goods are those to which exclusivity does not apply. Without legal interventions it is difficult or impossible to exclude "free-riders" from enjoying the benefits of what is produced. Traditionally, things like national defense and police services are listed as public goods because, if produced privately, those not paying for production would also benefit.
tire salesman or a gardener. Intellectual property laws, in effect, allow you to block access to your creative efforts and charge admission.

The parallels in the analysis are fairly obvious. In the case of negative externalities, the producer may produce too much because the costs incurred (internalized) are lower than the total cost. In the case of positive externalities, too little is produced because the producer is not fully rewarded for the productive effort. More technically, we say that the outcomes are not allocatively efficient. In the case of uncompensated negative externalities, resources are directed into the production of apples even though people do not value the apples as much as the cost of all resources needed to produce them. In the case of positive externalities, resources are not devoted to your English garden even though society values your efforts as a landscaper more than anything else you could produce.

For allocative efficiency to occur, generally both types of externalities must be treated. Although it is possible in the same market to have the overproduction tendencies of negative externalities offset by the underproduction pull of positive externalities, such an outcome would be pure happenstance. Plus, offsetting externalities in a single market is not the real problem. The problem is that resources that may be destined for different markets may be affected by both negative and positive externalities. For example, suppose the apple farmer and landscaper both use fertilizer. The demand for fertilizer will be relatively low for landscaping because of the public good character of the landscaper output and relatively high for the orchard owner because of negative externalities. Treating just negative externalities is only a partial solution to the problem of fertilizer misallocation.

Despite this balance in the importance of positive and negative externalities, legislative and judicial treatment of the two is anything but balanced. Tort and contract law as well as criminal law are responses to negative externalities. In these contexts, there are solid indications that law either implicitly, expressly and deliberately, or coincidentally furthers a goal of allocative efficiency. On the other hand, in the context of intellectual property and copyright law in particular—the chief legislative responses to positive externalities—one is hard-pressed to find, at least on the surface, an underlying theme of allocative efficiency. As already noted, part of what follows is an effort to pierce the surface in order to determine whether there is an underlying allocative efficiency rationale. First, however, a closer look at the treatment of negative externalities will serve to introduce the comparison.

B. THE TREATMENT OF NEGATIVE EXTERNALITIES

Three areas of law are largely devoted to the internalization process. In tort law, theories governing intentional harms, negligently-caused harms, and strict liability provide the link between negative externalities and internalization. In contract law, a breach harms the non-breaching party and the harm is internalized through a finding of contract liability. The objectives of criminal law are more diffuse, but one rationale for criminal law is that it informs people in advance that they will be required to internalize the harm caused to others. Sentencing in excess of actual harm is the result of the fact that not every person causing harm will be required to internalize.\footnote{In effect, the harm caused by each act may be only $100 but nine of ten criminal acts go undetected. Thus, if a $100 fine were imposed, the expected penalty would be only $10. To offset this effect, the actual penalty is raised to a multiple of the actual harm.}

There are complexities in the case of criminal law that make it a bit more difficult to work with in terms of developing a theory, so the focus here is on tort and contract law. Both areas involve a two-step internalization process. The first step is the finding of liability, which can be viewed as a determination that those affected negatively by the externality should be compensated. Or, put differently, it is a decision that internalization must occur. The second step is the assessment of damages. Having determined that a compensable externality has occurred, what amount should be internalized?

This two-step process can be converted to the assessment of positive externalities. A finding that an author has created a protected work and that there is a copyright violation is the “positive externality” side of a finding that a compensable negative externality has occurred. Similarly, defining the breadth of that protection and determining the damages awarded is comparable to a determination of the extent to which the positive externality can be internalized.

Given the similarity in the analysis, it is useful to take a closer look at the economic standards that arguably underlie the negative externality analysis of tort and contract law. Two related concepts are involved here: risk allocation and cost minimization. The risks of losses are allocated in a manner that minimizes the social costs of these losses. In contracts, the risk of non-performance is almost always allocated to the breaching party subject to doctrines like impossibility, mutual mistake, and the like. The rationale is that the party who has promised to perform is in the best position to anticipate factors that may lead him or her to be unable to perform or just to prefer not to perform. In effect, the party wishing to breach sees that it is more expensive\footnote{This could be in terms of the actual cost to perform or the opportunity cost of not breaching and performing for a higher bidder.} to perform than anticipated. From this
perspective, performance is a losing proposition. In extreme and rare circumstances, non-performance is not a breach. One could analogize this in tort law to a determination that the costs of avoiding the harm would have exceeded the harm itself. In general, though, the party wishing to breach must compare his or her loss from performing with the loss to the other party, in terms of expectancy, and choose the less expensive alternative.

Possibly more important than the finding of liability in a contract breach is the determination of damages. What we know is that sometimes there are damages resulting from a breach that cannot be recovered. However expressed, the rule of Hadley v. Baxendale is one that put limits on the breaching party's liability. In effect, the breaching party is not liable for every negative externality stemming from the breach. One way to express this limitation is that there are certain external effects that are so disconnected from the anticipation of the breaching party that it makes little economic sense—in terms of minimizing costs—to allocate the loss to the breaching party. It is this disconnectedness or irrelevance with respect to decisionmaking that is key to understanding the application of these principles to positive externalities as set out below.

The same themes appear in the context of tort liability. As in contract law, the underlying theme is to allocate risk in a way that minimizes the cost of intentional torts and accidents. In the case of intentional torts, the liability issue is relatively uncomplicated. Like the party who breaches a contract, from an economic standpoint there is a choice made between injuring another and paying damages or not committing the tort. In the case of accidents, the analysis is more complex but centers around minimizing the costs of accidents. Ideally, two steps are involved. First, what would it cost the respective parties to avoid the accident? If the expected cost of the accident was higher than the cost of avoidance, the party who is the lowest-cost-avoider is liable. If neither party could avoid the accident at a cost that is lower than the expected harm, the law disfavors the use of resources to avoid the accident and there would be no liability. The general analysis is relatively simple. It is efficient to avoid accidents that have a higher expected cost than their cost of avoidance, and the party who should avoid the accident is the party who could do it least expensively. In torts, the concept of "proximate cause" serves the role of limiting one party's liability for the negative externalities his or her actions may have caused in fact but which are so remote or unlikely to occur that it makes little economic sense to require internalization.

33 Debates exist as to whether the current pervasive use of comparative negligence is consistent with the economic ideal.
 Strict liability, or liability without negligence, may seem to veer away from cost-minimization efforts by virtue of the fact that the strictly liable party may not be the lowest-cost-avoider of the harm. In fact, there are two factors that seem consistent with most, if not all, strict liability cases. First, the party that is determined to be strictly liable is very likely to be the best cost-avoider. Cases involving products liability and keeping wild animals are good examples of this. Second, strict liability is most appropriate when the harmful conduct is continuing. In these instances, the calculation of what would be cost-minimizing is slightly different.34

The perhaps obvious point is that these areas of law have developed ways of determining when negative externalities should be internalized and the degree to which that internalization should take place. The theories are not necessarily consistent with economic efficiency across the board. After all, the common law itself does not compel an evolution toward rules that favor efficiency. Still, a solid argument has been made that the rules that have evolved are generally consistent with efficiency.

C. TRANSFERRING THE ANALYSIS TO POSITIVE EXTERNALITIES

In the case of copyright and positive externalities, the perspective changes but the analysis remains fundamentally the same. Thus, contract and tort rules can be seen to have dual goals of encouraging internalization of negative externalities as a means of achieving allocative efficiency and encouraging the minimization of the costs of harms.35 Copyright law is designed to encourage allocatively efficient levels of positive externalities and to minimize the social cost of those benefits. In the context of positive externalities, the principal concept is that of allocation of risk with respect to harms. In the case of positive externalities, the creative person similarly is assigned a risk (in this case, of a gain) in a manner that is designed to maximize benefits.

Three clarifications will bring the comparison into sharper focus. First, in the context of copyright, the objective is not to maximize total gains resulting from creativity. Protection of these gains results in costs. The objective is to maximize net social gains. If the net social gains are negative, the effort should not be

34 The standard example would be blasting. The cost of not blasting might be higher than the harm of the windows broken by a blast. The blaster would not be negligent. On the other hand, the cost of stopping the entire practice of blasting might be less than the cost of the harm caused when all incidents are added together. The practice of blasting may be inefficient while each incident might appear to be efficient. As Professor Shavell has argued, strict liability causes one to consider the level of the activity. See generally Stephen Shavell, Economic Analysis of Accident Law (1987).

35 This latter goal is referred to as productive efficiency.
protected. Second, these costs are of three types. The first cost is that of administering a copyright system. This general category includes all public costs associated with deciding legal disputes and maintaining a public system of record-keeping. The second cost includes private costs associated with transactions between parties that arise from copyright law. In effect, copyright protection, by virtue of exclusivity, requires parties to transact about the use of protected works. The third cost is that associated with the exclusivity itself as measured by the benefits lost by virtue of the fact that others cannot use the original expression of the copyright holder. Third, when comparing gains with losses, the relevant comparison is between total benefits and total costs of bringing a work into existence assuming the work is produced at the lowest possible social cost.

Thus, two limits on the process of internalizing positive externalities come into play. The first is that benefits are internalized as long as, under the most efficient method of protection, the costs of internalization do not exceed the benefits society derives from the creative efforts. Stated differently, the creative effort may produce external benefits but, if the costs of author internalization exceed these benefits, they should not be incurred and the work should not be protected. Works that fail that standard are not “copyright-worthy.” In torts, the corollary would be the choice not to avoid accidents that are more costly to avoid than the harm caused. In contracts, a related concept is the choice to excuse performance under some circumstances.

The second condition is that the benefits derived from the creative effort should be obtained at the lowest possible social cost. Put differently, as long as the creative effort is put forward, there is no need to incur costs to protect benefits beyond this minimum. These extra benefits, like damages that are not “foreseeable” under the Hadley v. Baxendale rule in contracts or proximately related to the harm in the torts context, are irrelevant to the author’s decisionmaking. Any protection beyond the minimum necessary does not increase the social benefit of the work and is burdensome in terms of administrative, transaction, and exclusivity costs.

In sum, an economic approach to positive externalities would observe two rules:

1. Internalization of positive externalities will be facilitated as long as the cost of the facilitation does not exceed the social benefits of the work.

36 The obvious exception is “fair use.”
37 This would be a comparison of the marginal cost and marginal benefit of a specific work.
38 There is an obvious relationship between these two goals. As the cost of internalization decreases, it becomes efficient to encourage higher levels of creativity.
2. No costs beyond the minimum necessary to bring copyright-worthy works into existence should be incurred.

III. MAKING THE RULES OPERATIVE

It would be convenient if these two rules could be translated to copyright law directly. They cannot be, and the purpose of this final discussion before examining the law is to describe how these economic questions can be framed and asked in the context of actual cases.


The first rule concerns whether a work should be protected at all. More specifically, have copyright doctrines developed that distinguish works for which costs of internalization are less than positive externalities from those in which these costs are more? The issue is raised below in a number of contexts, but an example may be useful to illustrate how the analysis is applied, how difficult it can be, and why there may not be a clear answer.

At least one doctrine—the "modicum" standard articulated in *Feist Publications, Inc. v. Rural Telephone Service Co.*—seems, on first impression, to be inconsistent with an economically rational approach to positive externalities. "Modicum works" offer little in the way of public benefits. Specifically, it is unrealistic to believe that each work possessing a modicum of creativity is copyright-worthy. In most cases the costs of protection are likely to exceed the public benefits, resulting in a net loss. On the other hand, it is not clear that "modicum works" result in much of a burden to others in terms of exclusivity. One reason for this is that substitute creative works are readily available. In addition, the fact that works with very little creativity receive "thin" protection suggests that a sensitivity to the benefits and costs of protection already exists in the courts.

The question of whether any particular work should be protected when it exhibits only a modicum of creativity is a different question from whether the overall "modicum" policy results in net loss. A more exacting analysis by the courts of each work gives rise to additional costs. The bigger question is whether a more expensive process of separating works that result in a net gain from those

---

41. For examples see infra text accompanying notes 49-67.
resulting in a net loss is worth the costs. This is obviously an empirical question. In effect, when all factors are considered, it is not clear that a rule protecting works containing only slight creativity is necessarily an inefficient one from the standpoint of positive externalities.

B. NO COSTS BEYOND THE MINIMUM NECESSARY TO BRING COPYRIGHT-WORTHY WORKS INTO EXISTENCE SHOULD BE EXPENDED

This second question is the one that is synonymous with *Hadley v. Baxendale* in contract law and proximity requirements in tort law. More specifically, when there is copyright protection, does there appear to be any effort made to tailor that protection so that it does not exceed the minimum necessary? Again, there is a temptation to conclude that there is not. Observations of "no more than necessary" standards would seem to require attention to copyright terms, the implications of new technology, and fair use standards. The answer may appear to be easy with respect to two of these. Copyright terms may vary but not in a way that is consistent with economic standards. Fair use, on the other hand, can clearly be applied in a manner to promote economic ends and, in particular, ensure that protection is no more extensive than necessary.

Again, it may be useful to examine how to approach this question in the context of a specific example. In *White-Smith Music Publishing Co. v. Apollo Co.*, the issue of whether the compositions involved were "copyright-worthy" was not in question.\(^4\) If it were, a finding that the positive externalities flowing from original musical compositions typically exceed administrative, transaction, and exclusion costs would likely have been economically sound.

With respect to the "no more than necessary rule," it is possible—perhaps surprisingly—that the decision reflects an economically correct outcome. The question is whether it was necessary to further burden third parties in order to draw forth creative efforts.\(^3\) Put in terms discussed here, the question could be framed: Was it reasonably foreseeable by the authors that revenues would be forthcoming from the licensing of the composition to producers of piano rolls? And, further, was this possibility part of the incentive to compose music? Thus, one interpretation of the case is that composers of music are not motivated by the possibility that an unforeseen technology will develop that will allow the performance of a composition by new means. In effect, the revenues from

\(^{42}\) 209 U.S. 1 (1908).

\(^{43}\) It is important to note that "creative effort" actually has two contexts. Obviously, already-produced works can be used without affecting their availability. On the other hand, a failure to protect these works and to uphold what might be called the implicit bargain between the State and authors, has an impact on current and future creative incentives.
licensing piano roll manufacturers was not sufficiently “proximate” to the creation of the original compositions to require assignment of that income to the composers.

This is not to say that this economic interpretation is correct as an empirical matter. There is little in the opinion to suggest even an implicit economic analysis. On the other hand, there may be an instinctive and subtle economic process at work. In particular, the Court focused on whether one could look at the rolls and read the music as one could read it off of sheet music. In other words, were piano rolls substitutes in the market for sales that composers might fairly be said to have expected and based their decisions on? The holding is, in effect, that the protection to piano rolls was more than necessary to call forth the creative efforts.

The possible economic rationality of White-Smith Music may be better appreciated by comparing the economic impact of the treatment of the same issue in the 1909 and 1976 Copyright Acts. As already noted, the 1909 Act extended copyright control to mechanical reproductions. The 1976 Act goes another step by extending copyright control to phonorecords. Phonorecords are defined as “material objects . . . fixed by any method now known or later developed.”44 In effect, all benefits are to be internalized no matter how remote the likelihood that those benefits will occur. If this policy were extended to contracts, the Hadley v. Baxendale rule would not exist; and in torts, the proximate cause limitations would be eliminated. Instead, in those areas of law, defendants would be liable for all damages—even those that are unknowable and, thus, disconnected from the decision to take an action in the first place.

IV. COPYRIGHT LAW AND POSITIVE EXTERNALITIES: THE THRESHOLD QUESTION

The first question in the context of a negative externality is whether the cost of avoidance exceeds the cost of the externality itself. In the context of positive externalities, the comparable question is whether the positive externalities exceed the cost of the process of ensuring that those externalities are internalized by the author. At first, it appears that copyright law has done a fairly poor job in this regard. There are a number of reasons for taking this view. As discussed above, under what has come to be known as the “modicum” standard for creativity, only minimal creativity can set the copyright apparatus into motion. Minimal creativity is unlikely to give rise to much in the way of positive externalities; but it can set off an expensive process of protecting the rights to internalize those

Relating this back to negative externalities, this would be comparable to using an expensive process to hold people liable for harms that are very minor. In effect, the administrative cost exceeds the gains made by accident avoidance.

Second, in copyright the concept of authorship has very little meaning. For example, one can be the author of an expression that he or she did not intend. What this means is that works that may result in positive externalities but which require no incentive by society to bring forth are nonetheless protected. Relating this back to negative externalities, this would be comparable to holding an individual liable for harms that are disconnected from his or her ability to avoid or react to such harms.

Finally, copyright has the odd character of protecting positive externalities when the work would have been created even without this extra cost to society. It is hard to imagine that the predictable designs on things like greeting cards and beach towels are driven by the desire to reap the benefits of being able to internalize positive externalities. A great deal of this generic art is more likely driven by the need to achieve temporary product differentiation in order to remain competitive. Any extra benefits derived from copyright protection are more likely to be in the nature of a windfall. Again, in terms of negative externalities, this is like awarding extra damages when a certain amount of damage or just internal necessity creates an incentive to minimize accident costs.

In fact, when it comes to the question of whether creative people should be able to invoke the legal system in order to internalize positive externalities at all, the legal system does not seem to perform as well as it does in the context of the complementary problem of negative externalities. A closer look, however, suggests that this may be too harsh a judgement. The analytical process by which copyright law is applied and several of the doctrines that have emerged actually can be squared with a rational positive externalities approach. The next section focuses on the process and these doctrines while the following one examines the special case of derivative works.

---

45 See Harrison, supra note 24, at 856-57.
47 See Harrison, supra note 24, at 868-69.
POSITIVE EXTERNALITIES TO COPYRIGHT LAW

A. ABSTRACTION, THINNING, AND EFFICIENCY

The notion of "thin" in copyright law refers to the fact that works with little creativity have only slight protection. Here the concept of "thinning" refers to the process of taking out of play those elements of a work that are not protected. Thinness and the thinning process are a natural extension of the standard that for an infringement to occur, the infringing work must be substantially similar to the protected elements of the work.\(^4\) Obviously, the actual question in terms of a copyright infringement is whether the infringing work is substantially similar to the protected elements of the original work. Elements are eliminated from the sphere of protection for a variety of reasons including: they are facts, scenes a faire, not original, or that protection would amount to allowing copyright of an idea or a process. After the thinning process, works evidencing very little creativity end up with thin protection, and everything else they contain can be freely taken.

The important question is whether, from an economic perspective, the thinning process plays a role in copyright comparable to a finding of no liability in the context of contract and tort law. In tort law, the crucial question is whether the defendant owed or did not owe a duty to the plaintiff. The determining factor as an economic matter is whether the cost of observing that duty exceeds the benefits. In copyright, the decision to take an element out of play amounts to a decision that there is no duty by a potential infringer not to take that element of another's work.

Before looking at the question in some detail, it is important to note that the process of thinning itself can result in costs even when protection is correctly denied. First and most obviously, the process often requires an extended and expensive period of litigation. Second, the process of separating protected from unprotected elements is a subjective one and can increase risks to authors. In a general sense, this risk is a cost to all those engaged in creative efforts and may deter those who work within the gray areas of what is protected and not protected.\(^5\)

Perhaps not coincidentally, the thinning process and its economic rationality owes a great deal to Judge Hand's opinion in the seminal case, Nichols v. Universal Pictures Corp.\(^5\)


\(^5\) The most obvious example outside of intellectual property law is antitrust law. In antitrust a lack of clarity about which practices are procompetitive or anticompetitive may discourage practices that are ultimately beneficial to consumers.

45 F.2d 119 (2d Cir. 1930).
describes the process of abstracting—or, in modern parlance, disassembling—a work. He writes:

Upon any work, and especially upon a play, a great number of patterns of increasing generality will fit equally well, as more and more of the incident is left out. The last may perhaps be no more than the most general statement of what the play is about, and at times might consist only of its title; but there is a point in this series of abstractions where they are no longer protected, since otherwise the playwright could prevent the use of his "ideas," to which, apart from their expression, his property is never extended.}\textsuperscript{52}

While Judge Hand’s discussion is best known for its description of the abstracting process, the economically important excerpt is that in which he observes that “property is never extended” to ideas.\textsuperscript{53} Ideas fall outside the scope of protection even though they may be highly original and the result of the work of the most creative minds. The reason for not protecting ideas is that the costs of protection will in general exceed the social benefits of protection. This is not to say that ideas may not be original and enormously important. Instead, the key is that protecting them so that the “author” internalizes those benefits is expensive. In the case of ideas, the specific social cost involved would be those stemming from exclusion of others.

The connection between abstraction and the separation of different expressive elements is also found in the analysis of \textit{scenes a faire}. \textit{“Scenes a faire”} refers to “scenes that flow naturally from unprotectable basic plot premises.”\textsuperscript{54} For example, a western movie is likely to contain a saloon scene, people in western attire, wood frame buildings, and calico fabrics. To allow these elements to be protected would be tantamount to protecting the idea of a play or movie set in the old west. A good recent example is \textit{Metcalf v. Bochco},\textsuperscript{55} in which the authors of a television screenplay sued Steven Bochco, the producer of a number of popular television series. In this case, the series in question was “City of Angels,” a Bochco production that plaintiffs claimed was an infringement of their own screenplay. Both works were about county hospitals in inner-city Los Angeles. One cannot copyright the idea of a hospital drama set in an inner city hospital.

\textsuperscript{52} Id. at 121.

\textsuperscript{53} Id.

\textsuperscript{54} Metcalf v. Bochco, 294 F.3d 1069, 1074, 63 U.S.P.Q.2d (BNA) 1412, 1415 (9th Cir. 2002). \textit{Scenes a faire} can also be found in the context of musical compositions. See Swirsky v. Carey, 376 F.3d 841 (9th Cir. 2004).

\textsuperscript{55} 294 F.3d at 1069.
That setting necessarily calls for plots that raise issues of race, poverty, and romantic involvements among the staff. In effect, these elements “go with the territory,” and if they are protected the effect is to foreclose the idea or premise to others. This can be more costly than the benefit that would derive from any one work. Of course, at some point, and as was noted by the Bochco case, the similarities are not a necessary extension of the basic idea or dramatic premise, and those elements fall into the protected sphere.56

The leading recent case noting just how thin protection may become is Feist Publications, Inc. v. Rural Telephone,57 in which the plaintiff claimed that the use by the defendant of its telephone listings in order to produce its own directory was an infringement. The Court noted that a telephone directory is a factual compilation and that facts are not copyrightable.58 In effect, by peeling away what was unprotected, the court granted very thin protection for the selection and arrangement of facts.59 The decision makes sense in many respects from an economic perspective.60 Although a comprehensive list of telephone numbers is certainly the source of huge positive externalities, the granting of a monopoly over the publication of that information is also very costly. In addition, some facts are readily available and others difficult to establish. Allowing protection of facts would mean a huge windfall for those who generate facts with little effort. A holding that is more equivocal than Feist on the matter of protecting factual information would likely give rise to repeated and costly incidents in which the exclusive right to factual information is litigated and which would preclude others from the republication of facts.

56 Id. In Bochco, not only were there similarities in the setting, but the two works both featured “young good-looking, muscular black surgeons who grew up in the neighborhood . . . .” Id. at 1073. In addition, both central figures were divorced without children and involved in the same overriding struggle relating to hospital accreditation. Id. See also Murray Hill Publ’ns, Inc. v. Twentieth Century Fox Film Corp., 361 F.3d 312, 70 U.S.P.Q.2d (BNA) 1220 (6th Cir. 2004).
58 Id. at 363.
59 Id. at 349.
60 Generally, the opinion is consistent with economic efficiency. This may not be the case when it comes to the Court’s treatment of sweat of the brow. Specifically, the Court rejected the idea that copyright law should be used to allow internalization of positive externalities resulting from the “sweat of the brow” of the author. In other words, copyright is designed to protect the fruits of creativity, not effort or investment. Id. at 354. In reality, even that part of the opinion is probably consistent with economic theory. The important issue is what the author has produced and the cost of protecting it. Sweat of the brow is typically raised when the arguably protected element is factual in nature. In these instances, the social cost of protection is high and only in exceptional circumstances would this cost be justified by the benefit of the discovery of facts.
Another useful example of an economically sensible outcome is *Beaudin v. Ben and Jerry's Homemade, Inc.*[^61^] a Second Circuit case in which the plaintiff designed hats colored with black and white Holstein cow-like splotches. The plaintiff sold several hats to Ben and Jerry's for resale in a store. Later, Ben & Jerry's had the hats manufactured by others and Beaudin claimed the new caps constituted an infringement. The court reasoned that it was doubtful that Beaudin had created anything that was protectable. In particular, the court was concerned that finding the cow splotches protectable would mean that anyone else who got the idea of representing the cow splotches in works would run the risk of infringing Beaudin's work.[^62^] Rather than hold that the work was unprotectable, the court went on to hold that even if some element of the hats was protectable, the protection was very thin and the Ben &Jerry's renditions were not substantially similar to that small protected interest.[^63^]

From an economic perspective, the holding amounted to a determination that cow-splotch hats were unlikely to ever be protected. In effect, whatever positive externalities might flow from the creative effort were exceeded by the costs to others of protecting that interest. The risk that others would feel constrained from using a similar design was a cost the court specifically discussed as something to be avoided. What distinguishes this case is that it was not difficult for the costs of protection to exceed the benefits because the “creativity” of taking a pattern found in nature and transferring it to hats or fabric is hardly substantial.

Similar recognition of the costliness of overprotection is noted in *Satava v. Lowry*,[^64^] a decision by the Court of Appeals for the Ninth Circuit. In that case, an artist created glass-in-glass sculptures that appeared to be jellyfish encased in a plastic bubble. The works were seen by another artist who began creating the same types of works. The lower court held that the works of the second artist were infringing. The Court of Appeals reversed, reasoning that “no copyright protection may be afforded to the idea of producing a glass-in-glass jellyfish sculpture or to the elements of expression that naturally flow from the ideas of such a sculpture."[^65^] The court went on to describe the remaining protection as thin and extending only to the “distinctive curls of particular tendrils,” the “arrangement of certain hues,” and the shape of the overall sculpture.[^66^] Again, the thinning process eliminated a “no-copying duty” from elements that it would

[^62^] Id. at 2.
[^63^] Id.
[^64^] 323 F.3d 805, 66 U.S.P.Q.2d (BNA) 1206 (9th Cir. 2003).
[^65^] Id. at 810.
[^66^] Id. at 812.
have been excessively costly to protect. For example, even a decision to allow protection of glass-encased jellyfish sculptures could lead to repeated issues about jellyfish versus other colored glass shapes within clear glass. In addition, it is not at all clear that the positive externalities of jellyfish in glass are great or that a decision denying protection will lead to a decline in production. In effect, regardless of the merits of these works, the costs of their protection would seem to exceed any social benefits.

As Feist, Beaudin, and Satava indicate, sometimes the thinning process means there is little left to protect at all. In the cases in which the thinning process leads to "thin" protection in an absolute sense, the question arises of why to offer protection at all. Put differently, are the positive externalities associated with thinly protected works ever great enough to justify any administrative and exclusion costs? This is an empirical question, but for the most part it appears that leaving an author with thin protection does little harm. First, thin protection means there is little in the way of exclusion costs. Second, by narrowing protection to details like the exact curl of a jellyfish's tendril or the curve of a cow's spot, the focus of whether copying has occurred and whether works are substantially similar is likewise narrowed and, thus, administrative costs are reduced. Finally, the outcome of thin protection is probably rarely what an author is aiming for. It may be all that is left after a serious effort. Shifting "thin protection" to "no protection" may discourage risky creative efforts, especially along the lines of minimalist expression.

In general, the abstracting and the thinning that follows seem to be roughly consistent with what an economically-based approach to copyright and positive externalities would suggest. The basic pieces that are culled out and put into the no-liability category—ideas, expressions that necessarily flow from ideas, processes, *scenes a faire*, facts, and useful articles—are elements that, if protected, would impose substantial costs on the public. Moreover, since they are necessary parts of a great many types of expression, there is little likelihood that the public will lose the benefits of their expression if they are not protected. For example, a western movie might include the typical saloon, western-style clothes, and calico patterns on fabrics. Finding that these *scenes a faire* are unprotected has no impact on an author's incentive to incorporate these elements into a future work since they are required elements in any future effort to evoke a western theme. In general, many of the distinctions made between what is copyright-worthy and what is not can be seen as an effort to balance First Amendment rights with copyright law. It is likely that the same distinctions would be made if the issue

---

were assigned to an economist bent on an efficient approach to copyright protection.

B. DERIVATIVE WORKS

One of the more direct and obvious efforts to incorporate a rational economic approach to positive externalities and copyright has come in the context of derivative works. Two cases stand out. The first is *L. Batlin & Son, Inc. v. Snyder* in which the Second Circuit Court of Appeals was faced with two authors who had created derivative works based on the "Uncle Sam" mechanical bank. Snyder first produced scaled-down plastic versions of the bank and obtained a copyright registration. He was followed by Batlin, who attempted to import his version from Hong Kong but was informed that his banks were covered by Snyder's copyright. Batlin filed an action to enjoin Snyder from enforcing his copyright. The issue was whether Snyder's work contained sufficient originality to warrant copyright protection. According to Judge Oaks, this required more than trivial variation from the original. Accordingly, for a derivative work to be protected, "[a] considerably higher degree of skill is required, true artistic skill, to make the reproduction copyrightable." One of the rationales employed by the court was the hazard of permitting the protection of derivative works with minor changes from the original. Thus, "[t]o extend copyrightability to minuscule variations would simply put a weapon for harassment in the hands of mischievous copiers intent on appropriating and monopolizing public domain work."

More direct in its economic concerns is *Gracen v. Bradford Exchange*. Gracen entered a contest to create paintings based on the Judy Garland character, Dorothy, from the Wizard of Oz. As the winner, Gracen was eligible to enter into a contract with a firm, the Bradford Exchange, that had acquired the rights to make collector plates based on the film. Gracen rejected the contract terms and the Bradford Exchange employed another artist who created the painting for Dorothy after seeing Gracen's work. The Seventh Circuit Court of Appeals assumed that the plates were identical to Gracen's painting but held that there was no copyright infringement.

The issue in this regard was whether Gracen's derivative work was copyrightable in the first place. If it was, the second artist could be an

---

68 536 F.2d 486 (2d Cir. 1976).
69 Id. at 489.
70 Id. at 491.
71 Id. at 492.
72 698 F.2d 300, 217 U.S.P.Q. (BNA) 1294 (7th Cir. 1983).
73 Id. at 302.
unauthorized copier. If not, he or she could freely copy and not be engaged in an infringement. The Court held that Gracen’s work was not copyrightable, noting a difference between “artistic originality” and “the legal concept of originality.” Legal originality, in the context of derivative works, according to the court requires the derivative work to be “substantially different from the underlying work.” According to Judge Posner, the legal function of originality in the context of derivative works is to avoid overlapping claims. He offered the example of artists attempting to copy the Mona Lisa. When working from an existing work, the derivative works will all necessarily bear a resemblance to each other. What will not be clear is whether any artist after the first derivative work actually copied the original or the derivative work.

The economic sensibility of Batlin and Gracen is clear. Some works are likely to generate costs that are high relative to the positive externalities they produce. In the case of derivative works, two types of dangers emerge. First, unless the derivative works are substantially different from the original and each other, it is unlikely that the second one will have added much to social welfare. On the other hand, both authors may claim a right to internalize that benefit. This means additional cost with no increase in benefits. Second, some derivative works involve changing the form of the original while doing very little else. In these instances, protecting the derivative work creates the risk of granting the author a monopoly over that new form of reproduction. Although the precise economic outcome is an empirical question, one can understand the rationale for requiring derivative works to meet a higher standard of originality.

Batlin and, in particular, Gracen have been criticized, typically by those who lose sight of copyright as a social welfare tool or reject that point of view. For example, one author writes, in questioning Batlin and Gracen, “[s]uffice it to say that the concept of originality in copyright has as its purpose promoting the progress of learning, culture and entertainment, and not sheltering persons who are indisputably engaged in unauthorized copying.” Obviously, the reasoning begs the question of what is unauthorized copying. The producer of a second derivative work is not engaged in unauthorized copying if the creator of the first derivative work does not have copyright protection. As an economic matter, the

---

74 Id. at 304.
75 Id. at 305.
76 See also Entm’t Research Group, Inc. v. Genesis Creative Group, Inc. 122 F.3d 1211, 43 U.S.P.Q.2d (BNA) 1705 (9th Cir. 1997).
78 Gorman, supra note 77, at 6.
first work is not copyright-worthy unless it is meaningfully different from the original. This type of generalized criticism ignores the fact that originality and even copyright law itself are a means to an end. In Justice Stewart’s terms, that end is the “general public good.” It makes little sense to protect efforts when that protection may make the public worse off.

A related criticism also misses the point. It notes that Gracen essentially lost her case because she succeeded in achieving her goal of creating a painting that looked like the film and photographs of Dorothy. As the critic puts it, “[t]he court condemned Gracen for achieving precisely her creative goal.” As a more general criticism, the author goes to reason that “[t]his claim that proof problems justify a perverse definition of originality is unpersuasive.” Finally, “the copyright requirement of originality makes no sense because it claims variation as a virtue, while authors of many objects . . . rightly regard variations as a vice.”

Aside from the hyperbole of “condemnation,” the interpretation is odd given the context. Gracen entered a contest, won it by purposely avoiding being too creative, and internalized a reward for her effort in the form of the prize money. The standard announced was to be applied to derivative works only and only to those in which a court could not find significant variation from the original. The notion that “proof problems” are all that are involved in the court’s decision suggests an excessively narrow perspective of the policies to be balanced. The logic offered by the author seems to favor extending copyright protection to what already exists even if it is the result of an effort to avoid originality. Protection of what is not original may be beneficial to individual authors but is inconsistent with advancing social welfare.

In the abstract, one could adopt the view that a cost-benefit approach to positive externalities is inappropriate and attribute lexical ordering to originality in the sense that once it exists it is worth any cost. From this point of view, even the most trivial originality would warrant even the most burdensome public investment in the form of protection. This is not, however, a proposal that anyone has taken seriously. Certainly, if Balin and Gracen involved judicial assessment of aesthetic merit, there would be room for the concerns suggested by their critics. Instead, what the opinions call for is an assessment of difference, not quality, as a means of screening out derivative works that do not warrant their relatively high potential costs of protection. The logic that works that are not

79 See Wiley, supra note 77, at 136-37.
80 Id.
81 Id. at 137.
82 Id.
83 Lexical ordering refers to the possibility that all value cannot ultimately be reduced to the same standards of comparison like utility or dollars.
much different from originals probably do not warrant protection seems sound. The positive externalities are likely to be slight, and the process of protecting these works can be administratively expensive.

V. THE SECOND ISSUE: NO MORE COSTLY THAN NECESSARY

As a fundamental matter, general copyright standards for delineating areas of liability and no liability are in line with economic efficiency. This is the first step. The second step is to protect those expressions that fall into the protected area at the lowest cost. Here, as will be seen, the results are quite different from the more general questions. Having decided what types of works should be protected, copyright law shows only limited sensitivity to minimizing the costs of that protection.

In theory, the way to achieve the lowest-cost positive externality would be to assess each work separately and then adjust the scope of protection necessary to bring forth the work but do no more. Each work would be protected by a combination of duration, infringement standards, and remedies that result in minimizing the social cost. This is probably impossible in reality. In addition, the expense of what would amount to a very sophisticated examination of each work and a determination of the payout necessary to make the artist's creative effort worthwhile would be excessive. Even if it were not excessive, it still might be bad policy. People who are creative may find themselves in a pooling-type arrangement in which the profitability of a few works fund an ongoing effort at experimentation with various forms and expressions of creativity.

Nevertheless, it appears that there are sensible ways to lower the costs to society of bringing forth creative works without discouraging those who are creative. Unfortunately, some decisions seem designed to increase the cost of the copyright system rather than reduce it and offer no hope of actually increasing creative efforts. Three areas of copyright law have great potential for rationalizing the system: copyright terms, the reaction to new technologies, and "fair use." As already noted, the record of copyright here is mixed as far as its economic sensibility.

---

84 The economic model for such an exercise would be similar to perfect price discrimination. Under perfect price discrimination, buyers pay exactly the maximum amount they are willing to pay for goods and services. This eliminates consumer surplus. In the context of suppliers of creative works, the goal would be to allow the internalization of benefits at the minimum level.
A. COPYRIGHT DURATION

In terms of maximizing net social benefit from the regime of copyright, nothing is as far off as copyright duration and the current standard of life plus seventy years. The reason is pretty clear-cut. First, as Justice Breyer notes in *Eldred v. Ashcroft*, only about 2% of copyrighted works have commercial value fifty-five to seventy-five years after they are created. Furthermore, whatever future commercial value a work may have must be discounted to present value. Thus, as Justice Breyer points out in response to the twenty-year extension to the copyright term included as part of the Copyright Term Extension Act (CTEA), “[n]o potential author can reasonably believe that he has more than a tiny chance of writing a classic that will survive commercially long enough for the copyright extension to matter.” In effect, since there can be little incentive effect of extended copyright terms, there is little reason to burden the public with whatever additional costs the term gives rise to. Again, per Justice Breyer, one cost will come in the form of the need to acquire “permissions,” often by those who do not profit from the use of the material but want to make it accessible to others. Another likely cost is the result of disputes among those who had no part in the creation of a work over the profits from that work many years after it was created.

As much as these criticisms expose the economic irrationality of extended copyright terms, they may actually understate the problem. For copyright duration to play a role in an economically efficient level of internalization, two factors are critical. First, the term would have to be set at the sufficient length just to allow the minimum necessary level of internalization. This is obviously not the case since copyright terms are unrelated to the social value of the work. Second, if the term is not varied on the basis of economic factors, then it would make sense for it to be fixed so that each author could make decisions about investments in creative efforts on the basis of a certain period of protection. In fact, copyright terms are not the same but vary with the age and health of the artist. The existing term of life plus seventy years would only make sense if one were convinced that relatively young and healthy authors were far more likely to produce works that resulted in positive externalities than older ones or less healthy ones. There is, obviously, no evidence that this is true.

---

87 *Eldred*, 537 U.S. at 254 (Breyer, J., dissenting).
88 Id. at 250.
The most bizarre disconnect between economic rationality and copyright is the retroactive extension of copyright terms. Works that are in existence can hardly be subject to further incentives. Any additional gains are windfalls and any costs to the public unnecessary. The Supreme Court had an opportunity to address this disconnect and bring a modicum of rationality to duration in *Eldred v. Ashcroft.* 9

The Court addressed several attacks on the twenty-year extension included in the CTEA. Three of them go to the economic issue and are ultimately quite similar. 90

One argument was that application to existing works violates the requirement that works contain some element of originality. A second was that an extension for an existing work cannot “promote the Progress of Science.” Finally, the extension ignores the fact that an author must provide a quid pro quo for copyright protection. All of these arguments stem from the reasoning that an implied contract is struck between the State and the author, a position the Court concedes is true. According to the Court, what is contained in that exchange for the author is an understanding that he or she will receive whatever the current copyright term is plus any extensions that may be enacted while the work is protected. Consequently,

> [given the consistent placement of existing copyright holders in parity with future holders, the author of a work created in the last 170 years would reasonably comprehend . . . a copyright not only for the time in place when protection is gained, but also for any renewal or extension legislated during that time.]

Curiously, the Court cites in support of this proposition various licensing agreements in which copyright holders grant rights to licensees for existing terms and any possible extensions. 92

This reasoning here is a self-conscious reach by the Court. 93 Even as a “reach,” however, the reasoning fails. As already suggested, the notion that authors are motivated by unknowable extensions that would attach to works with a slim probability of having commercial value—highly discounted when the extension attaches—is remote. Far more importantly, the motivation the Court attributes to Congress is inconsistent with other terms of the CTEA and other extensions. For example, the Copyright Act of 1976 effectively extended the

---

90 *Id.* at 186 (majority opinion).
91 *Id.* at 210.
92 *Id.* at 214-15 (footnote omitted).
93 The Court’s reasoning here is put in terms of what Congress “could rationally seek” by making the extension retroactive. *Id.* at 215.
copyright term. At the same time, it permits the copyright holder or his or her heirs to reclaim from those to whom rights have been transferred the period of the extension. In other words, broad language in a license or assignment granting the licensee or assignee rights for the copyright term and any extensions are terminable. In fact, according to the Act, "[t]ermination of the grant may be effected notwithstanding any agreement to the contrary, including an agreement to make a will or to make any future grant." The same provision applies to the addition of the twenty-year extension provided by the CTEA. The reason for allowing the termination of these extensions can only be based on the belief that the copyright holder did not understand himself or herself to be granting a yet-to-be-enacted extension even though the granting instrument refers directly to extensions.

The inconsistency of the Court's reasoning with the Act is fairly blatant. On the one hand, the Court envisions Congress as having retroactively extended copyright terms as a way of complying with authors' expectations. If these were, in fact, the expectations of authors, it would also be their expectation that any grant of existing copyright terms and extensions would apply to retroactive extensions, and they would be compensated for the expected value of the yet-to-exist extension. Instead, the Act treats the extensions as something the author would not have anticipated by virtue of disallowing any grant language to be interpreted to include a retroactive extension.

What is perhaps even more perverse from the standpoint of internalizing positive externalities is the position of an author following the combination of the Court's reasoning and the Copyright Act. If an author currently writes and is motivated by the knowledge that he or she will be the beneficiary of retroactive term extensions, he or she would also have to believe that those extensions are not worth anything at this time because licensees are likely to pay very little for rights that are likely to be terminable at the will not only of the author, but also at the will of his or her heirs. In fact, while the Court seems to see the author as a calculating profit-maximizer, Congress seems to view authors as irresponsible people who must be protected from themselves.

Obviously, an effort to tailor copyright terms to fit different levels of protection depending upon the level of positive externalities would itself give rise to social costs. It might be possible to create a tiered system in which works

---

96 See generally Paul Goldstein, Termination of Transfers and Licenses Under the New Copyright Act: Thorny Problems for the Copyright Bar, 24 UCLA L. REV. 1107 (1977).
qualify for different levels of protection depending on the relative values of the work and the difficulty authors may encounter in their efforts to internalize. This may seem troublesome because it asks courts to assess the relative value of different works, but the danger is probably less than it appears. First, particularly in the context of fair use analyses, courts routinely decide whether works are "transformative,"\(^9\) whether the work "adds something new,"\(^{100}\) or what works lie "closer to the core of intended copyright protection than others."\(^{101}\) Second, the focus from an economic perspective is not solely on the value of the work, but also on the barriers to internalization. In effect, the analysis required is probably no more complex than some that take place already in copyright or that take place when courts make decisions about, for example, the "rule of reason" in antitrust or "proximate cause" in torts. Still, it is costly and poses dangers of allowing judicial tastes to be too influential.

In general, it appears that copyright duration as expressed in the Copyright Act and as interpreted by the Supreme Court cannot be reconciled with a rational approach to positive externalities. In fact, it is not clear that term duration is connected to any economic goals related to the production of creative efforts. Instead, the driving force seems to be the never-ending battle over distributive outcomes. Social costs would likely be lowered without any significant impact on levels of creative effort by shortening the copyright term, creating a bright-line copyright term that does not vary with the lifespan of the author, and an express indication that future extensions, if any, are not to be applied retroactively.

B. NEW USES

1. *The Theory.* Although it may not seem so at first impression, closely related to copyright duration is the question of how a copyright is affected by new uses or technologies; both matters concern extensions. This was essentially the situation in *White-Smith Music*\(^{102}\) as it has been in more recent cases ranging from *Sony Corp. of America v. Universal Studios, Inc.*\(^{103}\) to *New York Times Co. v Tasini.*\(^{104}\) The issue in the context of new technologies can be framed in a variety of ways including whether the new use actually involves copying or whether, as in *Tasini,* the use was beyond that for which a license had been granted. At bottom, the issue is whether an existing copyright extends to the use of an existing work in a

---


\(^{100}\) *Id.* (citations omitted).

\(^{101}\) *Id.* at 586.

\(^{102}\) See text accompanying notes 111-12, infra.


new medium. Superficially, the answer seems to be "yes" because the underlying expression, regardless of the new medium, remains the same. This outcome may not be the most economically beneficial, and the development of a new medium presents an opportunity to apply a functional approach to the question in order to reconcile copyright with maximizing social welfare.

The question, as already noted, is whether the approaches taken by courts to new uses are consistent with minimizing the costs of works that are determined to be "copyright-worthy." From an economic perspective as it relates to positive externalities, the question could be posed in terms of the reasonable expectations of the author at the time the work was created compared to the expected costs of protecting those expectations. In fact, this view is easily squared with the Supreme Court's own analysis in both *Eldred v. Ashcroft* and *Mazer v. Stein.*

The idea is that a contract exists between the author and the State and that the author enters into that contract with a set of legitimate expectations that are the motivating factors. It is useful from this perspective to draw from the logic of conventional contract law used to address issues of excused performance, special damages, and contractual interpretation. First, in the context of excuse for non-performance, the issue is whether the party seeking to be excused assumed the risk of the event affecting performance. The idea is also found in the contract rule that a breaching party must pay special damages that are foreseeable. A finding that any type of damage was foreseeable is actually a finding that the breaching party assumed the risk of that type of damage. On the positive externality side, the issue would be whether the gains from a new use were reasonably foreseeable. If so, the author can be said to have "assumed the risk" of the gain. Finally, if one views copyright as a contract with the State, contract doctrine governing the "intent" of the parties is often analyzed from the standpoint of foreseeability.

The issue of new uses is related to term extensions and even retroactive extension in that an event occurs that may increase the value of the work. In effect, just like an unanticipated term extension, a technological advance can result in a "use extension." If the event leading to greater use of the copyright holder's work is not reasonably foreseeable, it makes little economic sense to allow the

---


107 *See ALLAN FARNSWORTH, CONTRACTS 599-642 (4th ed. 2004) (stating the standards that determine whether a contracting party has assumed the risk of events making performance more difficult).*

108 *Id.* at 792-95.

copyright holder to benefit from the technological advance by finding that his or her copyright extends to that use. These types of events are unlikely to have played any role in the creative efforts of the author and would be a windfall to the author\textsuperscript{10} while increasing all three forms of social costs.

The counter-argument would be analogous to that used by the Supreme Court in \textit{Eldred} in the context of term extensions. That argument would be that the contract between the author and the State includes all possible use extensions because throughout history authors have been granted rights to these extensions. Unlike term extensions, this has not been the case. Not only have rights not been extended to every new use, a policy that authors are protected from these uses cannot be administered in a way that results in certainty. Unlike term extensions that either exist or do not exist, whether a new use amounts to an infringement is often a difficult interpretive question. In effect, the argument that the State has already promised all authors that they will be broadly protected from all new uses is not persuasive.\textsuperscript{11}

This background means it is possible to see \textit{White-Smith Music} from a new perspective: one that emphasizes the nature of the bargain authors view themselves as having entered into with the State. In the sense of following through on the bargain struck with the composers of the original song, the issue would be whether they could reasonably foresee the development of piano rolls. If they did, did they have a reasonable expectation that their works could not be "reproduced" without their permission? These questions are not just important in the context of assuring that the composers in \textit{White-Smith Music} are given their expectancy under the bargain struck with the State, but that the expectations of future authors are shaped to encourage efficient conduct. Furthermore, "foreseeability" should not be taken literally. It is, as it generally is in law, a concept to describe a risk allocation decision, and it seems to turn on the probability of an event occurring.

In theory it makes sense to draw a line. A more practical question is whether a line can be drawn that makes economic sense without doing unacceptable damage to predictability and incentives. Two guidelines are important in this regard. First, everything else being equal, it makes sense to allocate the risk of unforeseen events—including those leading to gains—to authors. The role of the State is essentially passive without any direct capacity to effect the nature of works produced or the direction value-increasing or value-decreasing technological changes may take. Second, the issue is ultimately economic and


\textsuperscript{11} And, even if copyright law has been interpreted to give rise to this expectation, it is likely that the policy creating that expectation is inefficient.
should focus on the impact of the change on the market for the work. It is, after all, market reactions that ultimately determine the levels of internalization and motivation.

It is essential, therefore, to think in terms of the various forms of market impact. First, the new technology and medium can make the work available to those who would not otherwise use the work. For example, in White-Smith Music, some purchases of piano rolls would be market-expanding since those making purchases would under no circumstances have purchased sheet music. Second, the new technology and medium may have a substitution effect. Again in White-Smith Music, people who listen to music may buy piano rolls instead of engaging live musicians who buy sheet music. Finally, the new technology may have both these effects. For example, purchases of the piano rolls that produce the sounds of existing tunes may mean lost sheet music sales but increased exposure of the original material as people who would not have otherwise purchased the music now acquire it in a different form. Each of these possibilities needs to be considered.

a. Market Expansions. The easier eventuality to address is one that results in market expansion. In general, the better policy is one that denies to authors the income from unforeseeable eventualities that have market-expanding effects. Any income derived will be in the nature of a windfall, and it makes little economic sense for the public to shoulder the costs of preserving this windfall for authors. The logic of this is seen more clearly by considering the complementary rule: When the event resulting in market expansion is relatively foreseeable, the reasonable assumption is that authors were and will be motivated by these income streams. The income can hardly be regarded as a windfall. This would not necessarily mean that these authors should be protected—since the social costs of doing so may exceed the benefits, but the presumption is that these gains are part of the author's incentives.

These rules also have intuitive appeal. For example, what author creates in the hopes of internalizing the gains from an unanticipated market expansion? It

---

112 Granted, to some extent this division is artificial in that it begs the issue of impact. For example, if the author's rights include all possible uses of his or her work, then a market "expansion" is not that at all but simply the manifestation of what was always anticipated. Similarly, a new technology that results in substitution is not a substitution if it was never part of the author's calculus. For this reason, it is important to focus strictly on the market impacts. In the first instance, are people given access who would not have otherwise had access? In the second, are there people who would have purchased the first medium but for the technological advance?

113 The idea may also be understood by asking whether it makes economic sense to encourage creative efforts, the success of which depends on unknown technological changes.

114 To be sure, there is some flexibility in copyright, especially with regard to "fair use," that can be used to "correct" for economic considerations even in these instances.
seems an unlikely occurrence, but even if it does occur, it is not clear this is the type of speculation that should be encouraged. It is important to keep in mind that the existence of market expansion gains and the fierce legal battles over the rights to those gains does not mean that authors were motivated by those gains. A decision to file an action today is made on the basis of a comparison between expected future costs and benefits without regard for the origins of those gains. That in itself is an expensive and unproductive exercise since that battle creates no wealth.\footnote{More technically, this is a battle over the distribution of existing wealth. It does not create new wealth.}

Perhaps the prudent course is to view the likelihood that authors create in hopes of internalizing income from low probability market-expanding events as involving an empirical question. This hardly seems necessary. Specifically, what are the social benefits derived from creative efforts that would not take place but for a belief by the author that he or she will derive income from very low probability events that will make the work available to a larger market? On the other side of the scale are the social costs of excluding others from using these works should they come into existence, plus the use of the copyright apparatus to divide the income derived from the work, including some that was not relevant at the time of creation.\footnote{One possible addition to the list of costs is associated with the role denying access to the new use will play as an entry barrier to the new technology. It is probably not intellectual property or copyright law per se that gives rise to this cost. Even with copyright protection, many works cannot be sold for more than a competitive price because the works themselves are not associated with market power. If the inability to pay at least a competitive price for an input is the difference between entering and not entering, there is unlikely to be much in the way of social cost associated with the lack of entry. On the other hand, in other instances copyright and the nature of the work combine to create market power, and the owner can charge a supracompetitive profit. In other words, the author may have actually created something that is "special," and copyright prevents new competitors from emerging to force the price down to competitive levels. The failure to enter a market because sellers of inputs can demand supracompetitive prices does result in social costs. A rule responsive to this problem would not be a copyright rule as it is one dealing with the treatment of market power in all contexts.}

With respect to the first half of this comparison, there are a number of reasons why the social benefits that are dependent on low probability market-expanding events are likely to be small and, therefore, unlikely to make much of a difference at the margin. The obvious first one is that possible income must be multiplied by the probability that it will develop in order to derive an expected value. In addition, given the low probability or foreseeability, it is likely that these events are to take place years down the road, which means that the income must be heavily discounted. The likelihood for it to play any role seems even more remote when one considers the evidence that in some contexts people are often not very
adept at comprehending uncertain events. Prospect theory teaches us that people value expected gains less than they value expected losses. In effect, the possibility of winning a lottery is less a source of motivation than avoiding losing what one has. It seems quite reasonable that an author would view increased income from an unexpected market expansion as a gain, and the impact of substitution away from his or her work as a loss. What this means is that the gain will have less motivational importance than the actual expected values might suggest. In general, all this adds up to a very simple proposition: that it is unlikely that creative people like Walt Disney or Margaret Mitchell were influenced at the time of their creative efforts by the riches of which we are now conscious but they were ignorant. Almost certainly the social costs of addressing these gains and of excluding others from using the works outweigh the marginal impact on creativity.

b. Substitution Effects. The question of protection from media that result in substitutions is more difficult, and tinkering with it can be risky. Substitutions are different from expansions in that substitutions are more likely to be perceived as losses rather than unexpected gains. We know, if only from the existence of an insurance industry, that people are very sensitive to losses and there is a motivational impact. To understand the complexity, think in terms of the author who is on the edge of creating a new work and is sensitive to the market implications. The possibility may exist that a new technology will make a substitute medium available, but the author may create anyway because he or she is relying on the copyright system for protection. In effect, copyright has an insurance-like impact here. A reasonable belief that substitutions will not be permitted is something copyright must deliver on or there will be a negative impact on the author’s incentive. It is, to be sure, tempting to think the author who creates in the face of a new technology is assuming the risk, but that assumption gobbles up copyright law completely. After all, a foreseeable new use plays no different a role in the decisionmaking process than known substitution possibilities, and it is the baseline job of copyright to determine what is an infringement. The difficult question is when to protect the author from substitutions and when not to.

First, what about the author who is more or less blind-sided by a new technology that results in a medium that creates an opportunity for substitution

---


118 Kahneman & Tversky, supra note 117.

119 "Prospect theory" compares gains and losses from the status quo. In this context, an author is likely to view the positive effects of an unexpected market expansion as a gain and the impact of substitution as a loss.
and a loss of income? Here, the author could be said to assume the risk because he or she creates in the context of conscious ignorance. From this point of view, the author in 1920 would not be protected from photocopying because at the time of creation, the author knows that he or she cannot know what technological change lies ahead, but chooses to create anyway. Here though, the author in all likelihood does not view himself or herself as taking much of a risk on the reaction of copyright law itself to these unknowns. If anything, the insurance function of copyright is more pronounced here.

Second, should today’s authors be permitted to assume that they will be protected from all future substituting eventualities? More specifically, should the public generally be required to pay the “premium” on an insurance policy that says “no matter what” no new technology will be used to displace your work? Although there are dangers that this insurance may be too expensive, it is also virtually impossible to develop a rule for all cases in this category. Is this to say authors should be protected from all substitution-creating technological changes? Probably not. Protection, even in those cases, generates social costs and a weighing should take place. If possible, this analysis should be done on a case-by-case basis with the possibility of the emergence of rules for classes of cases. In this analysis, the important factor is whether, in the future, events of the same probability are unlikely to influence authors sufficiently to justify the costs of exclusion and administration. To some, the idea that one would not protect authors from works resulting from new technologies and which are substitutes may seem inconsistent with copyright. This misses the point. The purpose of copyright is to protect to the extent necessary. It also ignores the reality. In various ways—most importantly “fair use”—it is clear that copyright does allow substitutes to displace original works.

c. Expansion and Substitution Effects. The category of mixed causes is also complex. For example, what we now know is that after White-Smith Music was decided, the demand for sheet music declined while the demand for music in all kinds of recorded forms exploded. Demand for sheet music for the compositions involved in the case may have declined as buyers substituted away from sheet music to a more convenient form of listening. To some extent, the growth was simply the result of a superior medium. In fact, it seems very likely that thousands of people listened to music as a result of the new medium, and the compositions themselves were not primarily responsible for the increased exposure of the compositions. In a sense, the “but for” cause was the technological advance. In cases like this in which the dominant impact is expansion, the better decision is to find that copyright is not infringed.

d. A Suggested Approach. The approach suggested here can be illustrated with Venn diagrams, and a series of priorities can be created. In Figure 1, foreseen and foreseeable are shown as separate from unforeseeable events. Those universes then intersect with the universes of market-extending effects and substitution effects. The shaded intersection represents those instances in which an unforeseen event results in a market extension only. In these situations there is no economic reason to protect the author of the original work. In effect, a per se unprotected rule would be appropriate here. The middle area is one in which both substitution and extension effects are found; balancing these effects would determine which rule to adopt.

FIGURE 1

Unforeseen events

Market extending

Substitution

Foreseen and foreseeable

Substitution effects can also be foreseen and foreseeable or unforeseen. Here too, no clear per se rules emerge. Narrow interpretations of what is protected may undermine efficient incentives, and broad interpretation may unnecessarily increase social costs. These issues should be considered on a case-by-case basis. When the substitution is foreseen or foreseeable, in all likelihood the author legitimately expected protection, and it probably makes sense to begin with the presumption that the work is protected. On the other hand, when the substitution is unforeseen, it may make sense to reverse that presumption.

121 As with all per se rules, these two will not be correct 100% of the time, but it is doubtful that the cost of further refinements in these two categories can be justified by increases in social benefits.
The analysis creates a range or continuum of protections ranging from least to most protected as follows:\footnote{122}

1. Unforeseen or unforeseeable market extension effects. [No protection]
2. Mixed unforeseen market extension and substitution effects with market extension dominant. [Very strong presumption of no protection]
3. Mixed unforeseen market extension and substitution effects with substitution dominant. [Strong presumption of no protection]
4. Unforeseen substitution effects. [Presumption of no protection]
5. Foreseen substitution effect. [Presumption of protection]
6. Mixed foreseen substitution and market extension with substitution dominant. [Strong presumption of protection]
7. Mixed foreseen substitution and market extension with market extension dominant. [Very strong presumption of protection]
8. Foreseen market extension. [Fully protected]

2. The Cases. Especially in recent years, the issues raised by new technologies have dominated copyright law and have frequently been addressed by copyright scholars. Typically the issue arises in one of two contexts. One involves the use of a new technology and a claim of infringement by the author. This issue can be seen as whether the initial copyright's exclusivity extended to the new use. A decision that it does not means the new user is not infringing. The more common cases are instances in which a grant has been made and the grantor/licensor claims the grant did not extend to the new use.\footnote{123} Here the issue is one of contract interpretation with the focus on what the parties intended.\footnote{124} In these instances, it is not clear that a decision one way or the other has any clearly predictable social consequences. On the other hand, the reasoning involved may be instructive as to whether a more general rule of denying rights to unforeseen extension has evolved.

\footnote{122}{There are also combined effects not illustrated here. The most extreme would be unforeseen expansion combined with foreseen substitution. The combination would have to involve two simultaneously emerging technologies—one foreseen, one not. Although possible, this seems unlikely and is not discussed here.}
\footnote{123}{See generally Hardy, supra note 120.}
\footnote{124}{See, e.g., Bartsch v. Metro-Goldwyn-Mayer, Inc., 391 F.2d 150 (2d Cir. 1968). See generally Joshua A. Tepfer, The Policy Considerations of New Use Copyright Law as it Pertains to Ebooks, 4 MINN. INTELL. PROP. REV. 393 (2003); Rosenzweig, supra note 109.}
In the first group of cases, it makes sense to return to *White-Smith Music.* There, it will be recalled, composers did not claim that manufacturers of piano roles had gone beyond the limits of any licenses. Instead, the manufacturers argued that mechanical reproduction was not an interest reserved for the copyright holders in the first place. The Court held for the manufacturers with reasoning that reveals little in the way of economic logic. Instead, the rationale seems to be that one could not look at a piano roll and read music from it.

How would a more economically-minded Court have decided the case? The vast majority of the compositions under copyright at the time were likely to have been written when piano rolls and other forms of mechanical devices for reproducing music were unforeseen. Thus, both the substitution and market extension effects would have been unforeseen with market extension being dominant. The impact was to make music more accessible in the home. This would put the work in the market-extension-dominating category. A very strong presumption of no protection would follow. Certainly, new technology enabled composers to have greater exposure, but the nature of the compositions had little to do with what was a major shift in the market. In terms of positive externalities, the declining fortunes of composers had far less to do with free-riding than it did with simply being the victim of market shift. The decision meant the avoidance of exclusion and administrative costs that would have followed had recording companies been forced to negotiate for the rights.

In theory, a better approach would have been to distinguish between those compositions recently created and falling within a time period in which piano role production might have been anticipated and those created earlier. This, however, ignores the cost of repeated litigation focusing on the time of creation and the likelihood of the new technology at the time of creation. When all factors are balanced, the result of the case, if not the reasoning, can be reconciled with an economic approach to positive externalities.

This all became moot, of course, in 1909 when Congress granted the rights to composers and set up a compulsory licensing system for works already in recorded form. One can only speculate about the pattern of events if this had not occurred, and it is in this regard that the reasoning of the Court becomes critical. Would the fact that compositions found only in sheet music form could be used without payment have discouraged composing music so that today there would be less original music available? Under the formalistic approach employed by the Court, this seems possible. Under the approach discussed here, however, each

---

125 A good discussion of the history of the case is found in Hardy, *supra* note 120, at 673-77.

126 But unlikely. In the absence of statutory change, what would have happened is not that different from what did happen—sheet music would have become an obsolete method of publication. This seems inevitable. Sheet music is best seen as raw material that is used to produce
composition would be assessed on the basis of what was foreseeable at the time it was created. After a certain point, all compositions would be protected from each new technology within a few years of that technology's inception.

The facts are similar in *Kalem Co. v. Harper Bros.*[^2] but the result is different in that the new use was found to be an infringement. In 1911, Kalem produced a motion picture of Ben Hur, a novel to which Harper held the dramatization rights. In fact, in 1899, Harper contracted to have a play written and granted to a third party the rights to produce and perform the dramatization[^2]. Kalem claimed a motion picture did not fall within the rights held by Harper. Harper sued, claiming the motion picture was an infringement, and the Supreme Court agreed[^129]. At the time the book was written and published, it is not likely that the author or publisher was motivated by the possibility of a film production of Ben Hur[^130]. Motion pictures did exist in 1899 when Harper, with the author's permission, granted the dramatization rights, but it is unlikely that an extravagant film production of a book was foreseeable[^131]. The contract granting dramatization rights limited those rights to "producing on the stage" and to a single approved script[^132]. If one views film production as involving an unforeseen substitution, it appears hard to square with the outcome of the guidelines suggesting that a mild presumption of no protection would be appropriate. The

[^12]: 222 U.S. 55 (1911).
[^128]: Harper found itself at odds with the party—Klaw—to whom it had transferred the exclusive rights to produce and perform a dramatic version of Ben Hur. Klaw also wanted to produce a motion picture and Harper claimed successfully that the rights transferred did not extend to that use. *Harper Bros. v. Klaw*, 232 F. 609 (S.D.N.Y. 1916).
[^129]: The reasoning is markedly different from that found in *White-Smith Music* in that the Court noted the issue was one of methods of presenting the story and that changing the mechanical process did not alter the substance of seeing the "story lived." *Kalem*, 222 U.S. at 61.
[^13]: *Id.*
[^130]: The issue of foreseeability is debatable. For example, in the subsequent case of *Harper Brothers v. Klaw*, the court explained that "There were moving pictures, but it was then completely beyond the known possibilities of the art to produce a series of pictures representing such and so spectacular and elaborate a play or performance as is the Ben Hur of Klaw & Erlanger." 232 F. at 611. That opinion also goes on to treat the revenues from the motion picture as a windfall. Thus, "they are an accretion or unearned increment conferred of late years upon the copyright owners by the ingenuity of many inventors and mechanisms." *Id.* at 613.
[^132]: *Id.* at 610.
result is an increase in the social costs of the copyright above the minimum necessary.

On the other hand, the decision also can be understood as an effort to avoid a competitive imbalance. Stage and motion picture productions were substitute media at the time. A decision that dramatization rights did not extend to motion pictures would mean that those who produced plays would have to pay for the rights while those who made motion pictures would not. In the case, Harper would have paid for the rights to dramatize Ben Hur as a play while the motion picture producers would have acquired the story for free. Thus, while finding that the copyright did not prevent the production of the motion picture is attractive from the point of view of lowering exclusion and administrative costs, there are offsetting costs. It would have amounted to a decision that one producer was required to pay for an input while a competitor was not required to pay for the same input. The outcome would have been a flow of resources into the production of films that was unrelated to the attractiveness of films relative to plays.

Thus, although the case seems inconsistent with *White-Smith Music*, there is an important distinguishing factor. Sheet music is always, or nearly always, a means to an end of creating actual sounds. A novel, its stage adaptation, and a motion picture are all final products and in many cases compete with each other. In *White-Smith Music*, the Court was not faced with deciding between likely competitors for the format in which the final product was to be presented. In *Kalem v. Harper Brothers*, the decision was between competitors. Thus, the decision seems more influenced by a concern for competitive balance rather than authors' incentives.

The new technology issue in *Fortnightly Corp. v. United Artists Television, Inc.*[^33] was in the context of a group of community antenna television systems. The systems "picked up" signals from broadcast stations and transmitted those broadcasts to individual homes. The issue was whether receiving and carrying the broadcast signals to homes amounted to a performance in violation of the copyrights to motion pictures that were broadcast and then retransmitted over the cable system. As an economic matter, the copyright owner was attempting to internalize the benefits of this rebroadcast. The Supreme Court held that it was not a performance and made a distinction between the act of exhibition (performance), which it said broadcasters perform, and viewers, who are passive beneficiaries.[^34] The Court held that the cable system was comparable to viewers who had taken steps to enhance their ability to receive the broadcasters’ signals.[^35]

[^34]: *Id.* at 398.
[^35]: *Id.* at 399. In so doing, the Court distinguished and narrowed *Buck v. Jewett-La Salle Realty Co.*,
The majority opinion reveals little in the way of economic reasoning aside from an initial observation that "the Copyright Act does not give a copyright holder control over all uses of his copyrighted work."\(^{136}\) In terms of a positive externality analysis and the framework explained earlier, the case appears to involve an unforeseen market extension in that new viewers of televised broadcasts were brought into the system.\(^{137}\) Thus, the outcome is consistent with the classification described above.

Interestingly, a facially more economic orientation is found in Justice Fortas' dissenting opinion. According to Justice Fortas, the cable companies were using the property of others and the question for the court was whether "the owner of the copyrighted material should be compensated."\(^{138}\) He notes that the decision is critical for cable television and broadcasting and that "it would be hazardous to assume Congress will act promptly."\(^{139}\) Having created the predicate for a functional approach, he then takes a different path; he asserts that the majority has erred by straying from a relatively bright-line definition of performance in order to foster the growth of cable television. He concludes that "the task of caring for CATV is one for the Congress."\(^{140}\) In effect, the opinion shows a knowledge of the economic approach but an unwillingness to employ it. The majority opinion, on the other hand, announces an economically sensible outcome but reveals no express economic reasoning.

A case that brims with economic reasoning in the new use context is *Sony Corp. of America v. Universal Studios, Inc.*,\(^{141}\) in which the Supreme Court considered the liability of manufacturers of home videotape recorders. The Court held that the manufacturers were not contributory infringers even though purchasers of the machines were known by manufacturers to use them to reproduce copyrighted material.\(^{142}\) The analytical framework was set by the Court's early observation that the plaintiffs in the case "can exploit their rights [in their works] in a number of

---

\(^{136}\) Id. at 393 (footnote deleted).

\(^{137}\) This would probably be true at the time, but we now know that there are substitution effects, and viewers within broadcast range also rely on cable. The issues of free-riding and infringement were treated by the 1976 Copyright Act, section 111 of which provides for compulsory licensing.

\(^{138}\) Id. at 403 (Fortas, J., dissenting).

\(^{139}\) Id.

\(^{140}\) Id. at 408.


\(^{142}\) Id. The Court was influenced by the fact that the two plaintiffs involved—Universal Studios and Walt Disney Productions were not representing a larger class of copyright holders. Id. at 434.
ways: by authorizing theatrical exhibitions, by licensing limited showing on cable and network television, by selling syndication rights for repeated airings on local television stations, and by marketing programs on prerecorded videotapes or videodiscs.\textsuperscript{143} The Court also adopted as a starting point the view that the Court should be reluctant to expand copyright protection to new technology.\textsuperscript{144} It is hard not to infer that the Court was suggesting, in effect, that “enough is enough,” and at some point the copyright holder is overreaching. Clearly, the case was framed as an unforeseen market extension.

In holding that the manufacturers were not liable, the Court adopted a standard from patent law applied to “articles of commerce.” The question is whether the article is capable of “commercially significant noninfringing uses.”\textsuperscript{145} The Court noted the compelling evidence that the principal use of the machines was time-shifting and that a great number of copyright holders affected did not object to the copying. In fact, for many it meant greater exposure of their works.\textsuperscript{146} According to the Court, “to the extent time-shifting expands public access to freely broadcast television programs, it yields societal benefits.”\textsuperscript{147} In considering the works of those who did object, the Court found that there was very little indication that they were harmed by time-shifting.

Ultimately, the Court refused to place the interests of the copyright holders involved over those of non-objecting copyright holders, for whom the machines were beneficial, and the manufacturers. Its reasoning seems to fit a systematic approach to positive externalities. In particular, when adopting the view that the Court should be wary of expanding the scope of protection to new technologies, it cites \textit{White-Smith Music}\textsuperscript{148} and notes the need to avoid protecting authors more than necessary to benefit the public more generally.\textsuperscript{149}

As already noted, the issue of new technologies also arises in the context of disputes about the scope of a license when a method to exploit that license is developed that the parties did not expressly allow for. One possible reaction to these instances would be for a court to find that the use at issue was not granted because it was not within the scope of copyright protection in the first place. This would leave the licensee and anyone else free to exploit the work in that new use. This is not the track these cases have generally taken. Instead, they are governed by standard contract gap-filling rules.\textsuperscript{150} For example, in \textit{Bartisch v. Metro-Goldwyn-}

\begin{footnotesize}
\begin{enumerate}
\item[143] Id. at 421-22.
\item[144] Id. at 431.
\item[145] Id. at 442.
\item[146] Id. at 454.
\item[147] Id.
\item[148] Id. at 432 n.13.
\item[149] Id. at 432-33.
\item[150] For a discussion, see Tepfer, supra note 124; Rosenzweig, supra note 109.
\end{enumerate}
\end{footnotesize}
the issue was whether a grant of the motion picture rights to a work included the right to authorize broadcast of the motion picture on television. At the time of the assignment, television did exist but was in its very early stages.\textsuperscript{152} The assignment included the right to "project, transmit and otherwise reproduce the . . . work or any adaptation . . . thereof, visually or audibly by the art of cinematography or any process analogous thereto."\textsuperscript{153} The assignor was Warner Brothers, which had received an assignment from Bartsch, who acquired the motion picture rights in 1930. Bartsch claimed that the language of the grant and further language that "[a]ll other rights now in existence or which may hereafter come into existence shall always be reserved to the [o]wner" meant that the right to televise had not been included in the 1930 grant and, thus, could not be transferred.\textsuperscript{154}

The court, relying on a 1964 edition of Professor Melvin Nimmer's copyright treatise,\textsuperscript{155} opted for a broad interpretation of the rights granted. It held that the license did include the rights to authorize television broadcast. In terms of narrowing the copyright itself as a means of maximizing social welfare, the case is not of interest. There seemed to be no question that the television rights did exist at the time of the grant.\textsuperscript{156} The only issue was who owned them. Even here, however, the reasoning bears some relation to the classification described above. In finding that the grant had been made, the court noted that in 1930 the possibility of television was well known.\textsuperscript{157} This would put the right in the category of a foreseeable market extension and presumptively part of the scope of rights that the grantor would assign by the use of general language.

The reasoning of the court does, however, reveal some additional economic sophistication and sensitivity to the fact that a proper solution to a private contract matter may affect the public more generally.\textsuperscript{158} Thus, "favoring the

\textsuperscript{151} 391 F.2d 150, 157 U.S.P.Q. (BNA) 65 (2d Cir. 1968).
\textsuperscript{152} Id. at 154.
\textsuperscript{153} Id. at 151.
\textsuperscript{154} Id. at 152. Bartsch's reasoning actually had an additional component. When Bartsch transferred the motion picture rights, these were the only rights he possessed. After the assignment of those rights—first to Warner Brothers and then to MGM—he obtained the rest of the copyright. Thus, he had not transferred the television rights but still had them by virtue of receiving the remainder of copyrights. Id. at 152-53.
\textsuperscript{155} Id. at 155 (citing MELVIN NIMMER, THE LAW OF COPYRIGHT 125.3 (1964)).
\textsuperscript{156} If the work—in the form of a play—had been created in 1930 rather than being transferred, one might treat the case as falling in the foreseeable substitution and protect the television rights for the author against use by someone attempting to televise the play without permission.
\textsuperscript{157} Bartsch, 391 F.2d at 154. The court distinguished Kirke La Stelle Co. v. Paul Armstrong Co., 188 N.E. 163 (1938), a case it classified as dealing with a new use that was completely unknown at the time of contracting.
\textsuperscript{158} The court's principal reasoning is that the risk of inexact language was to be born by the
broader view in a case like this is that it provides a single person who can make the copyrighted work available to the public over the penumbral medium, whereas the narrower one involves the risk that a deadlock between the grantor and grantee might prevent the work’s being shown over the new medium at all.\textsuperscript{159} Although the likelihood of a deadlock preventing televising of the film is low, the court seems to suggest that the costs (transaction costs in this case) of its finding its way to the television screen is decreased by the broader interpretation of the grant.

Taking the new use chronologically one more step is \textit{Cohen v. Paramount Pictures Corp.}\textsuperscript{160} At issue was a musical composition, the rights to which were transferred for use in a film and on television. When the holder of those rights made copies of the film (and music) on videotape, the owner of the copyright to the composition claimed it was an infringement. The court held that videotape use was not within the scope of the contract even though the video would be viewed on television sets. The critical phrase in the grant was “exhibition by means of television,” which the court said could not include videocassettes since they had not been invented at the time of the contract. Of course, they also had not been invented and were evidently unforeseeable at the time the music was composed.

Thus, the court was faced more or less with a windfall either for the copyright holder or the licensee. According to the court, the licensee should not “‘reap the windfall’ associated with the new medium.”\textsuperscript{161} The court also reasoned that the contract language reserving “all rights and uses in and to said musical composition, except those herein granted to the licensee” meant that unknown videocassette rights could not have been granted.\textsuperscript{162} This is not an unreasonable approach, but the court stumbles badly when seeking policy support for its holding. It goes on to assert that the Copyright Act was “enacted for the benefit of the composer.”\textsuperscript{163} The case appears to be one of an unforeseen market extension since the use of the song in a videotape of a film that the composition was not written for in the first place is sufficiently remote to have had no impact on the incentive to create. Moreover, it is not clear that a decision favoring the filmmaker would have any great impact on future composers. As long as one adheres to the foreseeability guideline, current and future composers will be unaffected by decisions as they relate to particular new uses. Again, however, in

\textsuperscript{159} Id.

\textsuperscript{160} 845 F.2d 851, 7 U.S.P.Q. (BNA) 1570 (9th Cir. 1988).

\textsuperscript{161} Id. at 854 (quoting Comment, \textit{Past Copyright Licenses and the New Video Software Medium}, 29 UCLA L. REV. 1160, 1184 (1982)).

\textsuperscript{162} Id.

\textsuperscript{163} Id. at 855 (quoting Jondora Music Pub’g Co. v. Melody Recordings, Inc., 506 F.2d 392, 395, 184 U.S.P.Q. (BNA) 326, 328 (3d Cir. 1974)).
a case like this and other contract cases, it is not clear there is much of an impact on social welfare. Ultimately, the issue is not between the author and free access but a conflict between two parties both of whom have an interest in exploiting the work by limiting access of the public more generally.

A recent new technology case involving a contract dispute is New York Times Co. v. Tasini.\(^{164}\) The issue was actually a rather narrow one. Freelance writers licensed publications to print their articles as part of their newspapers and magazines. These articles would appear in the print media among other articles. The publishers then made the articles available in electronic and CD-Rom databases that enabled researchers to "pull up" and read the articles independently—not as part of the original publication. It was this reproduction the authors objected to. The response of the publications was that they were exercising their rights with respect to collective works. Under Section 201(c) of the 1976 Act:

In the absence of an express transfer of the copyright or of any rights under it, the owner of copyright in the collective work is presumed to have acquired only the privilege of reproducing and distributing the contribution as part of that particular collective work, any revision of that collective work, and any later collective work in the same series.\(^{165}\)

In other words, they argued that including the articles as a part of databases was merely a revision of the original collection.

The Court ruled for the authors, using exclusively a formalistic analysis similar to White-Smith Music and focusing on what an article would look like when pulled up from a database as opposed to being viewed in the context of the original publication.\(^{166}\) The dissenting opinion, authored by Justice Stevens, initially applies the same form of analysis, initially describing how databases can be viewed as revisions.\(^{167}\) After this discussion, however, the dissent begins to reveal an approach more in keeping with a rational approach to positive externalities. According to Justice Stevens, it is unlikely that the drafters of the 1976 Copyright Act anticipated the use of electronic databases when considering section 201. Accordingly, it was up to the Court to interpret that section in a way that was consistent with copyright policy more generally. Quoting Melvin and David Nimmer, Justice Stevens writes: "[t]he primary purpose of copyright is not to

---

\(^{166}\) Tasini, 533 U.S. at 501-04.
\(^{167}\) Id. at 511-18 (Stevens, J., dissenting).
reward the author, but is rather to secure ‘the general benefits derived by the public from the labors of authors.’” He argues that the majority decision “subverts” that goal in favor of “authorial rights.” Justice Stevens, joined by Justice Breyer, expresses a willingness to include in the balance the impact the majority’s interpretation will have on the access of the public to the articles. Against this decrease in access, he notes that it is not clear that the authors gain anything other than retrospective statutory damages. In short, the dissent was willing to take the economic route and concluded that the interpretation by the majority simply increased costs to the public without increasing the incentive of freelance authors.

The overall impression one has from the new use cases is that there is little to connect their reasoning to the goal of minimizing social costs. There are instances in which the decisions are consistent with that outcome, but this may be more happenstance than anything else. Perhaps the economic rationality is a bit more pronounced than in the case of copyright duration, but it would be incorrect to claim that any meaningful trend has developed.

C. FAIR USE

A third method that has the capacity to adjust copyright to achieve the “no more costly than necessary” goal is fair use. Fair use can lower social costs by reducing unnecessary exclusivity and lowering transaction costs. In addition, a clearly stated and understood policy can lower administrative costs. Fair use differs from duration and new use jurisprudence in two ways. First, it has the potential to be the scalpel of copyright law. It can be applied to particular uses of particular works and, in many instances, will not create broad-based rules. In effect, fair use rulings can be more contained in their implications than rulings about duration or new uses. Of course, a policy of liberal or conservative applications of fair use generally can have the impact of a broad rule. Second, the Copyright Act includes a fairly detailed description of when fair use is to be applied, and the elements listed can easily be interpreted in a way that promotes positive externalities at the lowest cost.

---

168 Id. at 519; 1 MELVIN NIMMER & DAVID NIMMER, COPYRIGHT § 1.03[A] (2000) (quoting Fox Film Corp. v. Doyal, 286 U.S. 123, 127 (1932)).

169 Tasini, 533 U.S. at 522.

170 Id. The dissent noted that the New York Times had started in 1995 requiring freelance authors to agree to grant the Times “electronic rights.” Id. at 522.

171 For a thorough analysis of fair use from an economic perspective, see Wendy Gordon, Fair Use as Market Failure: A Structural and Economic Analysis of the Betamax Case and its Predecessors, 82 COLUM. L. REV. 1600 (1982).

The lowest-cost requirement here entails allowing others to use the copyrighted works of authors as long as the internalized benefit remains sufficiently high to provide the incentive to create. Again, the policy must be forward-looking as well as backward-looking. A backward-looking perspective alone will always counsel in favor of broad subsequent use because the work already exists. On the other hand, the subsequent use must not be so broad that it undermines authors of yet-to-be-produced works. Thus, in many respects the application of fair use has some of the character of new use policy in that the goal is not to violate the reasonable expectations of authors.

From an economic perspective, an important distinction can be made between commercial and non-commercial uses. When the work for which fair use is claimed is used in a context in which payment could not be made, most of the costs of exclusivity are decreased by allowing the use without any substantial impact on the incentives of authors. A fair use policy that consistently permits non-commercial uses lowers the social costs of copyright law. This view conforms to the statute itself. The first element of the four-part test focuses on "the purpose and character of the use, including whether such use is of a commercial nature or is for nonprofit educational purposes." "Purpose and character" in this context refers to the Act's provision that uses for "criticism, comment, news reporting, teaching, ... scholarship, or research [are] not an infringement of copyright." A non-commercial use is also likely to be consistent with the fourth prong of the fair use analysis. The focus of that prong is "the effect of the use upon the potential market for or value of the copyrighted work."

A more difficult question is how to assess fair use when that use is commercial. The problem is that, in the context of a commercial use, presumably the work is an input no different from any other. In those contexts, the basic theory is that the allocation should be determined by a private transaction and a fair use not permitted. This moves the transaction costs to private parties and insures that the work is allocated efficiently. Still, there are at least four instances when fair use should be permitted in the commercial context. When transaction costs are high and the fair user attributes greater value to the use of the work than the loss suffered by the original author, it can be efficient to permit the fair use. This is an application of the Kaldor-Hicks efficiency standard. The problem,

---

173 If there is no market for the work in its fair use, this does not mean the author still may not prefer that it not be available in that use. Thus, it is possible that the author is worse off when a non-commercial use is permitted. Still, these instances are likely to be the exceptions.

177 See generally JEFFREY L. HARRISON, LAW AND ECONOMICS 59-60 (2002).
as has been noted, is that Kaldor-Hicks has more potential when an involuntary transfer does not produce additional consequences. In the context of intellectual property, involuntary transfers to other commercial uses can undermine author incentives. Consequently, a transfer based on transaction cost problems alone is something to be approached with great caution.

Second, there may be instances in which the fair use is commercial but the user is unable to fully internalize the gains from the fair use. In these instances, the value of the fair use may exceed the original author's loss, but that value may not be reflected in the price the fair user is able to pay in a private transaction. Here, the transaction would not have occurred at any price, so it is not really the case that transaction costs are reduced. An involuntary transfer should not undermine incentives, because the market transaction that occurs is not one the author could have made. On the other hand, this application does lower the costs of exclusivity.

Third, there are instances in which a possible fair use is entirely commercial. Here the analysis very closely tracks the new use analysis. From an economic perspective, the question is whether allowing the fair use will decrease incentives sufficiently to offset any benefits from the use by the new author. The operative considerations here are the bargain between the state and the author, the author's reasonable expectations, and foreseeability. A use that usurps a market the author would have anticipated exploiting can have a negative impact on incentives. On the other hand, there is little reason not to permit fair use when the use involves a market the author would not have counted within an expected income stream when creating the work. But differently, if fair use were not applied and the author compensated, could that compensation be viewed as a windfall?

There is one more possibility that fits the wholly commercial category. Suppose the new use is one that the copyright holder knows exists but would never exploit herself. For example, the author of a book probably would not write a review of it or create a parody that holds the original work up to ridicule. Such an effort could undercut the value of the original work in the eyes of the public. On the other hand, although that use is likely to have a negative effect from the point of view of the original author, it might also result in significant social benefit. Efforts to purchase the rights by the potential fair user may fail, not because the social benefit does not exceed any harm to the author, but because the author holds monopoly power with respect to the work. In fact, "harm to the author" is a somewhat misleading framework within which to analyze this. Intellectual property, unlike conventional property, is not consumed. Thus, copyright holders cannot link their losses to mutually exclusive uses. This

"hold out" by the monopolist is a form of transaction cost that can be avoided by permitting fair use in those instances in which monopoly power is used to block socially beneficial uses. Section 107 of the Act captures this idea with the list of non-infringing uses that includes "criticism, comment, news reporting, teaching, . . . scholarship or research."179

Steps one and four of the statutory fair use analysis—the nature of the use and the impact on the market for the original—are largely consistent with a rational approach to positive externalities. Steps two and three of the fair use test are not as obviously subject to economic tests. Step two—"the nature of the copyrighted work"—has been interpreted to mean that certain works are "closer to the core of intended copyright protection."180 The idea is that fictional works are to be protected more than those based on fact. Or, the greater creativity found in a work, the less likely that a user without permission will be able to successfully claim that he or she made a "fair use." This step blends into the general idea of protecting works when the social benefits exceed the costs.181 One of the reasons for not protecting ideas, facts, and scenes afaire at all are that the social costs associated with exclusivity are relatively high. Although "close or not close" to the core may suggest "important or not important," in actuality works that are not close to the core are so important that people cannot exclude others from their use. Thus, a liberal application of fair use when works are not "closer to the core" clearly lowers costs associated with exclusivity in a context in which those costs could be quite high. From the economic/cost reducing perspective, the third part of the test—"the amount and substantiality of the portion used in relation to the copyrighted work as a whole"182—is primarily important in not extending fair use so far as to essentially undercut the incentives of the original author. In effect, it puts a limit on the amount that can be taken so that it does not exceed that which is needed for the socially beneficial use.

In general, Section 107 of the Act dovetails very nicely with an economic approach to positive externalities except in one important respect. As already noted, step four of the analysis examines the impact of the potential fair use on the value of the original work, a process that has a chicken-and-egg character to it. The value must be determined in order to assess the impact of the use, but the value itself is a function of the breadth of protection including what uses are to be regarded as fair uses. A positive externalities approach avoids the question by

182 See supra text accompanying notes 5-9.
asking in a more direct way what the impact will be of a finding of fair use on the social cost of protecting the work and the incentive for future producers.

The fact that fair use standards can be interpreted to reflect an economically rational approach to positive externalities is a different matter than whether they actually have been interpreted in this way. The leading Supreme Court discussion of fair use to date is found in Campbell v. Acuff-Rose Music, Inc. The facts, no doubt familiar to even those with a passing interest in copyright law, involve the use by the rap group 2 Live Crew of the Roy Orbison song “Pretty Woman.” The rights to the song were held by Acuff-Rose. The case is an excellent one for analysis because the use is extensive and exclusively commercial. In addition, private transaction costs were likely to be low and the users likely to fully internalize any gains from the use. In these instances it is likely that the parties themselves could bargain to determine the most efficient use of “Pretty Woman.”

Two aspects of the Court’s opinion are particularly significant. First, in applying the first step of the fair use test, the Court held that parody was the type of “purpose” that would cut in favor of finding that the use was “fair.” In effect, parody is commentary and has the potential to be transformative. Second, with respect to the fourth test, the Court noted that a transformative use is unlikely to have an impact on the market for the original work by virtue of acting as a substitute. The Court also noted that the effect of decreasing demand as a result of criticism is not equivalent to substituting one work for another. This is a critical point and in keeping with the treatment of conventional property. In effect, just as one’s property right in the conventional sense does not extend so far as to stop others from commenting about how that property is used, intellectual property rights also cannot be used to block commentary. In this case, the reasoning of the Court tracks very closely a positive externalities approach. There are actually two related ways to reach this conclusion, First, because intellectual property can be used to satisfy two different demands simultaneously, 2 Live Crew’s version of “Pretty Woman” was unlikely to have an impact on the ability of Acuff-Rose to further exploit the work in any market reasonably anticipated by the composers. In effect, by limiting Acuff-Rose’s exclusivity,

185 2 Live Crew attempted to purchase the rights to make a record of a parody of “Pretty Woman” and were refused. Id. at 572.
186 Id. at 579-81.
187 Id. at 590-92.
188 The Court ultimately reversed the Court of Appeals, holding that the use was not a fair use on the basis of that court’s erroneous view that the commercial nature of the parody, in light of the first step of the four-factor test, made the use presumptively unfair. Id. at 594.
189 The Court did, however, note the possibility that the work could impact Acuff-Rose’s ability to license the work to others desiring to create a rap version. The failure of 2 Live Crew to address
social welfare was increased without a cost to Acuff-Rose. Second, even though the parody might decrease the demand for the original, demand-decreasing works are not the type that the author would have originally exploited, and the value to society of commentary leading to spending decisions is higher than gains internalized by the authors as a result of decreased information.  

The Court’s earlier decision in Harper & Row, Publishers, Inc. v. Nations Enterprises is also one that can be squared with a positive externalities approach. The case dealt with President Ford’s memoirs that were to be published as a book. An excerpt was also to be published by Time magazine. The Nation came to possess portions of the manuscript prior to either authorized publication and used them in an article that essentially scooped Time. Here, The Nation sought the shelter of “fair use,” arguing that its publication was news. An important aspect of the opinion is the Court’s handling of the argument that as an unpublished work, fair use should be applied more liberally. The Court rejected this view, applied the four-factor test and held that the use was not fair. In effect, the use was commercial and had an instant impact on the market for the rights to the work. There was little public benefit to prepublication by The Nation. Whatever benefit there might have been was clearly offset by the negative effect on incentives of a holding that one may steal the commercial property of an author and sell it with impunity.

A more controversial recent case in which the economically correct call is a closer one is Suntrust Bank v. Houghton Mifflin Co. The fair use issue arose with respect to the book “The Wind Done Gone,” which, as the title suggests, was a parody of “Gone With the Wind,” told from the point of view of a slave. “The Wind Done Gone” specifically addresses the cultural biases and inaccuracies of the original work by retelling the story. The Court of Appeals for the Eleventh Circuit held that the new book did constitute a “fair use.”

The commercial purpose of the new work at least creates the possibility that finding that it is a fair use will have an impact on demand for the original work and on the incentives of future authors. Here that possibility would be weighed against the decreased exclusivity with respect to the original work and the social gains from a commentary of possible significance. A general rule that a work may be “mined” in order to produce another work that ridicules the first work can have a disincentive effect. The danger would be that the second author could

---

190 For a subsequent application of Acuff-Rose, see Leibovitz v. Paramount Pictures Corp., 137 F.3d 109, 45 U.S.P.Q.2d (BNA) 1834 (2d Cir. 1998).
192 268 F.3d 1257, 60 U.S.P.Q.2d (BNA) 1225 (11th Cir. 2001).
193 The court applies a broad definition of parody to include an effort to “comment.” Id. at 1268.
194 Id. at 1276.
essentially free-ride on the original in order to write a shadow version of that work that undercuts the popularity of the original. In fact, it may even alter the theme and expression of future original fictional works, especially those with historical bases. On the other hand, the threat may also encourage the author purporting to offer something that is historically accurate to use greater care.

In the context of "Gone with the Wind," this analysis seems strained because the work already existed and has been extensively exploited. Thus, it bears emphasizing that the issue is what the impact is on future "Gone With the Wind" authors. Here, there are market elements that decrease the disincentives a finding of fair use may give rise to. By its nature, a parody can only be successful if the consuming public is familiar with the original work; parodies—whether in music or literature—are produced about works that are widely known and usually known in some detail. In effect, most authors are likely driven to create works that are successful enough that a parody of that work by another author would make economic sense. The possibility of a parody, even one that borrows heavily, is unlikely to keep an author from writing the most popular work possible.

This does leave the strained possibility that an author makes tremendous efforts to create an enormously popular work because he or she then anticipates the opportunity to sell the "parody rights" to that work. A finding of "fair use," so the argument might go, would mean there is less to "sell" by creating the work and therein lies a disincentive. In the context of "Gone with the Wind," this was almost certainly not the case. In the context of future authors, it seems unlikely to be what, at the margin, motivates their creativity. Moreover, a view that the author owns the "parody rights" can be a socially costly one. It may effectively block important commentary resulting from the original author’s refusal to sell or from transaction costs stemming from bilateral monopoly conditions.

When these factors are balanced, the court in *Suntrust* seems to have made the right decision from the point of view of minimizing the costs of the copyright-worthy work. This is not to say, however, that the court expressed itself in terms that suggested an economic orientation toward social benefits and positive externalities. The one noteworthy exception is its analysis of the fourth prong of the fair use test—"the effect on the market value of the original." In that discussion, the Court focuses on the impact on the value of derivative rights to

---

195 It is important to remember that the parody must be of the work itself. The generalized use of a work to ridicule a third work or to make a more general commentary is usually not a fair use.
196 In the unlikely event an author decided to create a parody of an unpopular work, it would be difficult for the author of the original to show that the market had been diverted by the parody.
197 As an economic matter, conditions under which there is one buyer and one seller can give rise to strategy behavior and an impasse.
198 *Suntrust*, 268 F.3d at 1274.
"Gone With the Wind." It notes that whatever value there may be with respect to these rights is greatly diminished by the fact that the work was nearing the end of its copyright term.\textsuperscript{199} From an economic perspective, the application of fair use near the end of a copyright term will be less costly in terms of author incentives than an early term application.

Less encouraging from the standpoint of a rational positive externalities approach to copyright is the decision of a panel of the Second Circuit Court of Appeals in Rogers v. Koons.\textsuperscript{200} Jeff Koons, a sculptor, created a work based on a photograph by Art Rogers of a group of puppies. There was no question that Koons copied Rogers's work carefully except that it was a large multi-colored sculpture. Koons's "fair use defense" was based on parody. Here the court defined parody as "when one artist, for comic effect or social commentary, closely imitates the style of another artist and in so doing creates a new art work that makes ridiculous the style and expression of the original."\textsuperscript{201} The court found that Koons failed the test because the work was intended to be a more general commentary on the superficiality of society at large.\textsuperscript{202} This particular finding seems somewhat extraordinary. One wonders how Koons could use the original work to comment on American tastes and not be commenting on the work he uses to illustrate the point. The case is quite different from the typical one in which a party uses the style of an original work\textsuperscript{203} or the melody of a song to make fun of a completely different work.

The court's reasoning with respect to the fourth fair use test—the impact of the value of the original—is even more puzzling. According to the court, the test is "whether defendants ... planned to profit ... without paying ... for the use of [the] photo."\textsuperscript{204} Whether the defendants planned to profit is a different question from the impact on the value of the original work and on the incentives of the author. It is also suggested that Koons's use reduced the value of the photograph. Of course, as the Supreme Court noted in Acuff-Rose, reduced demand stemming from ridicule or criticism is not something from which copyright protects the author.\textsuperscript{205} In a broader context, a decision the other way would have lowered the costs of exclusivity and transacting while having little if any significant impact on the demand for Rogers's work other than the possibility of exposing its superficiality. The decision seems off-base from an economic

\textsuperscript{199} Id. at 1275.
\textsuperscript{200} 960 F.2d 301, 22 U.S.P.Q.2d (BNA) 1492 (2d Cir. 1992).
\textsuperscript{201} Id. at 309-10.
\textsuperscript{202} Id. at 310.
\textsuperscript{204} Rogers, 960 F.2d at 312.
\textsuperscript{205} See supra text accompanying notes 184-90.
perspective, and there is language in the opinion that suggests the court was simply disgusted with Koons.\textsuperscript{206}

A final case and a closer one in terms of positive externalities is \textit{Princeton University Press v. Michigan Documents Services, Inc. (MDS)}\textsuperscript{207} The case deals with the production of "coursepacks" or collections of photocopied materials for classroom use. The Copyright Act itself provides that copying "for purposes . . . [of] teaching (including multiple copies for classroom use) . . . is not an infringement."\textsuperscript{208} As the court notes, the determination of whether any particular use, including an educational use, is a fair use depends on the four-factor analysis. The defendant, the manufacturer and seller of coursepacks, argued that the activity was a fair use. In a deeply divided \textit{en banc} opinion, the Court of Appeals for the Sixth Circuit held that it was not.

A critical element of the court’s analysis was the fourth step of the fair use test. The majority was persuaded that there was an impact on the value of the original by virtue of the fact that publishers often charged licensing fees to those who copied from their publications.\textsuperscript{209} The dissenting judges argued that the students could have photocopied the works on their own and that would have been a fair use.\textsuperscript{210} The use of a third party to perform the same function, so the argument goes, does not change the substance of the use and actually lowers the costs to the students. In fact, from this point of view, the copy centers simply facilitated a fair use in a manner that was substantively no different from someone delivering a book to a student who later photocopies part of it. Moreover, since professors assigning the coursepacks would not require the students to purchase the books in which specific articles were found, there would be no impact on the market for the original. The dissent’s argument on this point is a tad overstated. Nothing in the majority opinion will require students to photocopy their materials. They can do that or they can pay a copy center to do the same thing and pay a price that reflects a licensing fee. When done by a copy center, whatever efficiencies result from mass copying will not be lost.

The case presents a number of interesting wrinkles. First, how can one know whether a use lowers the value of a work without first knowing that value—a determination that depends on the fair use decision itself? Second, although the publishers may have received licensing fees, there appears to be no indication that particular articles were written by authors or included in specific collections by publishers as a result of potential licensing fees. Still, the fees are beneficial to

\textsuperscript{206} Rogers, 960 F.2d at 303-05.
\textsuperscript{207} 99 F.3d 1381, 40 U.S.P.Q.2d (BNA) 1641 (6th Cir. 1996).
\textsuperscript{209} MDS, 99 F.3d at 1386-88.
\textsuperscript{210} Id. at 1393-94.
publishers and likely to make it possible to publish more than would otherwise be the case. Third, while the ultimate use by the students was noncommercial, the intermediate copying was a commercial endeavor. Finally, in many respects, the publishers were serving the same function as MDS in that they collected and made available the creative works of others.

A positive externalities approach is able to side-step some of these interesting questions and focus on the specific issue—given that the photocopied works are worthy of protection, what is the minimum social cost that will assure their production? More specifically, at the margin, is the licensing fee necessary to bring these works to market? First, as far as the actual authors are concerned, this seems unlikely. As noted in the case, most academic writing is not done in hopes of obtaining a profit from limited circulation. Writing of that nature is largely motivated as part of a job requirement and by potential professional advancement.

Second, with respect to publishers, does the potential for licensing fees increase the likelihood of specific works becoming available to the public? This is a different question from whether the publishing industry is healthier or whether the volume of works published will increase. No doubt the ability to collect licensing fees is beneficial to the industry. On one hand, the health of the industry is disconnected from an incentive to publish particular articles within a collection of works. This makes the majority decision in MDS look more like an effort to subsidize publishers generally without regard to what is published and any incentive effects on authors. This may be a laudable goal, but “industry subsidization” seems outside the scope of the Copyright Act. On the other hand, a licensing fee right may make publishers sensitive to works that are likely to be the subject of reprinting requests. At least in theory, creating an incentive to publish works that are likely to be important to students and their instructors may itself be the source of a substantial public benefit.

On balance, MDS is a hard one to call. Even though the Copyright Act itself does not have a generalized industry subsidization goal, the question can be raised as to whether a positive externalities should factor this in. There is good reason for addressing the question. Copyright is ultimately about public goods, and in the context of many other public goods a general subsidization is necessary for the good or service to be produced at all. In the case of publications like those involved in MDS, however, this may be a point that is ultimately irrelevant. Increasingly, works like those found in university press publications are available at various internet web sites for little or no charge. In effect, technology seems well on the way toward supplanting ordinary hard-copy publications. In sum, while the licensing fee may not be the lowest-cost method of providing the necessary incentives to encourage production of original works, it may also
ultimately become irrelevant as a result of technological changes and market adjustments.

Unlike copyright duration and the reactions of courts to new uses, "fair use" analysis is often quite consistent with a positive externalities approach to copyright. There is no question that the statute itself provides important guidance in this regard. Most important is the express requirement that market impact be part of a court's consideration.

VI. SUMMARY

Negative externalities result from activities that harm third parties. Contract law, tort law, and, to some extent, criminal law are often seen as economically rational responses to these harms. The principal goal is to insure internalization of these costs by the party causing them so he or she may make a decision about whether the benefits of the activity outweigh all the costs. Those responsible can pay for the harm or take measures to avoid the harm. In some instances, the economically rational outcome is for the harm to occur. Thus, the goal is not simply to avoid harm but to minimize the cost of the harm and measures taken to avoid it. There are actually two steps to the analysis. First, what harms should be avoided? Second, how can those harms be avoided at the lowest cost?

This Article is an effort to "flip" this analysis to positive externalities and apply it to copyright law. As with negative externalities, there are two crucial questions. First, when do the benefits of protecting a creative effort exceed the social costs of doing so? The social costs are those associated with exclusivity, administering the copyright system, and any increase in transaction costs resulting from the protection. The second question is how to protect the work and incur the lowest possible social cost.

The principle focus of this Article is to assess the success or failure of copyright law to live up to this "positive externalities" approach. When it comes to the question of which works to protect, copyright law performs surprisingly well. Doctrines like scenes a faire, the uncopyrightability of facts, and the idea/expression distinction go a long way toward avoiding costs associated with exclusivity without creating disincentives. Flexibility in defining the "thinness" and "thickness" for protection is also used to effectively address this first question. In general, whether through evolution, reasoning, or coincidence, the rules that have emerged tend to resemble those to which an economic approach would lead.

Copyright law performs far less well when it comes to protecting works at the lowest possible social cost. In order to make this assessment, three specific areas of the law were examined. Theories were presented for each with respect to how a positive externalities approach would be applied. The first area was copyright
duration. Here there appears to be no connection between the period of protection and minimizing the costs of protection. Copyright terms are actually indeterminate and far longer than necessary to protect most works. The excessive time probably adds little to the store of creative works, but creates substantial risks of prolonged and expensive battles over the revenues produced by a work.

The treatment of new uses and new technology fair only slightly better than copyright terms. The critical issue in this context is foreseeability. New uses that are unforeseeable and extend the protected work into a new market are irrelevant to creative effort and can result in social costs. It is in this area that courts seem to stick to formalistic line-drawing without a great deal of sensitivity to policy. This is not to say that the outcomes are always inconsistent with a positive externalities approach. Even when they are, however, the reasoning does not engender a great deal of confidence that a rational and predictable social welfare-maximizing perspective is at work.

The final area examined—"fair use"—presents quite a different story. The doctrine is generally applied in a manner that is consistent with reducing the social costs of protecting copyright-worthy materials. Largely guided by the statute itself, which dovetails with a positive externalities approach, courts exhibit a sensitivity to how much "fair use" can be permitted before there is an unacceptable impact on incentives. The places for error in this analysis stem from two sources. To some extent, courts may focus on the benefits to a fair user as opposed to the harm and disincentive to the original author.\(^{211}\) Second, in some instances, the reasoning and outcomes could be improved by a broader perspective assessing whether disputes actually have implications for future creativity or are simply struggles over the distribution of profits.\(^{212}\)

\(^{211}\) Although the profits earned as a result of an infringement are recoverable along with damages this is part of the remedy for infringement. The test for whether there is an infringement does not factor in the benefits to the alleged infringer independent of harm to the author. A close reading of Rogers v. Koons, see text at notes 200-06, supra, suggests the court may have been as concerned with the profit made by the infringers as it was with the impact on the author of the original.

\(^{212}\) See generally Harrison, supra note 24.