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# Reconciling Original with Secondary Creation: The Subtle Incentive Theory of Copyright Licensing

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# RECONCILING ORIGINAL WITH SECONDARY CREATION: THE SUBTLE INCENTIVE THEORY OF COPYRIGHT LICENSING

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*Copyright literature has been long familiar with the lack of licensing choices in various creative markets. In the absence of a lawful licensing alternatives, consumers of works as well as secondary creators wishing to use protected elements of preexisting works are often left with no choice but to either infringe on the copyright of the rightholder or refrain from the use. As further creation is regularly impeded, the dearth of licensing greatly conflicts with the utilitarian foundation of copyright and its constitutional goal to promote creative progress. Legal scholarship has submitted various recommendations in response to the licensing failure, homing in on one of two approaches: (1) an aggressive intervention through compulsory licensing or levy systems to facilitate secondary use and consumption while remunerating rightholders, and (2) a passive approach that counts upon the invisible hand of the market to develop the most efficient licensing solutions or appropriate bypasses. This Article contributes to the ongoing discourse by introducing a third, middle ground approach: the subtle incentive theory of copyright licensing.*

*The subtle incentive theory encourages rightholders to engage in licensing by considering the lack of licensing alternatives in the market for a particular work as a mitigating factor in the fair use analysis. Specifically, the subtle incentive theory propounds the mirror image of a test that was already mandated in *American Geophysical Union v. Texaco* in the mid-1990s, but which has since then been used exclusively to deny fair use. By so doing, the subtle incentive theory mends a logical error in fair use reasoning and promotes a better creation market by making a zero-cost doctrinal change to ameliorate copyright licensing shortfalls. While the subtle incentive theory avoids aggressive interference in market dynamics and respects rightholders' proprietorial choices, it does not leave the licensing failure to be repaired exclusively by the market, and adds an important policy statement as to the significance of original and secondary creation alike.*

## I. INTRODUCTION

The United States Constitution grants authors an exclusive right to their works to promote utility by encouraging further creation.<sup>1</sup> It is not the

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mere endowment of the right that is at the root of the incentive - it is the promise of the reward. This promise bears little economic value until the work is demanded and an interested user is willing to remunerate the rightholder for the use. Indeed, it is the licensing of a work<sup>2</sup> — the agreement between a rightholder and a user to use the work in accordance with a set of stipulated terms— that lies at the heart of the utilitarian approach to copyright. Against this backdrop and the large, unsatisfied demand, the lack of licensing possibilities in various creative markets is puzzling and disturbing. The demand for accessible and efficient licenses persists in the realm of copyright, despite occasionally fluctuating and moving between creative markets. Often, this demand is satisfied by rightholders who recognize the economic potential of their work.<sup>3</sup> This is especially true for professional authors – they may create a work and license it in return for future, agreed-upon earnings.<sup>4</sup> Alternatively, they may entrust a preexisting work to those who are professionally marketing and distributing similar works.<sup>5</sup> Nevertheless, in some markets and for some uses, the demand for accessible and efficient licenses has not been met. Reasons for the undersupply vary and include rightholders’ being unaware of possible demand for licenses, the emergence of new markets that entail continuous market adjustments and business adaptations that may not be financially justified from the outset, and rightholders’ reluctance to engage in licensing for non-economic reasons.<sup>6</sup>

When a license is not readily available a prospective user will most likely find the road to licensing to be long and discouraging. A user in such scenario would have to identify the rightholder, locate her, contact her, and either get a quote for the licensing fee or reasonably negotiate a license. Copyright divisibility, which confers upon rightholders a package of individual rights that correspond to specific categories of use, further complicates the process and often forces the user to obtain multiple clearances for a single work.<sup>7</sup> Moreover, investment in licensing attempts is highly uncertain, because even once the rightholder(s) is identified, located, and reasonably negotiated

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<sup>1</sup> U.S. CONST. art. I, § 8, cl. 8 (defining legislative branch’s role regarding copyright and patent).

<sup>2</sup> This Article uses the term “license,” but refers to any legal form of authorized use, paid or unpaid, that is based on a transaction between a rightholder and a user.

<sup>3</sup> This Article uses the term “rightholders” or ‘copyright holders’ to refer to the licensor and not to the licensee, who may become a rightholder under a valid license.

<sup>4</sup> A common example of such license is book-publishing agreements.

<sup>5</sup> This is mainly true for the music industry, but also to book publishers.

<sup>6</sup> Wendy J. Gordon, *Fair Use as Market Failure: A Structural and Economic Analysis of the Betamax Case and Its Predecessors*, 82 COLUM. L. REV. 1600, 1630-32 (1982) (hereinafter: *Gordon, Fair Use as Market Failure*)

<sup>7</sup> Jessica Litman, *Real Copyright Reform*, 96 IOWA L. REV. 1, 20 (2010). See also Genevieve P. Rosloff, *"Some Rights Reserved": Finding the Space Between All Rights Reserved and the Public Domain*, 33 COLUM. J.L. & ARTS 37, 49 (2009)

with, permission is not guaranteed due to the proprietary entitlement of copyright, which leaves the licensing choice in the hands of the rightholder.<sup>8</sup>

The digital age, in this respect, should be perceived as a great promoter of licensing possibilities as it allows both rightholders and users to economize communication and information costs.<sup>9</sup> Surprisingly, however, the Internet and the inception of digital technology have also motivated a growing licensing demand by exposing additional markets for works and allowing more people to engage in the creative process. Contrary to the early days of the Internet, when content was provided to passive consumers exclusively by professional contributors, users now actively interact and collaborate with each other as creators of what is known as User-Generated Content (UGC).<sup>10</sup> Naturally, the recently opened gate brought through not only boundless information, but also massive copyright infringement, which rightholders attempted to fight in various ways. On top of traditional lobbying and litigation tactics, informal practices arose, some of which involved licensing to ex-ante ratify infringing UGC.<sup>11</sup> Nevertheless, the demand for licensing still exists in the UGC market, with many Internet users in various forums and discussions groups all repeating one pressing question: “Is there any semi simple way to get permission?”<sup>12</sup>

A similar licensing shortage exists in orphan works. An orphan work is defined as a copyrighted work whose owner cannot be identified or located to authorize a use by a potential licensee wishing to employ the work lawfully

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<sup>8</sup> See *infra* notes 59-60 and accompanying text.

<sup>9</sup> Chris Forman, *The Corporate Digital Divide: Determinants of Internet Adoption*, MANAGEMENT SCIENCE, Vol 51, no. 4, 641, 643 (2005) (“The Internet has offered potentially significant savings in communication costs between geographically dispersed establishments.”). As costs are minimized through technological means and via the successful operation of collecting societies like the Copyright Clearance Center (“CCC”), some scholars proposed that the fair use doctrine could no longer be justified solely on the grounds of reducing transaction costs. For such views see for example, Tom W. Bell, *Fair Use vs. Fared Use: The Impact of Automated Rights Management on Copyright's Fair Use Doctrine*, 76 N.C. L. REV. 557 (1998); Robert P. Merges, *The End of Friction? Property Rights and Contract in the “Newtonian” World of On-line Commerce*, 12 BERKELEY TECH. L.J. 115, 130 (1997). For the opposite view see Wendy J. Gordon & Daniel Bahls, *The Public's Right to Fair Use: Amending Section 107 to Avoid the “Fared Use” Fallacy*, 2007 UTAH L. REV. 619 (2007), and Lydia Pallas Loren, *Redefining the Market Failure Approach to Fair Use in an Era of Copyright Permission Systems*, 5 J. INTELL. PROP. L. 1 (1997) (hereinafter *Loren, Market Failure*).

<sup>10</sup> Yafit Lev-Aretz, *Second Level Agreements*, 45 AKRON L. REV. 137, 141-42 (2012) (hereinafter, *Lev-Aretz, Second Level Agreements*)

<sup>11</sup> A prevailing example of such arrangement is YouTube’s Partners Program, which allows rightholders to monetize infringing uses via ad-revenue share. *Lev-Aretz, Second Level Agreements, supra* note 10.

<sup>12</sup> A quote from Dylan Jones on FILMPUNCH FORUM, *How to Get Permission to get a Song(s) in a Video?*, (May 15, 2012) <http://filmpunch.org/forums/topic/how-to-get-permission-to-get-a-songs-in-a-video/>. See also a thread by the user TexmasTV on GOOGLE FORUM *How do I properly license music for use on my YouTube series..?* (Mar. 12, 2011) [http://productforums.google.com/forum/#!topic/youtube/v\\_v4C3660ro](http://productforums.google.com/forum/#!topic/youtube/v_v4C3660ro) (“I just want to know what steps I should take to make sure I’m doing this legally, and I want this to be seen as a legitimate operation.”)

in some productive capacity.<sup>13</sup> The rise of the Internet and spread of information decreased transaction costs previously associated with identifying rightholders and licensing, thus the orphan works problem, which undoubtedly existed long before the inception of the Web, should have been dulled. Like the effect on UGC licensing, however, the digital age acts as a double-edged sword in the orphan works context as well; it has cut communication and information costs in a way that allows for more works to be licensed, but at the same time it has created information flood, which accelerated the number of unidentified works that cannot be legitimately used due to insufficient licensing information.

The undersupply of licensing choices has a number of adverse consequences. Not surprisingly, without effective alternatives, users often turn to piracy to fulfill their informational needs.<sup>14</sup> Piracy, in this respect, has not only offered free, intangible products that otherwise required payment, but also facilitated simpler access to such products. In some cases, piracy has acted as a boulevard to content that was not legitimately reachable to consume or use in any other way. This theory is confirmed by studies demonstrating a significant decrease in piracy once a lawful alternative becomes available.<sup>15</sup> Examples of such alternatives include digital music stores that allow users to buy a single track as opposed to the previous choice of purchasing an entire CD;<sup>16</sup> streaming services such as Netflix<sup>17</sup> and Spotify,<sup>18</sup> providing low or no-cost, on-demand content consumption; and licensing services such as YouTube's free audioswap feature,<sup>19</sup> and music licensing services like Friendly music<sup>20</sup> and the Vimeo music store<sup>21</sup> that sell tracks to be used in UGC videos for a modest fee.

Importantly, rightholders do not lose licensing fees only when users choose to engage in piracy. They also lose the potential licensing revenue of those users who adhere to the law, and thus do not turn to piracy, but who nonetheless forgo the use of the work due to the impracticality of licensing. Further inimical to derivative creation, the dearth of licensing choices reduces the availability for use of preexisting works to secondary creators which they can either draw inspiration from when authoring a new work or build upon

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<sup>13</sup> See Register of Copyrights, *Report on Orphan Works* 1 (2006), available at <http://www.copyright.gov/orphan/orphan-report-full.pdf> (discussing the difficulties associated with orphan works).

<sup>14</sup> See *infra* notes 75-81 and accompanying text.

<sup>15</sup> *Id.*

<sup>16</sup> Danwill David Schwender, *Reducing Unauthorized Digital Downloading of Music by Obtaining Voluntary Compliance with Copyright Law Through the Removal of Corporate Power in the Recording Industry*, 34 T. JEFFERSON L. REV. 225, 253 (2012).

<sup>17</sup> Netflix is a provider of on-demand Internet streaming media, [www.netflix.com](http://www.netflix.com).

<sup>18</sup> Spotify is an Internet-based music streaming service, [www.spotify.com/us/](http://www.spotify.com/us/).

<sup>19</sup> YouTube Help, *Swap the Audio Track on Your Video*, at <https://support.google.com/youtube/answer/94316?hl=en> (“The audio swapping tool allows you to add music to your video from a library of licensed songs.”)

<sup>20</sup> Friendly Music is an online store offering a catalog of fully licensed songs for purchase to use on UGC uploads. See <http://www.friendlymusic.com>.

<sup>21</sup> Vimeo music store is a licensing music store offering free tracks under creative commons licenses, licenses for personal Web use, and licenses for professional commercial Web use. <http://vimeo.com/musicstore>.

when creating a derivative. This state runs counter to the constitutional motivation behind the grant of copyright, as it hinders – as opposed to promotes – “the Progress of Science and useful Arts.”<sup>22</sup> Licensing shortfalls also scale down speech diversity, as they reinforce the dominance of mainstream speech.<sup>23</sup>

Legal scholarship has already recognized the dearth of licensing alternatives in the digital age.<sup>24</sup> Proposals for cure can be generally divided into two categories<sup>25</sup> – the ‘hands-on’ approach, supporting an aggressive intervention in the market via compulsory licensing or levy systems, and the ‘hands-off’ approach, relying on the invisible hand of the market to create the necessary bypasses to the licensing failures in a way that is more efficient than compulsory licensing systems or other forms of intervention.<sup>26</sup> The ‘hands-on’ approach advocates the initiation of either a compulsory licensing scheme or a tax-and-subsidy system in which users would be allowed to employ a copyrighted work without the consent of the rightholder in return for a prescribed fee.<sup>27</sup> The ‘hands-off’ approach suggests that high transaction costs act to challenge copyright holders, who in response find ways to reduce them.<sup>28</sup> Once the copyright entitlement is assigned, goes the argument, it will

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<sup>22</sup> U.S. CONST. art. I, § 8, cl. 8.

<sup>23</sup> Several models in economic literature demonstrate that mainstream expression enjoys better exposure and larger investment in anticipation of a bigger market share. Neil Weinstock Netanel, *Copyright and A Democratic Civil Society*, 106 YALE L.J. 283, 333 (1996) (hereinafter: *Netanel, Copyright*) (Citing Bruce M. Owen & Steven S. Wildman, VIDEO ECONOMICS 101-50 (1992), who survey several models).

<sup>24</sup> See for example, Daniel Gervais, *The Tangled Web of UGC: Making Copyright Sense of User-Generated Content*, 11 VAND. J. ENT. & TECH. L. 841, 841-870 (2009) (hereinafter *Gervais, The Tangled Web*); Deborah Halbert, *Mass Culture and the Culture of the Masses: A Manifesto for User-Generated Rights*, 11 VAND. J. ENT. & TECH. L. 921 (2009), Jessica Litman, DIGITAL COPYRIGHT, 53 (2001) (hereinafter, *Litman, Digital Copyright*), and Jessica Litman, *The Exclusive Right to Read*, 13 CARDOZO ARTS & ENT. L.J. 29, 37-52 (1994) (hereinafter *Litman, The Right to Read*) (contending that copyright law has been designed to channel remuneration to creators by regulating the behavior of intermediaries).

<sup>25</sup> The only proposal that diverge from this sharp classification was made recently by Peter S. Menell & Ben Depoorter, who suggest imposing litigation costs on plaintiffs that reject reasonable license offers. See Peter S. Menell & Ben Depoorter, *Copyright Fee Shifting: A Proposal to Promote Fair Use and Fair Licensing* (UNIV. CAL. BERKELEY PUB. LAW, Working Paper No. 2159325, 2012), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2159325](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2159325). While Menell & Depoorter also discuss the difficulties associated with clearing rights, their description of the problem, as well as their designed solution is focused on cumulative authors, who often make commercial and semi-commercial uses. As such, their proposed scheme is not design to alleviate licensing shortage in all creative fields and for all creative uses. This solution also grants a preliminary permission to the secondary user, and by so doing resembles a form of compulsory license. Nevertheless, and most importantly, that proposal and the one submitted here do not conflict and can work together to fight the licensing failure in copyright.

<sup>26</sup> *Infra* part III provides a full discussion on the two proposals, including their merits and drawbacks.

<sup>27</sup> Edward Lee Lamoureux et al., INTELLECTUAL PROPERTY LAW & INTERACTIVE MEDIA: FREE FOR A FEE 52 (2009).

<sup>28</sup> Robert P. Merges, *Contracting into Liability Rules: Intellectual Property Rights and Collective Rights Organizations*, 84 Cal. L. Rev. 1293, 1295 (1996) (hereinafter *Merges, Contracting into Liability Rules*).

be most efficiently shared out through private ordering: specifically by using Collective Rights Organizations (“CROs”) to facilitate class licensing and copyright enforcement.<sup>29</sup>

Against the two extremes, this Article proposes the subtle incentive theory of copyright licensing - a third, middle-ground approach to alleviate the licensing shortage in copyright. The subtle incentive theory encourages rightholders to engage in licensing by incorporating within the fourth factor review of a fair use defense consideration of the existence of an accessible and efficient licensing scheme and a user’s bona fide attempt to purchase a license. If an accessible and efficient licensing choice were offered in the market for the relevant work, the fourth factor would favor the plaintiff, whereas if an attempt to obtain a license failed due to the lack of an accessible and efficient alternative, the fourth factor would support a finding of fair use. By using the fair use defense as its legal anchor, the subtle incentive theory motivates licensing without depriving rightholders of their property right or otherwise forcefully intervening in market dynamics. Importantly, the subtle incentive theory is an example of how, in view of the slim chances of legislative reform in the foreseeable future, a slight doctrinal change can make a real difference in copyright reality.

The fair use doctrine is based on both a non-exhaustive list of eligible uses including “criticism, comment, news reporting, [and] teaching ..., scholarship, or research,”<sup>30</sup> and on four factors to be considered by the court: (1) the purpose and character of the use, including whether such use is of commercial nature or is for nonprofit educational purposes; (2) the nature of the copyrighted work; (3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and (4) the effect of the use upon the potential market for or value of the copyrighted work.<sup>31</sup> The fourth factor, which is the focal point of the subtle incentive theory, weighs against fair use if the use potentially harms the market of the original work as well as the logical market for derivative works.<sup>32</sup>

In *American Geophysical Union v. Texaco*,<sup>33</sup> the court looked into the loss of *potential* licensing revenue for markets that are “traditional, reasonable, or likely to be developed.”<sup>34</sup> The decision was widely criticized for its circular reasoning, and consequent decisions stated that the mere offering of a license would not deem any use unfair.<sup>35</sup> Still, the presence of a reasonable licensing

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<sup>29</sup> Paul Goldstein, COPYRIGHT § 10.1.1, at 10:7 & n.19 (1999). *See also* Merges, Contracting into Liability Rules, *id.*, at 1295, 1328-58 (“The lesson learned in a number of industries is that privately established Collective Rights Organizations (CROs) will often emerge to break the transactional bottleneck.”).

<sup>30</sup> 17 U.S.C. § 107 (2006).

<sup>31</sup> *Id.*

<sup>32</sup> *Campbell v. Acuff-Rose Music, Inc.*, 510 U.S. 569, 592 (1994); *Harper and Row Publishers Inc. v. Nation Enterprises*, 471 U.S. 539, 568 (1985).

<sup>33</sup> 60 F.3d 913 (2d Cir. 1994).

<sup>34</sup> *Id.*, at 929-30. Other cases have also used the theory of lost licensing revenue in their fourth factor analysis. *See for example*, *Princeton Univ. Press v. Mich. Doc. Servs.*, 99 F.3d 1381 (6th Cir. 1996) (en banc); *Basic Books v. Kinko's Graphics Corp.*, 758 F. Supp. 1522 (S.D.N.Y. 1991).

<sup>35</sup> *See infra* notes 260-265 and accompanying text.

choice was regularly used to negate a fair use treatment.<sup>36</sup> Nonetheless, the mirror side of this test – meaning, the unavailability of an accessible licensing choice – hasn’t been used to support fair use until very recently. In two cases relating to uses by non-profit educational institutions, the fourth fair use factor was linked to the lack of actual licensing practice; in *Cambridge Univ. Press v. Becker*<sup>37</sup> and in *Authors Guild Inc. v. Hathitrust*,<sup>38</sup> the Court found that the defendants’ use was fair, *inter alia*, because an appropriate licensing solution did not exist.

Those decisions, however, do not herald the full incorporation of missing, as opposed to existing, licensing choices into the fourth factor. Those cases are the only two cases in a period of over 18 years of fair use decisions to consider the lack of a licensing alternative as an affirmative standard to support fair use.<sup>39</sup> Both cases are currently pending appeals, thus their outcome and their reasoning could still be overruled.<sup>40</sup> The cases also bear significant factual resemblance with one another: the alleged infringers are nonprofit institutions, the use was for educational purposes, and the works at issue pertain to the market for texts and books.<sup>41</sup> Consequently, those rulings could be rightfully understood as applicable only for uses of copyrighted texts for educational purposes within a noncommercial setting. Moreover, those cases do not offer a clear strategy for the inclusion of a comprehensive licensing test within the fourth factor. The *Texaco* and *Cambridge* decisions also admit the reasonableness of the licensing price as a new element in the fourth factor analysis, but do so without justifying such inclusion or illustrating its application to future cases.<sup>42</sup>

In this context, the subtle incentive theory delivers two vital improvements: (1) it promotes a better-balanced fair use analysis by importing a mirror image of a licensing test that was already put forward by the *Texaco* court over a decade ago, and (2) through a simple doctrinal change with zero implementation costs, it provides a subtle incentive for rightholders to engage in licensing. The subtle incentive theory is limited appropriately to preclude

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<sup>36</sup> See *infra* note 280 and accompanying text.

<sup>37</sup> *Cambridge Univ. Press v. Becker* 863 F. Supp. 2d 1190 (N.D. Ga. 2012).

<sup>38</sup> *Authors Guild, Inc. v. Hathitrust*, 902 F. Supp. 2d 445 (S.D.N.Y. 2012).

<sup>39</sup> A review of all fair use cases decided since *Texaco* is on file with the author. Indeed, after *Texaco* was decided, courts look at the relevant market but none of them considered the actual licensing possibilities the defendant had at the time before the use, and especially the non-existence of a realistic licensing alternative. For example, in *Campbell*, 510 U.S. at 1177, the “unlikelihood that creators of imaginative works will license critical reviews or lampoons of their works” supported a finding of fair use. While in a way it is to say that there is little chance that licensing possibilities would exist in the said market, this statement remains general, as opposed to concrete, to the facts on the case.

<sup>40</sup> Andrew Albanese, *Publishers Appeal 'Flamed' Decision in GSU E-Reserves Case*, PUBLISHERS WEEKLY, (Sep. 11, 2012) <http://www.publishersweekly.com/pw/by-topic/digital/copyright/article/53903-publishers-appeal-flawed-decision-in-gsu-e-reserves-case.html>. *Authors Guild, Inc. v. Hathitrust*, JUSTIA DOCKETS & FILLING, at <http://dockets.justia.com/docket/circuit-courts/ca2/12-4547>.

<sup>41</sup> All cases also discuss licensing opportunities through the CCC: See *Texaco* 60 F.3d at 930-931, *Hathitrust*, 902 F. Supp. 2d at 464, *Becker*, 863 F. Supp. 2d at 1212-1217, 1236-1238. The same, except for the commercial nature of the defendant applies to the *Texaco* case.

<sup>42</sup> See *infra* notes 283-287 and accompanying text.



substantial harm to rightholders' creation incentives. Because the subtle incentive is generated by adding a variable to the fair use calculus, it is not determinative as to the grant of the defense.<sup>43</sup> The theory is also highly flexible: the rightholder who lost a case, *inter alia*, because she did not engage in licensing can change this outcome for all future cases by simply offering licensing choice in the relevant market.

While the incentive is, indeed, subtle it is nevertheless still a valuable incentive. The inclusion of the existence of licensing choices in a fair use analysis would encourage copyright owners, especially those that are corporate rightholders or otherwise repeat players, to develop licensing alternatives. Under the subtle incentive theory, the only group of copyright owners who is not expected to be motivated to develop licensing alternatives is a fairly insubstantial one: only rightholders for whom the cost of licensing exceeds not only the cost of lost licensing fees that could have been otherwise paid had licensing been offered in the market, but also the costs of enlarging the pool of fair uses under the subtle incentive theory.<sup>44</sup> Furthermore, against the backdrop of unlikely legislative solutions, the subtle incentive theory crowns one policy to guide the inspiration and application of copyright laws — a policy that appropriately compensates rightholders for the use of their work without depriving them of their liberty to choose whether or not to engage in licensing, while providing secondary users a simple way to legitimately make use of a copyrighted work.

The Article unfolds as follows. Part II describes the continuous licensing failure in copyright creative markets and its consequences. Part III elaborates on the existing solutions proposed by legal commentary — the 'hands-on' v. the 'hands-off' approach, their vices, and their virtues. Part IV introduces the subtle incentive theory and provides some background on the fair use doctrine, and especially the judicial development of the fourth factor. Part V repopulates the subtle incentive theory and provides a list of guidelines to instruct the court on the application of the theory in concrete fair use cases. Lastly, part VI surveys scholarly-established fair use justifications to show to what extent the subtle incentive theory accords with current fair use scholarship. A conclusion follows in Part VII.

## II. COPYRIGHT'S LICENSING SHORTAGE

The market for copyrighted goods operates through voluntary transactions in which the right to use informational goods is transferred in return for some consideration. It is these transfers that lie at the heart of the utilitarian approach to copyright — rightholders are encouraged to invest time and resources into creating new works because they know that they will be paid for the use of their works by future licensees. Throughout copyright history,

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<sup>43</sup> Wendy Gordon noted that the *Texaco* court used a similar argument to explain how physically foregone license fees can be considered without falling into circular reasoning: “fatal circularity can be avoided by treating physically foregone license fees as a part of the analysis rather than conclusive on fair use.” Wendy J. Gordon, *Fair Use Markets: On Weighing Potential License Fees*, 79 GEO. WASH. L. REV. 1814, 1838 (2011) (hereinafter *Gordon, Fair Use Markets*)

<sup>44</sup> See *infra* notes 296 and accompanying text.

however, the demand for an accessible, simple, and efficient licensing scheme has not always been completely satisfied. Occasionally, lawmakers responded by initiating statutory licensing systems to allow specific uses of copyrighted works in return for administratively-prescribed, fair fees with no need to obtain permission from the rightholder.<sup>45</sup> In other cases market-based solutions emerged using self-help means to facilitate efficient licensing or licensing bypasses.<sup>46</sup> The digital era has further reduced transaction costs by facilitating an unprecedented spread of information, enhancing creation capabilities, and providing exposure to, and of, new works. Uses that could not easily be licensed before are now being routinely authorized and paid for without much hassle; new licensing opportunities have opened up for copyright holders.

Nevertheless, while occasionally fluctuating and moving between creative markets, the demand for efficient licensing is steadily present in copyright reality. Statutory and market-based alternatives have failed to provide a comprehensive answer to the licensing call; they are constantly challenged by the rise of new technologies, new market developments, or new licensing needs, and they require a universal system that cannot adequately attend to some of the individual licensing requests. Take, for example, a relatively new form of expression: people avail themselves of existing and emerging Internet applications to express their creative personalities through content uploaded online known as UGC.<sup>47</sup> All over the world users create and share UGC - through blogs, micro-blogging, fan-fiction and photo-sharing websites, video platforms like YouTube, and social networks like Twitter and Facebook. UGC varies from pure reproductions of preexisting works and derivative versions of such works, to works that borrow what may qualify as fair use, to original works of authorship.<sup>48</sup> So, despite their significant social value, UGC platforms were criticized and sued for facilitating mass copyright infringement.<sup>49</sup> In a previous work I demonstrated how, concurrently with turning to courts for help, rightholders have been cooperating with UGC webhosts through what I termed ‘Second Level Agreements’ in an effort to establish a licensing bypass and monetize the new UGC market.<sup>50</sup> Second

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<sup>45</sup> Compulsory licensing was first established in the 1909 Copyright Act for purposes of musical compositions. 17 U.S.C. § 1(e) (1952) (repealed 1978); *see also* Copyright Act of 1976, 17 U.S.C. §§ 111, 115-16, 118 (2006) (compulsory licenses for jukeboxes); Copyright Act of 1976, 17 U.S.C. § 118 (2006) (compulsory licenses for public broadcasting); Copyright Act of 1976, 17 U.S.C. § 111 (compulsory licenses for cable television).

<sup>46</sup> An example of one such efficient licensing scheme that evolved through the market is the rise of online music stores like iTunes and Amazon. Second Level Agreements are an example of a successful licensing bypass, *Lev Aretz, Second Level Agreements, supra* note 10.

<sup>47</sup> *Gervais, The Tangled Web, supra* note 24, at 841-870.

<sup>48</sup> *Lev Aretz, Second Level Agreements, supra* note 10 at 141-144.

<sup>49</sup> *See for example, UMG Recordings, Inc. v. Veoh Networks Inc., 665 F. Supp. 2d 1099 (C.D. Cal. 2009), and Viacom Int'l Inc. v. YouTube, Inc., 940 F. Supp. 2d 110 (S.D.N.Y. 2013).*

<sup>50</sup> *Lev Aretz, Second Level Agreements, supra* note 10.

Level Agreements have allowed video and music UGC platforms to prosper,<sup>51</sup> and a similar model has also invaded the image market recently.<sup>52</sup>

Surprisingly, discussion forums all over the Internet are filled with users' inquiries about licensing options for their UGC uploads. Some users divulged their preference to purchase a license to use the copyrighted content in their posts as a precaution to insure them against liability.<sup>53</sup> Others were looking for a legal way to obtain a license, so they can clear their use and restore a post that may have been removed or altered by the platform.<sup>54</sup> Users with both non-commercial and semi-commercial intentions (e.g., small businesses) expressed their interest in paying for a license, so their material could remain online.<sup>55</sup> Determined users who endeavored to obtain a license shared the doom of their journey with much vexation.<sup>56</sup> Others were discouraged from

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<sup>51</sup> *Id.*, at 166-68.

<sup>52</sup> The first to offer a licensing service of this sort in the image market was a small startup named PicScout. The product offers image detection tools for monitoring visual content that is used on the Internet as well as for helping potential users discover images that may be lawfully licensed and used. Getty Images, one of the world largest stock photo agencies, acquired PicScout back in 2011, and now this tool is offered for use to Getty's customers, Jonathan Bailey, Getty Images Acquires PicScout, *Plagiarism Today* (Apr. 7, 2011), <http://www.plagiarismtoday.com/2011/04/27/getty-images-acquires-picscout/>. Getty Images also struck a deal with Pinterest, a visual-discovery based social network, to identify exclusive Getty Images content on Pinterest, and in return for relevant metadata, Pinterest will pay Getty Images which will then share the fees with images' rightholders. See Getty Images, Getty Images Partners with Pinterest, *Getty Images Blog* (Oct. 25, 2013), <http://blog.gettyimages.com/2013/10/25/getty-images-partners-pinterest/#.UwUcPUKwKAs>.

<sup>53</sup> For example, a post by the user FredDavenport, "How can I use music that is legal. Doing some family and non-profit music slide shows and would be glad to pay for the music." YOUTUBE'S HELP FORUM (Jul. 14, 2010) <http://www.google.com/support/forum/p/youtube/thread?tid=125242e9ea10050d&hl=en>.

<sup>54</sup> For example, a post by the user Little Miss FreakShow: "I love making music videos. However, they keep getting blocked because all the music in the world seems to be owned by WMG. I've tried putting notices on the details box giving credit to owners of music that I use, but still my videos keep getting blocked. It's very frustrating. How do I get permission to use music on Youtube?" YAHOO ANSWERS (2009) <http://uk.answers.yahoo.com/question/index?qid=20090504162600AAMfdLE>.

<sup>55</sup> See FredDavenport, *supra* note 53. For an example of semi-commercial purposes, see a post by the user 1msusportsinfo: "We do a lot of highlight videos and promotional pieces for events and would like to post them on YouTube without the music getting taken off. I am willing to buy a service, so is there anything?" on YOUTUBE'S HELP FORUM (Apr. 18, 2010) <http://www.google.ru/support/forum/p/youtube/thread?tid=7c94e12c14363c00&hl=en>.

<sup>56</sup> For example, a post by the user Vercingetorix: "I wanted to make a video to accompany a piece of music... soon after uploading the video I was informed that the audio would be disabled because I had violated copyrighted material from "WMG"... The disabling of the music made the video nonsensical... So, I finally decided to do something about it by finding out who had the rights to the song and legally get permission... I searched for a couple of days and came up empty handed... The next logical step was using the "Contact Us" portion of the Warner Music Group website... Now each time I wanted to contact them I had to fill in a form - I did this quite a number of times over a two-month period and never received a response. I came across a site that said it would contact people on your behalf to get rights to use music, movies, etc., and give you a quote for the cost so you could legally get the rights... So I regularly contacted this company over a two-month period again having to fill in a form each time - and I never received a response. So I have hit a brick wall and would like to know what the next logical step would be in trying to get permission to use this song? Or, at

commencing action towards obtaining a license following advice from their experienced peers. As one frustrated YouTube user put it: “Since I am just an individual, am I damned to be a copyright infringer forever??? ... Mr. Big Company, whoever you are... just tell me who to call and how much money... not interested in breaking the law... please give some directions about how to go about it the right way.”<sup>57</sup>

Indeed, users wishing to legally employ copyrighted works in their posts have to face many obstacles, and, in many cases, they end up realizing licensing is simply not an option for them. Acquiring a license for UGC purposes is a long, time consuming, and costly course. Identifying the copyright owner may be daunting, especially when the desired work is not a popular one. Moreover, since copyright divisibility bestows upon copyright holders a bundle of rights which can be monetized according to certain categories of use, the user may have to locate multiple owners, each holding one part of the total bundle.<sup>58</sup> Even if the copyright holder entrusts a CRO to manage her rights, the user would still have to locate two CROs, as reproduction rights and performance rights are managed separately by different CROs.<sup>59</sup>

The ordeal would not come to a halt when the copyright owner(s) is identified, because the next step for the user would be to contact the rightholder to negotiate a license. An amateur individual, with limited resources, would rarely get any response from corporate rightholders and CROs. If the user were lucky enough to get to the point of negotiating a license, she could be subject to inconsistent demands by different CROs.<sup>60</sup> The user is also likely be asked to pay a licensing fee she cannot afford,<sup>61</sup> especially if the license requested is to use a popular work.<sup>62</sup> Copyright industries have been reluctant to provide no-cost or reduced-price licenses for non-profit and non-commercial uses.<sup>63</sup> The costs of dealing with a great number of simple transactional-licensing requests, as well as the costs of setting and administrating a system for differential pricing exceeds the expected returns, thus, for corporate rightholders, perpetuating the status quo makes more sense economically.<sup>64</sup>

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the very least, a response from a human?” YOUTUBE’S HELP FORUM (Aug. 16, 2009) <http://www.google.com/support/forum/p/youtube/thread?tid=48e112ea6309599c&hl=en>.

<sup>57</sup> A post by the user samanthabcarroll on YOUTUBE HELP FORUM (Nov. 11, 2009), <http://www.google.com/support/forum/p/youtube/thread?tid=4ea9d6fbca50a8f2&hl=en>.

<sup>58</sup> Mark A. Lemley, *Dealing with Overlapping Copyrights on the Internet*, 22 U. DAYTON L. REV. 547, 571 (1997); Lydia Pallas Loren, *Untangling the Web of Music Copyrights*, 53 CASE W. RES. L. REV. 673 (2003) (hereinafter, *Loren, Untangling the Web*).

<sup>59</sup> Tanya M. Woods, *Working Toward Spontaneous Copyright Licensing: A Simple Solution for a Complex Problem*, 11 VAND. J. ENT & TECH L. 1141, 1147-1148. (2009).

<sup>60</sup> Jessica Litman, *Real Copyright Reform*, 96 IOWA L. REV. 1, 20 (2010) (hereinafter *Litman, Real Copyright Reform*), and *Loren, Untangling the Web*, *supra* note 58, at 689-702.

<sup>61</sup> *Gervais, The Tangled Web*, *supra* note 24, at 848.

<sup>62</sup> Michal Shur-Ofry, *Popularity as a Factor in Copyright Law*, 59 U. TORONTO L.J. 525, 549-552 (2010) (describing the potentials of market failure in the process of licensing popular works).

<sup>63</sup> Neil W. Netanel, *Impose a Noncommercial Use Levy to Allow Free Peer-to-Peer File Sharing*, 17 HARV. J.L. & TECH. 1, 79 (2003) (hereinafter *Netanel, Impose a Noncommercial Use Levy*).

<sup>64</sup> *Id.*

Another example of the hurdles associated with licensing can be found in the orphan works market. An orphan work is defined by the United States Copyright Office as a “situation where the owner of a copyrighted work cannot be identified and located by someone who wishes to make use of the work in a manner that requires the permission of the copyright owner.”<sup>65</sup> Works fall into orphanage for various reasons, such as incomplete records of identifying ownership information, uncertain publication status, uncertain authorship information (e.g., is it a work made for hire, a joint work, public domain materials, etc.), and out-of-date copyright information (e.g., deceased author or a transfer of authorship).<sup>66</sup>

Even though most of the discussion around orphan works involves books, the types of works likely to fall into orphanage are those with limited commercial worth but high academic and cultural value, like photographs, unpublished documents, letters, and sound recordings.<sup>67</sup> With technological advancements increasing exposure to original works as well as the creation of derivative works, the number of users that are affected by the orphan works problem has escalated accordingly.<sup>68</sup> When a work that needs to be licensed is an orphan work the potential licensee can either use the work without permission – thus standing a chance of being sued for copyright infringement – or forgo the use altogether. Some users, especially those with limited resources, have opted to shy away from the use of the copyrighted work.<sup>69</sup> Surprisingly, evidence suggests that in many cases the creators of the works, who often own the copyright to them, might not mind their employment and may appreciate the publicity.<sup>70</sup> While the orphan works issue has enjoyed significant Congressional attention<sup>71</sup> and is widely discussed in legal commentary<sup>72</sup> a solution has yet to materialize.

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<sup>65</sup> Register of Copyrights, Report on Orphan Works, *supra* note 13 (discussing the difficulties associated with orphan works).

<sup>66</sup> Library of Congress, *Comments of the Library of Congress in Response to the Copyright Office Notice of Inquiry “Orphan Works”* 4-5 (2005), <http://www.copyright.gov/orphan/comments/OW0630-LOC.pdf>.

<sup>67</sup> Katharina de la Durantaye, *Finding a Home for Orphans: Google Book Search and Orphan Works Law in the United States and Europe*, 21 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 229, 235 (2011). See also JISC, *In from the Cold: An Assessment of the Scope of “Orphan Works” and Its Impact on the Delivery of Services to the Public* 5 (2009), available at <http://www.jisc.ac.uk/media/documents/publications/infromthecoldv1.pdf>.

<sup>68</sup> Olive Huang, *U.S. Copyright Office Orphan Works Inquiry: Finding Homes for the Orphans*, 21 BERKELEY TECH. L.J. 265, 274 (2006).

<sup>69</sup> De la Durantaye, *supra* note 67 at 235 (noting that “In the over 850 submissions made to the U.S. Copyright Office following its Notice of Inquiry regarding the orphan works problem, especially not-for-profit organizations recount instances in which they shied away from digitizing and preserving copyrighted works of which the owners cannot be identified and located.”).

<sup>70</sup> *Id.*

<sup>71</sup> The Shawn Bentley Orphan Works Act of 2008, § 2913, 110th Cong. (2008) and the Orphan Works Act of 2008, HR 5889, 110th Cong. (2008) were introduced as potential answers, but failed to pass.

<sup>72</sup> See for example: Huang, *supra* note 68; Maria A. Pallante, *Orphan Works and Mass Digitization: Obstacles & opportunities*, 27 BERKELEY TECH. L.J. 1251; Keith Porcaro, *Private Ordering and Orphan Works: Our Least Worst Hope?* 2010 DUKE L. & TECH. REV. 15; Sami J. Valkonen & Lawrence J. White, *An Economic Model for the Incentive/Access Paradigm of Copyright Propertization:*

The difficulties associated with the process of clearing copyrighted images for online and offline uses offers a good illustration of the orphan works issue. For instance, consumers might encounter significant complications when attempting to obtain a license to reproduce old portraits shot by studios that are no longer in business, or when the photographer is deceased.<sup>73</sup> Although the Professional Photographers of America (PPA) provides a helping hand in identifying and locating the relevant rightholder, given the massive number of copyrighted images in circulation, finding the copyright owner is, in many cases, a difficult, and sometimes impossible, mission.<sup>74</sup>

The lack of an efficient licensing solution harms both rightholders and prospective authors in a few ways. First, the lack of a lawful licensing alternative has been proven to be conducive to the initiation and maintenance of piracy. For instance, the astonishing turn to illegal file sharing in its early days was attributed, *inter alia*, to the recording industry's tardy acceptance of online distribution models.<sup>75</sup> Presented with the choice of either purchasing and uploading an entire CD to play a specific music track, or simply downloading the desired recording from a file-sharing service many consumers opted for the less burdensome choice.<sup>76</sup> Since its introduction by Apple in 2003, iTunes has been celebrated as a great revenue generator for rightholders of musical content.<sup>77</sup> Similarly, a recent study found that illegal music file sharing declined significantly in 2012, with 40% of American Internet users who had illegally downloaded music in 2011 reporting that they had stopped or consumed less illegal content.<sup>78</sup> According to the same study, the main cause for the decrease in illegal sharing was a growing use of legal streaming alternatives.<sup>79</sup> Another study affirmed that legal media services can displace piracy; 30% of surveyed music consumers and 40% of TV/movies consumers conceded that the emergence of low cost legal streaming alternatives has reduced their piracy activities.<sup>80</sup>

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*An Argument in Support of the Orphan Works Act*, 29 HASTINGS COMM. & ENT. L. J. 359 (2007), and Matthew Sag, *Orphan Works as Grist for the Data Mill*, 27 BERKELEY TECH. L.J. 1503 (2012).  
<sup>73</sup> Jeremiah A. Armstrong, *The Digital Era of Photography Requires Streamlined Licensing and Rights Management*, 47 SANTA CLARA L. REV. 785, 817 (2007).

<sup>74</sup> *Id.*

<sup>75</sup> Schwender, *supra* note 16, at 253.

<sup>76</sup> *Id.* See also Eric Berger, *The Legal Problems of the MP3*, 18 TEMP. ENVTL. L. & TECH. J. 1, 19 (1999) (“If the RIAA can find a way to offer its product for a reasonable price, the RIAA would likely see a sharp decline in the popularity of illegal MP3s. While cheap is more expensive than free, and piracy will always exist in some form, most consumers, even those who partake in the piracy, would like to do what is legal. However, right now there is not much legal competition.”).

<sup>77</sup> *iTunes Store Sets New Record with 25 Billion Songs Sold*, APPLE PRESS INFO (Feb. 6, 2013), <http://www.apple.com/pr/library/2013/02/06iTunes-Store-Sets-New-Record-with-25-Billion-Songs-Sold.html>.

<sup>78</sup> The NPD Group, *Music File-Sharing Declined Significantly in 2012*, (Feb. 12, 2013), at <https://www.npd.com/wps/portal/npd/us/news/press-releases/the-npd-group-music-file-sharing-declined-significantly-in-2012/>.

<sup>79</sup> *Id.*

<sup>80</sup> The American Assembly, Columbia University, *Copyright Infringement and Enforcement in the US*, A Research Note, November 2011.

Piracy has not only been a way to avoid paying for copyrighted content, it has also been a hassle-free route to get access to, consume, and use copyrighted materials. When an appropriate lawful choice was offered piracy numbers went down, and many selected the lawful choice. Several examples can testify to the drop in piracy when an efficient licensing choice exists, such as the rise of online music stores, the introduction of streaming services, (e.g., Spotify and Netflix that provide an effortless way to find and consume content), and the successful launch of Friendly Music, the first music store to license tracks for use in users-created videos.<sup>81</sup>

In addition to contributing to the mushrooming and success of piracy, the absence of an efficient licensing choice prevents a major revenue stream for owners of copyrighted works. When users are willing to pay but do not get to negotiate with rightholders because the path to negotiation is too time-consuming or otherwise costly, rightholders lose potential licensing fees. Furthermore, in many cases legitimate derivative works increase the economic value of the original work by offering additional exposure to interested buyers.<sup>82</sup>

The lack of licensing alternatives has also been detrimental to further creation. The harm can be described as both indirect and direct disservice. The indirect loss takes place on the consumption level, where the lack of efficient licensing – assuming it does not drive one to utilize an illegal alternative – inhibits access to various works of authorship that otherwise would have been consumed. To illustrate this point consider again the height of music file-sharing: if one wished to enjoy a certain musical track that could not be obtained legally, and this person insisted on refraining from illegally downloading the content from a peer-to-peer service where it was readily available, there was no way for her to consume the desired recording.<sup>83</sup> Content consumption, due to its importance, should not be undermined – it provides social exposure to a wider spectrum of cultural and educational goods. Furthermore, as copyright law recognizes,<sup>84</sup> because authors inherently

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<sup>81</sup> Friendly Music is a licensing service owned by Rumblefish and endorsed by YouTube, <http://friendlymusic.com/#mood>. In an interview I conducted with Paul Anthony, Rumblefish's CEO, Mr. Anthony talked about the great demand for noncommercial and semi-commercial licensing. A demand that has only begun to be satisfied by the 6 million licenses sold within Friendly Music's first year of operation. An Interview with Paul Anthony (Sep. 2, 2012), on file with the author.

<sup>82</sup> Christina Bohannon, *Reclaiming Copyright*, 23 CARDOZO ARTS & ENT. L.J. 567, 596 (2006). Bohannon gives the example of three novels that borrowed some elements from preexisting works, and points out that "in each of these three examples, the Amazon.com website, which makes all of these works available for purchase, advertises that customers who purchased the more recent work also purchased the original work. Moreover, in two of these three examples, Amazon.com encourages purchase of the original work as well as the more recent work by offering a discount to purchasers who buy both books at the same time.")

<sup>83</sup> Similarly, if the rightholder chooses not to license to streaming services like Netflix and Amazon, without brick and mortar stores to obtain physical copies of movies, consumers are left with no viable alternative.

<sup>84</sup> While copyright does not confer the right to create derivatives on secondary users, the importance of a (paid) use of preexisting works is embodied in the Constitutional goal: the "Promotion of Science and Useful Arts" is done by remunerating earlier creators.

draw on preexisting works for the sake of inspiration and to create derivative versions, consumption of copyrighted content encourages subsequent creation.<sup>85</sup>

Further creation is also being impeded directly: in the absence of a workable licensing choice, prospective producers wishing to integrate or build upon an author's work are prohibited from doing so lawfully because they cannot reimburse the author for the right. An efficient transfer or license of copyright, which is hindered by a market failure, is objectionable for economic and policy considerations. It also stands in sharp contradiction to the primary motivation behind U.S. copyright law as set forth by the U.S. Constitution: "To promote the Progress of Science and useful Arts."<sup>86</sup> When an efficient licensing choice exists it allows the generation and distribution of creative works that otherwise might not be created, while its absence inhibits the production of new works and limits expression.

Finally, the lack of licensing choice can also harm speech diversity. According to several models in economic literature, publishing companies, motion picture studios, and other media firms demonstrate an inherent bias favoring mainstream expression that is expected to attract large audiences while disfavoring minority taste.<sup>87</sup> The growth of corporate rightholders, which capture great shares in the copyright market, has intensified the problem of homogenous expression culture.<sup>88</sup> This problem has been considerably attenuated due to the immense exposure provided by the rise of UGC, which allows the myriad expressions to be consumed by everyone without the sifting previously conducted by media conglomerates. Without a proper licensing scheme, however, many of these expressions constitute copyright infringement. Often, the secondary author in such cases would prefer to avoid the risk of having her post remove or being exposed to legal liability and would not make her work available. Even if the author risks liability and chooses to post her work online, there is a chance the work would be removed by the hosting platform, which may not be willing to face the possibility of a secondary liability lawsuit.<sup>89</sup> Hence, the lack of an efficient licensing solution contributes to the problem of homogenous expression culture by limiting the positive exposure effect of UGC to cases of original content or content that is otherwise permitted under an informal practice.

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Remuneration, however, is achieved through licensing the work for consumption by consumers and for use by secondary users.

<sup>85</sup> Paul Goldstein, COPYRIGHT: PRINCIPLES, LAW AND PRACTICE §1:14 (1989) ("If copyright law is to promote the national culture and learning, it must allow subsequent creators to draw on copyrighted works for their inspiration and education.")

<sup>86</sup> U.S. CONST. art. I, § 8, cl. 8.

<sup>87</sup> Netanel, *Copyright*, *supra* note 23 at 333.

<sup>88</sup> *Id.*, citing Diana Crane, THE PRODUCTION OF CULTURE: MEDIA AND THE URBAN ARTS 55-75 (1992); Paul DiMaggio, *Market Structure, the Creative Process, and Popular Culture: Toward an Organizational Reinterpretation of Mass-Culture Theory*, 11 J. POPULAR CULTURE 436, 440 (1977), and Ben Bagdikian, THE MEDIA MONOPOLY 3-26 (1992).

<sup>89</sup> Lev-Aretz, *Second Level Agreements*, *supra* note 10, at 144-149.



### III. Scholarly-Prescribed Solutions: A ‘Hands-On’ Approach v. A ‘Hands-Off’ Approach

Licensing difficulties have already been recognized in different creation fields, and scholars have attempted to identify the roots for the copyright system incapacity to offer a useful licensing mechanism.<sup>90</sup> The explanation is quite simple: since its inception in 1710, copyrights were traded through licenses or assignments among professionals.<sup>91</sup> Copyright owners traditionally only granted licenses to professional users, and commissioned CROs to handle licensing when a large selection of works is owned by a plurality of owners.<sup>92</sup> Since personal employment of copyrighted content had little commercial value, copyright law did not apply, at least practically, to cases of individual uses within the privacy of one’s home.<sup>93</sup> During the past sixteen years, copyright owners have concerned themselves with individual consumers and end-users, but the law has not changed to reflect the new authorship capabilities and creation reality.<sup>94</sup>

Legal scholarship has proposed various solutions as possible cures to the described licensing shortage. The existing proposals can be divided into two main schools: the “hands-on” approach, which advocates for aggressive governmental intervention through a statutory licensing regime or a levy system, and the “hands-off” approach, which favors the invisible hand of the market as the preferred regulator with minimal to zero governmental intervention.<sup>95</sup> In the next subsections I briefly survey these two schools and discuss their merits and drawbacks.

#### A. A Hands-On Approach

##### *i. Compulsory Licensing Models*

The compulsory licensing model is not new to U.S. copyright law,<sup>96</sup> and some of its versions are considered successful.<sup>97</sup> In general, a compulsory

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<sup>90</sup> See example, *Gervais, The Tangeled Web* *supra* note 24, at 841-870--; Halbert, *supra* note 24, *Litman, Digital Copyright*, *supra* note 24, at 53, and *Litman, The Right to Read*, *supra* note 24, at 37-52.

<sup>91</sup> *Gervais, The Tangeled Web*, *id.*, at 846-847.

<sup>92</sup> *Id.*

<sup>93</sup> Jessica Litman, *Lawful Personal Use*, 85 TEX. L. REV. 1871, 1873-1874 (2007) (“Fifty years ago, copyright law rarely concerned itself with uses that were not both commercial and public”).

<sup>94</sup> *Gervais, The Tangeled Web*, *id.*, at 846-847.

<sup>95</sup> Adam Smith’s theory of the invisible hand argues that economic and social efficiency is maximized when individuals act in their own self-interest. Adam Smith, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 456 (R.H. Campbell et al. eds., Oxford Univ. Press 1976) (1776).

<sup>96</sup> Compulsory licensing was first established in the 1909 Copyright Act for purposes of musical compositions. 17 U.S.C. § 1(e) (1952) (repealed 1978); *see also* Copyright Act of 1976, [17 U.S.C. §§ 111, 115-16, 118 \(2006\)](#) (compulsory licenses for jukeboxes); Copyright Act of 1976, [17 U.S.C. § 118 \(2006\)](#) (compulsory licenses for public broadcasting); Copyright Act of 1976, [17 U.S.C. § 111](#) (compulsory licenses for cable television).

<sup>97</sup> For example, the effectiveness of mechanical licensing has given rise to proposals of similar statutory regimes for music sampling [see e.g., Aaron Power, *15 Megabytes of Fame: A Fair Use*

license is a form of unwritten contract, permitting a class of users to use a copyrighted work in return for the payment of a fee or royalty at some later date.<sup>98</sup> Under such mechanism the license must be granted to the class of users who meet the statutory requirements, and a rightholder can neither deny a use nor set her wished-for price.<sup>99</sup> In other words, by establishing compulsory licensing systems the government converts the property rule entitlement of copyright to a liability rule based on the principle of “take now, pay later.”<sup>100</sup> Previous resorts to compulsory licensing regimes had been justified as a response to the emergence of new technology, which concurrently interfered with an exclusive right and introduced new social utility considerations.<sup>101</sup>

When a compulsory licensing model is prescribed, Congress acknowledges that, for a specific use of a protected work, the conventional copyright allocation does not appropriately effectuate copyright social utility objectives.<sup>102</sup> To remedy this inadequacy Congress attempts to restore the proper balance between authors and the public by allowing the latter to use the work in accordance with the statutory licensing terms while securing compensation for rightholders.<sup>103</sup> Legislatively mandated licensing lowers transaction costs in two ways: first, contractual stipulations are established in advance, hence reducing negotiation costs;<sup>104</sup> second, administrative support is built into the statute, so compulsory licensing allows parties to economize on record keeping, royalty distribution, and payment charging.<sup>105</sup>

Legal scholars have called for the initiation of either a compulsory licensing system or a similar, tax-and-subsidy scheme in which users would be allowed to employ a copyrighted work in return for a fixed royalty.<sup>106</sup> Proponents of both of these proposals are concerned that enforcement struggles are withering the justifications behind the existing entitlement structure, and desire to make the most of the improved dissemination opportunities afforded by digital advancements.<sup>107</sup> Recent proposals generally pertain to specific licensing contexts, most of which involve digital technology uses, such as the consumption of music and motion pictures via file sharing,<sup>108</sup>

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*Defense for Mash-Ups as DJ Culture Reaches its Postmodern Limit*, 35 SW. U. L. REV. 577, 596 (2007)], and Register of Copyrights, *Report on Orphan Works*, *supra* note 13.

<sup>98</sup> Midge M. Hyman, *The Socialization of Copyright: The Increased Use of Compulsory Licenses*, 4 CARDOZO ARTS & ENT. L.J. 105, 107 (1985).

<sup>99</sup> *Id.*

<sup>100</sup> Laurence R. Helfer, *World Music on a U.S. Stage: A Berne/TRIPs and Economic Analysis of the Fairness in Music Licensing Act*, 80 B.U. L. REV. 93, 107 (2000).

<sup>101</sup> Lateef Mtima & Steven D. Jamar, *Fulfilling the Copyright Social Justice Promise: Digitizing Textual Information*, 55 N.Y.L. SCH. L. REV. 77, 104 (2010).

<sup>102</sup> *Id.*

<sup>103</sup> *Id.*

<sup>104</sup> *Merges, Contracting into Liability Rules*, *supra* note 28, at 1295.

<sup>105</sup> *Id.*

<sup>106</sup> *Lee*, *supra* note 27, at 52.

<sup>107</sup> Joseph P. Liu, *Regulatory Copyright*, 83 N.C. L. REV. 87, 126 (2004)

<sup>108</sup> See e.g., William W. Fisher III, PROMISES TO KEEP: TECHNOLOGY, LAW, AND THE FUTURE OF ENTERTAINMENT 199-258 (2004) (hereinafter *Fisher, Promises to Keep*); Netanel, *Impose a Noncommercial Use Levy*, *supra* note 63 at 37-59; Raymond Shih Ray Ku, *The Creative Destruction of Copyright: Napster and the New Economics of Digital Technology*, 69 U. CHI. L. REV. 263, 312-15

sampling music and mashups,<sup>109</sup> and online transmissions.<sup>110</sup> Neil Netanel, for example, offered a model of a noncommercial-use levy administered by the Copyright Office and carried out through taxing goods, the worth of which is boosted by file sharing (like MP3 players).<sup>111</sup> William Fisher recommended an administrative compensation system run by the copyright office, under which a tax collected on devices and services would be used to pay right holders in proportion to the consumption of their content.<sup>112</sup> Lawrence Lessig, who predicted that file sharing would step down for streaming technology, supported Fisher's proposal as a transient means, which would have to change accordingly in the future.<sup>113</sup> The Electronic Frontier Foundation (EFF) proposed a compulsory licensing model with an opt-in choice for consumers – rather than imposing taxes, users would be offered to pay a flat fee in return for unlimited downloading of content and immunity for their actions.<sup>114</sup>

Many supporting arguments bolster the use of compulsory licensing systems to solve current licensing difficulties. The establishment of compulsory licenses has been traditionally justified in cases when technology has made old licensing methods for established rights ponderous and inefficient.<sup>115</sup> The rise of digital technology rendered existing licensing models unfit for the mass of creative users wishing to employ copyrighted materials, and intervening in the market failure through compulsory licensing mechanisms seems adequate. By removing the difficulties involved in identifying and locating rightholders, bargaining over licensing fees, and transferring assets, compulsory licenses lessen transaction costs and allow many transfers that would not otherwise occur.<sup>116</sup> This way, rightholders would be remunerated for the use of their work, without having to manage abundant licensing requests with potential pricing differences. While it is possible, perhaps even likely, that the ceiling price provided by a compulsory license regime would be lower than an individually negotiated price for each

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(2002); Glynn Lunney, Jr., *The Death of Copyright: Digital Technology, Private Copying, and the Digital Millennium Copyright Act*, 87 VA. L. REV. 813, 854-58 (2001); Lionel S. Sobel, *DRM As An Enabler Of Business Models: ISPs As Digital Retailers*, 18 BERKELEY TECH. L.J. 667, 684-87 (2003).

<sup>109</sup> See e.g., Thomas P. Wolf, *Toward a "New School" Licensing Regime for Digital Sampling: Disclosure, Coding, and Click-Through*, 2011 STAN. TECH. L. REV. N1 (2011); Olufunmilayo B. Arewa, *From J.C. Bach to Hip Hop: Musical Borrowing, Copyright and Cultural Context*, 84 N.C. L. REV. 547, 635-41 (2006).

<sup>110</sup> R. Anthony Reese, *Copyright and Internet Music Transmissions: Existing Law, Major Controversies, Possible Solutions*, 55 U. MIAMI L. REV. 237, 268-73 (2001) (suggesting to extend current compulsory licenses to temporary RAM storage incidental to licensed or exempt uses).

<sup>111</sup> Netanel, *Impose a Noncommercial Use Levy*, *supra* note 63, at 35-59.

<sup>112</sup> Fisher, *Promises to Keep*, *supra* note 108, at 9-10, 199-258. While the initial deployment of Fisher's system was proposed to be voluntary, it was expected to later replace the current copyright law system with a compulsory scheme. See also Jessica Litman, *Sharing and Stealing*, 27 HASTINGS COMM. & ENT. L. J. 1, 33 (2004) (hereinafter *Litman, Sharing and Stealing*).

<sup>113</sup> Lawrence Lessig, FREE CULTURE 298-304 (2004).

<sup>114</sup> *A Better Way Forward: Voluntary Collective Licensing of Music*, ELECTRONIC FRONTIER FOUNDATION (Feb. 2004), [https://www.eff.org/files/collective\\_lic\\_wp.pdf](https://www.eff.org/files/collective_lic_wp.pdf).

<sup>115</sup> Robert Stephen Lee, *An Economic Analysis of Compulsory Licensing in Copyright Law*, 5 W. NEW ENG. L. REV. 203, 209 (1982).

<sup>116</sup> *Helper*, *supra* note 100, at 107.

use, the costs associated with such individualized negotiations often prevent them from coming about.<sup>117</sup>

A compulsory licensing scheme would also be beneficial to users; it would encourage new expression by allowing secondary authors to legally consume content and to employ protected materials in their works. Lawrence Lessig's articulated remorse for the industry's persistent rejection of the file sharing compulsory licensing model successfully captures this advantage:

“(h)ad businesses been free to rely upon these licenses, there would have been an explosion in innovation around these technologies... Anyone who had an idea could have deployed it, consistent with the terms of the compulsory license. Thus, innovation in content distribution would have been greater too.”<sup>118</sup>

Another desirable byproduct of the compulsory licensing model is the educational message it conveys. When users (or society as a whole) are required to pay for the use of information, the notion that copyright has its price is communicated. Finally, a compulsory license regime was also praised for harmonizing U.S. copyright law with the law of other foreign countries, like Canada and Germany.<sup>119</sup>

Despite these benefits, compulsory licensing involves many difficulties that have been long recognized by legal commentary.<sup>120</sup> Critics have argued that, by replacing copyright's traditional property rule protection with liability rules, the government expropriates property rights without cause and interferes unduly with market mechanisms.<sup>121</sup> Under existing copyright law, copyright holders have an exclusive right to decide how to release their works, and they should not be forced to act against their wishes.<sup>122</sup> Critics also argued that such intervention prevents market-based alternatives, which could make the licensing process more efficient, from being developed.<sup>123</sup> Compulsory licenses also influence investments in the production, development, and marketing of creative works.<sup>124</sup> By placing an artificial ceiling on the amount

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<sup>117</sup> Netanel, *Impose a Noncommercial Use Levy*, *supra* note 63, at 79.

<sup>118</sup> Lawrence Lessig, REMIX, 111 (2008) (hereinafter *Lessig, Remix*).

<sup>119</sup> Peter K. Yu, *P2P and the Future of Private Copying*, 76 U. COLO. L. REV. 653, 708 (2005).

<sup>120</sup> Commentators have doubted the value and operation of compulsory licenses. See Lee, *supra* note 115, at 209; Hyman, *supra* note 118; Robert Cassler, *Copyright Compulsory Licenses-Are They Coming or Going?*, 37 J. COPYRIGHT SOC'Y 231, 232-35 (1990); Scott M. Martin, *The Berne Convention and the U.S. Compulsory License for Jukeboxes: Why the Song Could Not Remain the Same*, 37 J. COPYRIGHT SOC'Y 262 (1990); Frederick F. Greenman, Jr. & Alvin Deutsch, *The Copyright Royalty Tribunal and the Statutory Mechanical Royalty: History and Prospect*, 1 CARDOZO ARTS & ENT. L.J. 1 (1982); Bruce Schaffer, *Are the Compulsory License Provisions of the Copyright Law Unconstitutional?*, 2 COMM. & L. 1 (1980); E. Fulton Brylawski, *The Copyright Royalty Tribunal*, 24 UCLA L. REV. 1265 (1977).

<sup>121</sup> Ashlye M. Keaton & Jerry Goolsby, *In the Trenches of Copyright Law: Challenges and Remedies*, 12 TUL. J. TECH. & INTELL. PROP. 211, 219 (2009).

<sup>122</sup> Yu, *supra* note 119, at 712.

<sup>123</sup> Paul Goldstein, *Preempted State Doctrines, Involuntary Transfers, and Compulsory Licenses: Testing the Limits of Copyright*, 24 UCLA L. REV. 1107, 1139 (1977).

<sup>124</sup> *Id.*, at 1135.

that can be paid for a work, compulsory license regimes reduce differentiation among works produced; no work will attract investment that exceeds the aggregate returns determined by the compulsory licensing ceiling price.<sup>125</sup> Also, given the personal nature of many creative acts, the diminution in authorial control without ensuring sufficient recognition of the personality rights of the artist was criticized for discouraging creation.<sup>126</sup> Critics further argued that compulsory licenses extended the copyright monopoly beyond the constitutional scope set forth in the Copyright Clause and Supreme Court rulings because the licenses cannot distinguish non-copyrightable components from copyrightable components.<sup>127</sup>

Likewise, flat rate pricing schemes fail to differentiate between derivative uses which may vary in quantitative size and qualitative importance.<sup>128</sup> The flat rate associated with compulsory licensing models also negates rightholders' ability to participate in price discrimination – a practice that may augment social welfare by adding to the owner's income and by allowing more people to engage in the market of creation.<sup>129</sup> Moreover, a legislated royalty "floor" often becomes a "ceiling" under a compulsory licensing scheme.<sup>130</sup> A compulsory license model also triggers a cross-subsidization problem: when low-volume users are charged similar rates as high-volume users, the low-volume users subsidize high-volume users.<sup>131</sup>

Opponents of the compulsory licensing scheme have also pointed to the numerous practical impediments associated with the initiation of a compulsory licensing system as a sufficient reason to abandon such attempts:<sup>132</sup> the implementation of a tax-based system would likely generate public protest;<sup>133</sup> the need to monitor usage to ensure correct allocation of the collected funds to rightholders raised privacy concerns;<sup>134</sup> the costs of maintaining an accurate tracking system could also prove to be expensive, thus rightholders may wind

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<sup>125</sup> *Id.* See also Jason S. Rooks, Note, *Constitutionality of Judicially-Imposed Compulsory Licenses in Copyright Infringement Cases*, 3 J. INTELL. PROP. L. 255, 271-272 (1995).

<sup>126</sup> Doris Estelle Long, *Dissonant Harmonization: Limitations on "Cash N' Carry" Creativity*, 70 ALB. L. REV. 1163, 1193 (2007).

<sup>127</sup> *Rooks*, *supra* note 125 at 273.

<sup>128</sup> For a similar argument regarding music sampling see *Wolf*, *supra* note 109, at 35.

<sup>129</sup> William Fisher, *The Implications for Law of User Innovation*, 94 MINN. L. REV. 1417, 1449 (2010).

<sup>130</sup> *Merges, Contracting into Liability Rules*, *supra* note 28, at 1304-06, 1310-11, 1391-92.

<sup>131</sup> *Yu*, *supra* note 119, at 709-710. See also Jane C. Ginsburg, *Copyright and Control over New Technologies of Dissemination*, 101 COLUM. L. REV. 1613, 1643-1644 (2001). Some commentators argued that the cross-subsidization problem is overstated, because many low-volume users would be happy to pay for unlimited file sharing even if they do not actually download much content. Furthermore, the easy legal access to downloadable content could motivate some of the low-volume users to become high-volume users. See Netanel, *Impose a Noncommercial Use Levy*, *supra* note 63, at 67-74. See also Peter Eckersley, *Virtual Markets for Virtual Goods: The Mirror Image of Digital Copyright?*, 18 HARV. J.L. & TECH. 85, 107 (2004).

<sup>132</sup> J. Wesley Cochran, *Why Can't I Watch This Video Here? Copyright Confusion and Performance of Videocassettes & Videodiscs in Libraries*, 15 HASTINGS COMM. & ENT. L.J. 837, 888-890 (1993).

<sup>133</sup> Jessica Wang, *A Brave New Step: Why the Music Industry Should Follow the Hulu Model*, 51 IDEA 511, 532 (2011).

<sup>134</sup> Steven Masur, *Collective Rights Licensing for Internet Downloads and Streams: Would it Properly Compensate Right Holders?*, 18 VILL. SPORTS & ENT. L.J. 39, 41 (2011).

up underpaid.<sup>135</sup> It was also argued that the difficulty to set up an appropriate dividing protocol for the allocation of the royalty pool as well as the inability of the licensing system to generate sufficient funds to compensate rightholders could hinder the establishment of any compulsory licensing scheme.<sup>136</sup> Most importantly, the initiation of a statutory licensing regime requires legislative action, which has never been easy to complete for copyright issues, and is even harder to accomplish today in light of the complicated politics of copyright.<sup>137</sup>

A decade after the first compulsory licensing proposals were proposed to provide an answer to the file sharing problem, we enjoy the benefit of hindsight. Even though many of the disadvantages delineated above could be solved, and despite the fact that the compulsory licensing proposals could actually improve copyright law and practice for all involved parties, none of them have gained any traction.<sup>138</sup> While it is well established that major copyright legislation, as the one required for the implementation of additional compulsory licenses, normally takes years, even decades, between introduction and enactment, and even though the file sharing discussion remains highly relevant today, none of the proposals have made it to Congress. The content industry repudiated all proposals for a compulsory licensing regime insofar as file sharing is concerned,<sup>139</sup> and as Pamela Samuelson noted, “Copyright industry groups... often write the laws that the legislature enacts.”<sup>140</sup> Indeed, past legislative changes have produced the public perception that copyright law is compelled and controlled by lobbying and political interest group pressure on behalf of the entertainment industry.<sup>141</sup>

## ii. Voluntary Licensing Models

Another, less extreme form of the ‘hands-on’ approach can be found in proposals to initiate voluntary licensing models. Under a voluntary licensing system, users pay for the use of content, but instead of obtaining a license from each right owner, they buy one from collection societies. These societies aggregate copyrighted works and administer the collection and distribution of royalties.<sup>142</sup> In the twentieth century, a similar system was used with much success for broadcast radio.<sup>143</sup> Proponents of the voluntary collective licensing

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<sup>135</sup> Ginsburg, *supra* note 131, at 1643-1644.

<sup>136</sup> Yu, *supra* note 119, at 708-712.

<sup>137</sup> See generally, Yafit Lev-Aretz, *Copyright Lawmaking and Public Choice: From Legislative Battles to Private Ordering*, 27 HARV. J. L. & TECH. (forthcoming).

<sup>138</sup> Lessig, *Remix*, *supra* note 118, at 109-10.

<sup>139</sup> Litman, *Sharing and Stealing*, *supra* note 112, at 34-35.

<sup>140</sup> Pamela Samuelson, *Should Economics Play a Role in Copyright Law and Policy?*, 1 U. OTTAWA L. & TECH. J. 3, 7 (2004). See also Jessica D. Litman, *Copyright Legislation and Technological Change*, 68 OR. L. REV. 275 (1989) (“The history of copyright revision efforts during the first half of this century demonstrates how a process of private negotiations, initially adopted as an expedient alternative to a government commission, came to dominate copyright revision.”) (Hereinafter *Litman on Copyright Legislation*).

<sup>141</sup> Ben Depoorter, Alain Van Hiel, & Sven Vanneste, *Copyright Backlash*, 84 S. CAL. L. REV. 1251, 1290 (2011).

<sup>142</sup> Jared S. Welsh, *Pay What You Like—No, Really: Why Copyright Law Should Make Digital Music Free for Noncommercial Uses*, 58 EMORY L.J. 1495, 1528 (2009).

<sup>143</sup> *The Electronic Frontier Foundation*, *supra* note 114.

model usually point to existing CROs, e.g., ASCAP,<sup>144</sup> BMI,<sup>145</sup> and SESAC,<sup>146</sup> as the appropriate “checkpoint” to transfer revenue from a multiplicity of users to a multiplicity of copyright holders.<sup>147</sup> CROs’ business is precisely to deal with large amounts of users, usage data, and rightholders,<sup>148</sup> by offering users quick and easy one-stop shops for purchasing licenses.<sup>149</sup> CROs are also in a better position to locate potential users, negotiate with them, and enforce rights.<sup>150</sup> Thus, allowing CROs to license authorization to use works can be more efficient than individual negotiations and licensing for both copyright owners and users.<sup>151</sup>

In the context of file sharing, Jessica Litman proposed a statutory, voluntary licensing model, under which file sharing would be subject to a blanket license with prescribed terms.<sup>152</sup> A government agency together with designated licensing agents would administrate the collection and distribution of funds.<sup>153</sup> Litman basically offered to build “a music space that resembles the current digital information space in the ubiquity of music it contains and the ease with which music may be shared.”<sup>154</sup> Importantly, contrary to compulsory licensing proposals, under the voluntary regime copyright holders would have the right to opt out. By choosing to either allow their works to be used for some financial return or to offer them under a digital rights management-protected format, rightholders would be able to control distribution of their materials.<sup>155</sup>

The voluntary approach is preferred, according to Litman, because once the legal and technological environment adapts to file sharing, allowing rightholders not to engage in the system would do little harm.<sup>156</sup> Moreover, there is little sense in forcing creators who choose the current system, despite how badly it has served them, to engage in an improved system, if the latter can be successful without their cooperation.<sup>157</sup> Litman also conceded that under such a system the compensation of major rightholders would probably be very high, as opposed to owners of less successful music, who would probably suffer underpayment.<sup>158</sup> Voluntary licensing is also less likely to

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<sup>144</sup> American Society of Composers, Authors, and Publishers

<sup>145</sup> Broadcast Music Inc.

<sup>146</sup> The Society of European Stage Authors and Performers.

<sup>147</sup> Daniel J. Gervais, *The Price of Social Norms: Towards a Licensing Regime for File-Sharing*, 12 J. INTEL. PROP. L. 39, 59-60 (2004) (hereinafter *Gervais, the Price of Social Norms*).

<sup>148</sup> *Id.*, at 61-62. See also Daniel Gervais, *Collective Management and Copyright: Theory and Practice in the Digital Age*, in COLLECTIVE MANAGEMENT OF COPYRIGHT AND RELATED RIGHTS 1, 1-3, 15-18 (Daniel Gervais ed., 2010) (hereinafter *Gervais, Collective Management and Copyright*).

<sup>149</sup> Séverine Dusolliera & Caroline Colin, *Peer-to-Peer File Sharing and Copyright: What Could Be the Role of Collective Management?*, 34 COLUM. J.L. & ARTS 809, 817-818 (2011)

<sup>150</sup> *Id.*

<sup>151</sup> *Id.*

<sup>152</sup> *Litman, Sharing and Stealing*, *supra* note 112, at 41-42.

<sup>153</sup> *Id.*

<sup>154</sup> *Id.*, at 40.

<sup>155</sup> *Id.*, at 41.

<sup>156</sup> *Id.*, at 45.

<sup>157</sup> *Id.*, at 46.

<sup>158</sup> *Id.*, at 45.

abrogate the U.S. international commitments under the Berne Convention and the WIPO Copyright Treaty.<sup>159</sup>

Alexander Peukert, a German legal scholar, has proposed a parallel system to Litman's voluntary regime.<sup>160</sup> Under Peukert's proposed system, the default rule bestows upon rightholders the exclusive right to enforce their copyright and allows them to opt in to a levy-based system set up by the government.<sup>161</sup> Daniel Gervais also advocated for a voluntary licensing system to legalize file sharing. The model essentially proposed charging users with monthly fees, which would be brokered by intermediaries like ISPs, copyright collectives, technology companies, or a combination of two or all three of these entities.<sup>162</sup> In an earlier proposal, submitted to the Canadian government, Gervais suggested an extended collective licensing model in which copyright owners would, by default, be enrolled in the system, but would have the choice to opt out if they wish.<sup>163</sup>

The voluntary licensing models offer some notable benefits. First, they are based on mutual agreement and do not impose themselves on the affected parties. Most of the voluntary licensing proposals introduce new business models to be implemented upon minor modifications to the existing legal framework, thus guaranteeing a more efficient, less-costly and quicker implementation than the one expected for compulsory licensing regime.<sup>164</sup> A voluntary system also allows copyright owners to retain strong control over the licensing of their creative works, in compliance with copyright proprietary essence. The voluntary licensing models share some of the advantages offered by the compulsory licensing models – users could create legally, rightholders could access a potential revenue generator, and free expression would be encouraged and augmented.

These models, however, also shares some of the difficulties associated with compulsory licensing schemes. The potential for under compensating rightholders is said to be greater under a voluntary regime.<sup>165</sup> A system without a legally binding obligation to pay for the use could make the compensation lower than necessary to retain an incentive to create.<sup>166</sup> Assuming that users would volunteer to pay for content they can get through

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<sup>159</sup> *Id.*

<sup>160</sup> Alexander Peukert, *A Bipolar Copyright System for the Digital Network Environment*, in PEER-TO-PEER FILE SHARING AND SECONDARY LIABILITY IN COPYRIGHT LAW (Alain Strowell ed., 2009) at 148-195.

<sup>161</sup> *Id.*, at 191.

<sup>162</sup> Gervais, *the Price of Social Norms*, *supra* note 147, at 60-63.

<sup>163</sup> Daniel Gervais, *Application of an Extended Collective Licensing Regime in Canada: Principles and Issues Related to Implementation* (2003), [http://aix1.uottawa.ca/~dgervais/publications/extended\\_licensing.pdf](http://aix1.uottawa.ca/~dgervais/publications/extended_licensing.pdf).

<sup>164</sup> *The Electronic Frontier Foundation*, *supra* note 114.

<sup>165</sup> Joel C. Boehm, *Copyright Reform for the Digital Era: Protecting the Future of Recorded Music Through Compulsory Licensing and Proper Judicial Analysis*, 10 TEX. REV. ENT. & SPORTS L. 169, 199-200 (2009).

<sup>166</sup> *Id.*



file sharing for free was criticized for overestimating people's generosity.<sup>167</sup> The system is also susceptible to free riding users who would opt out but may still enjoy its benefits at the expense of those who choose to pay.<sup>168</sup> Moreover, such a system may falsely teach users that paying for music or copyrighted content is relative to an individual's choice.<sup>169</sup> The cross-subsidization problem is also likely to arise here because users are charged the same even though their consuming value may differ.<sup>170</sup> Practical difficulties, like how to divide the licensing fees collected, were also cited as potential obstructions of a voluntary system.<sup>171</sup> Administrated by CROs, the voluntary licensing schemes may also favor larger content owners and be subject to strong influence by major corporations.<sup>172</sup> The greatest hurdle of all, however, rests in the greatest benefit of the model – its voluntary nature. The voluntary system could be successful only if a sufficient number of copyright owners (and in some proposals – a vast amount of users) agree to engage. In the present environment, garnering the approval from all copyright holders within a reasonable period of time may prove to be impossible.<sup>173</sup>

#### B. A Hands-off Approach

The invisible hand approach to the licensing failure argues that, when challenged by high transaction costs, copyright holders would come up with efficient ways to reduce them. Under this view, copyright law prescribes the sphere of the entitlement, and once the entitlement is assigned, it will be efficiently shared out through private ordering.<sup>174</sup> Specifically, rightholders would entrust the administration of their property rights to private CROs that facilitate class licensing and copyright enforcement.<sup>175</sup> CROs are said to be able to significantly reduce transaction costs associated with licensing by

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<sup>167</sup> Alvin Chan, *The Chronicles of Grokster: Who is the Biggest Threat in the P2P Battle?*, 15 UCLA ENT. L. REV. 291, 321 (2008). This argument, however, is not entirely persuasive in the face of successful low-fee services like Netflix and Spotify.

<sup>168</sup> *Id.*

<sup>169</sup> *Id.*

<sup>170</sup> *Yu*, *supra* note 119, at 715.

<sup>171</sup> *Id.*

<sup>172</sup> *Litman, sharing and stealing*, *supra* note 112, at 43. See also *Welsh*, *supra* note 142, at 1529.

<sup>173</sup> *Litman, Sharing and Stealing*, *id.*, at 34-38 (noting that in the previous proposals for copyright reforms that would allow licensed peer-to-peer file sharing were spurned by the recording and motion picture industry).

<sup>174</sup> See, e.g., *Merges, Contracting into Liability Rules*, *supra* note 28, at 1301-07 (demonstrating how private ordering is more efficient in allocating the property entitlement than compulsory licensing regime); Paul Goldstein, *Copyright*, 55 LAW & CONTEMP. PROBS., Spring 1992, at 82-83 (maintaining that entitlement allocation is conducted better by market forces); R.H. Coase, *The Federal Communications Commission*, 2 J.L. & ECON. 1, 18 (1959) (“The allocation of resources should be determined by the forces of the market rather than as a result of government decisions.”).

<sup>175</sup> Paul Goldstein, COPYRIGHT § 10.1.1, at 10:7 & n.19 (2d ed. Supp. 1999); see also *Merges, Contracting into Liability Rules*, *supra* note 28, at 1295, 1328-58 (“The lesson learned in a number of industries is that privately established Collective Rights Organizations (CROs) will often emerge to break the transactional bottleneck.”).

offering a homogenous licensing menu, combining enforcement power and setting a blueprint for royalty distributions.<sup>176</sup>

Robert Merges, who is most often identified with the hands-off approach, has recognized the incentive of industry participants to invest in institutions like CROs to reduce the costs of the intellectual property rights (‘IPR’) exchange.<sup>177</sup> Coupled with strong property rules for intellectual property owners, the market then can best stimulate private bargaining that acts much as a statutory liability rule without needing to turn to compulsory licenses.<sup>178</sup> According to Merges, those private licensing engagements are more desirable than compulsory licenses for two main reasons.<sup>179</sup> First, compulsory licensing models suffer from political economy problems, such as rent seeking by both rightholders and users over the initial design of the licensing system as well as later modifications that may be required by changes in the market.<sup>180</sup> Second, IPR transfers are conducted more efficiently through CROs, as the agreements are generally more flexible than compulsory licensing mechanisms.<sup>181</sup> When fixing the royalty rate, CROs can get more direct feedback from industry participants to offer a compensation structure that is consistent with their needs.<sup>182</sup> To put the point slightly differently, the rules set by CROs are “the product of internal negotiations by knowledgeable people in the industry.”<sup>183</sup> And so, even though CROs cannot perfectly substitute for comprehensive negotiations between individuals, the rules of exchange they hatch succeed better than compulsory licenses at resembling market bargains.<sup>184</sup> The flexibility of this model also permits price discrimination and retains differentiation among works produced.

The invisible hand approach avoids many of the problems associated with the compulsory licensing strategy. As it requires no legislative action it evades rent-seeking problems, saves lobbying costs, and is amenable to market changes.<sup>185</sup> Furthermore, the hands-off perspective does not involve substituting the long-standing property rules of copyright with liability rules – a step that is in the heart of a long-lasting debate,<sup>186</sup> which, aside from its

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<sup>176</sup> Helfer, *supra* note 100 at 108.

<sup>177</sup> Merges, *Contracting into Liability Rules*, *supra* note 28, at 1295. See also Robert P. Merges, *Of Property Rules, Coase, and Intellectual Property*, 94 COLUM. L. REV. 2655, 2655 (1994) (hereinafter *Merges, of Property Rules*)

<sup>178</sup> Merges, *of property rules*, *id.*

<sup>179</sup> Merges, *Contracting into Liability Rules*, *supra* note 28, at 1314-15 (“when private contracts or institutions are a viable alternative, bargaining should be channeled out of the legislative arena”).

<sup>180</sup> Merges, *Contracting into Liability Rules*, *id.*, at 1299 (if past experience with compulsory licenses is any guide, the royalty rates might well become “locked in,” and therefore subject to only very modest changes over time”).

<sup>181</sup> *Id.*

<sup>182</sup> *Id.* See also Helfer, *supra* note 100, at 192.

<sup>183</sup> Merges, *Contracting into Liability Rules*, *id.*, at 1300.

<sup>184</sup> *Id.*

<sup>185</sup> *Id.*, at 1299.

<sup>186</sup> See e.g., Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972); Merges, *Contracting into Liability Rules*, *supra* note 28; Ian Ayres & Eric Talley, *Solomonic Bargaining: Dividing a Legal Entitlement to Facilitate Coasean Trade*, 104 YALE L.J. 1027, 1029-1036 (1995).

potential virtues and vices, would be extremely difficult to complete in today's complicated copyright politics. The hands-off strategy also allows the market to develop better licensing alternatives, and encourages the most efficient pricing model, since the payment rate is determined by industry players or by an organization that closely interact with such players.

This proposal, however, has its own share of difficulties. First, it upholds a status quo in the market while awaiting a market-based solution. The market may, or may not, come up with a better way out, and by the time a definite response has taken place a great amount of expression could be frustrated. It is not clear from Merges' articles whether the costs of this loss were incorporated into the cost-benefit analysis of the invisible hand licensing model. Also, it could well be the case that from an economic perspective offering an accessible licensing choice would not maximize efficiency in all instances, and leaving some creation fields without a licensing solution would actually be more effective in promoting overall economic efficiency. Dismissing such cases would mean promoting the progress of science and useful arts only when such promotion is consistent with economic efficiency standards. The fundamental purpose of copyright, however, is to reward and advance creativity, as opposed to economic efficiency.

As an example of a successful licensing model, Merges points to ASCAP,<sup>187</sup> demonstrating how ASCAP succeeded in designing a workable licensing solution for public performance rights of musical compositions, and he submits that the same model can be imported to other copyright markets to facilitate licensing.<sup>188</sup> The use of ASCAP as a leading example of a prevailing model was criticized for not adequately considering the special framework within which ASCAP functions. To provide an effective licensing solution, a clearance system operated via CROs would have to cover a significant repertoire of copyrighted works and enjoy cooperation with a substantial portion of rightholders, who approve a pricing schedule and assign their power to allow use.<sup>189</sup> On top of the time required for the clearance system to develop, a long interim period is also expected, within which the clearance system would have to obtain comprehensiveness and acceptance to become a true solution for the licensing failure. The use of CROs was also criticized for creating its own market distortion, since these organizations gain considerable market power over time and trigger antitrust concerns.<sup>190</sup>

Another point to consider when thinking about free market solutions is that corporate rightholders in the music industry have been generally reluctant to provide licensing solutions to individuals.<sup>191</sup> Legal commentary attempted to provide an explanation for the persistent rejection of new licensing models

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<sup>187</sup> Merges, *Contracting into Liability Rules*, *supra* note 28, at 1378 (“ASCAP's experience shows that it is possible to apply existing institutional know-how to a new set of transactional problems.”).

<sup>188</sup> *Id.*, at 1328-1340.

<sup>189</sup> *Id.*

<sup>190</sup> Helfer, *supra* note 100, at 108

(“these organizations also enjoy substantial market power to extract monopoly rents from licensees”).

<sup>191</sup> Netanel, *Impose a Noncommercial Use Levy*, *supra* note 63.

that could potentially increase the industry's revenue. Neil Netanel points to the costs and difficulties of price discrimination as possible grounds for the rejection.<sup>192</sup> And while Netanel concedes that “digital technology might lower the costs and institutional barriers to price discrimination,” where the user wishes to employ copyrighted content in her own expressive work, rightholders will generally prefer to engage in “a costly, individualized, non-automated assessment of what price to charge.”<sup>193</sup> Lital Helman echoes this view by arguing that music industry executives choose control over profit-maximization.<sup>194</sup> According to Helman, in what she describes as a classic agent-principle problem, creators are interested in maximizing revenues from their works, but their record companies are interested in maximizing their control over the exploitation of works to sustain their dominance in the market.<sup>195</sup> Niva Elkin-Koren agrees that rightholders may avoid licensing their content in order to maintain their monopoly power.<sup>196</sup> It could also be a case of non-rational “herd” behavior, in which radical market changes result from small movements irrationally imitated by others.<sup>197</sup> Corporate rightholders typically engage in herd behavior, thus are hesitant to experiment with new business models, as demonstrated by the music industry's reluctance to shift to digital distribution to provide an alternative to file sharing.<sup>198</sup> Another example can be found in the industry's unwillingness to collaborate with intermediaries like online licensing store Friendly Music, who already employs a successful licensing platform for individual and noncommercial producers.<sup>199</sup>

All the theories that analyze the absence of licensing solutions point to either irrational behavior on the rightholders' end which perpetuates

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<sup>192</sup> *Id.* (“Determining user valuations, setting differential pricing, designing product and distribution systems to enable differential pricing, and creating and enforcing prohibitions against consumer arbitrage require considerable information, labor, and financial and organizational resources.”)

<sup>193</sup> *Id.*, at 79. Netanel also notes that copyright holders would rarely authorize controversial and critical expression even if the offered licensing fee were reasonable. *Id.*

<sup>194</sup> Lital Helman, *When Your Recording Agency Turns into an Agency Problem: The True Nature of the Peer-to-Peer Debate*, 50 IDEA 49 (2009).

<sup>195</sup> *Id.* (“although on the surface the focus of the resistance to file-sharing is on the compensation of artists... resistance is really driven by the fight for control over the market of copyrighted works by the big record companies”).

<sup>196</sup> Niva Elkin-Koren, *Cyberlaw and Social Change: A Democratic Approach to Copyright Law in Cyberspace*, 14 CARDOZO ARTS & ENT. L.J. 215, 295 (1996) (“This concern links considerations of property and democracy, allocation of resources and free speech... The centralized structure of the information flow which draws a clear line between producers and paying consumers is beneficial for copyright owners, and they are most likely to maintain it. What incentive would a copyright owner have to license users to create their own customized version of a movie?”).

<sup>197</sup> Christopher Avery & Peter Zemsky, *Multidimensional Uncertainty and Herd Behavior in Financial Markets*, 88 AM. ECON. REV. 724, 724 (1998).

<sup>198</sup> Matthew Fagin et. al., *Beyond Napster: Using Antitrust Law to Advance and Enhance Online Music Distribution*, 8 B.U. J. SCI. & TECH. L. 451, 491 (2002) (“The “big five” have been reluctant to shift toward channels of digital distribution until they have “secured” their work”).

<sup>199</sup> In an interview with Friendly Music's founder and CEO, Paul Anthony, Mr. Anthony noted that the big record labels have been curious about the platform but have not been interested in offering their content for licensing through the store yet. An Interview with Paul Anthony (Sep. 2, 2012), on file with the author.

unsatisfied licensing demand, or to excessive control and monopoly concerns, where rightholders are behaving rationally, but their interests counter those of society as a whole. Both causes are of the kind that can leave the market without a licensing solution for a long time and make the hands-off approach less appealing. Some of these theories, such as the agent-principle problem, call attention to a market failure that, by itself, justifies intervention. Furthermore, the costs of inaction are dual; these costs are derived from speech that is being concealed or obstructed, and they stem from licensing fees that could have been otherwise channeled to rightholders.

#### IV. LICENSING POSSIBILITIES AND THE FAIR USE DOCTRINE

This Article contributes to the ongoing licensing discourse by introducing a third, middle ground approach, aimed at incentivizing rightholders to offer an efficient licensing choice without depriving them of their property right in their creation or otherwise forcefully intervening in market dynamics. Under the subtle incentive theory, the existence of an efficient licensing scheme and a user's genuine attempt to obtain a license would be taken into consideration whenever a fair use defense is invoked. The fourth factor would tilt in favor of an infringer in the absence of an accessible and reasonable licensing solution in the fair use analysis, when a sincere attempt to obtain a license failed because transaction costs associated with licensing were too high. The subtle incentive theory perfectly exemplifies how, in light of the slim chances of legislative reform in the foreseeable future, a slight doctrinal change, for which the ground is already set and which entails zero cost, can make a difference in copyright reality.

In the following pages I provide a brief overview of the fair use defense to allow better understanding of the subtle incentive theory and its place within the doctrine.

##### i. *The Fair Use Defense*

The Fair Use defense acts as a limitation to the protection granted to a copyright holder in section 106 of the Copyright Act.<sup>200</sup> Under this defense, infringing uses are excused when a finding of infringement would unfairly frustrate copyright's commitment to maximizing the production and dissemination of useful works to the public.<sup>201</sup> Prior to its enactment as an exception in the Copyright Act of 1976,<sup>202</sup> the fair use doctrine existed only as a common law, judge-made rule of reason.<sup>203</sup> The statutory language, however, does not formulate a bright line rule for deciding whether a particular use is a fair use; instead the statute allows the uses of a protected work reflecting purposes, delineated in a non-exhaustive list, like "criticism, comment, news

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<sup>200</sup> See generally 17 U.S.C. §106 (subjecting owner's exclusive rights to the exceptions set forth in sections 107 through 118).

<sup>201</sup> Iowa State Univ. Research Found., Inc. v. Am. Broad. Cos., 621 F.2d 57, 60 (2d Cir. 1980).

<sup>202</sup> 17 U.S.C. § 107 (2006).

<sup>203</sup> Castle Rock Ent. v. Carol Publ. Group, Inc., 150 F.3d 132, 141 (2d Cir. 1998) (noting that "[u]ntil the 1976 Copyright Act, the doctrine of fair use grew exclusively out of common law").

reporting, teaching ..., scholarship, or research.”<sup>204</sup> To aid courts in determining whether a use is fair, Section 107 singles out four factors, none of which is determinative, that a court should consider when the fair use defense is invoked by an alleged infringer: (1) the purpose and character of the use, including whether such use is of commercial nature or is for nonprofit educational purposes; (2) the nature of the copyrighted work; (3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and (4) the effect of the use upon the potential market for or value of the copyrighted work.<sup>205</sup> When weighing these factors, courts review each of them in consideration of the other factors and the objectives of copyright law.<sup>206</sup>

Under the first element of the fair use test, the purpose and character of the use, courts often consider two aspects: to what extent, if at all, the work at question is transformative, and whether the infringing use is of a commercial nature or is a nonprofit educational application.<sup>207</sup> A creative contribution to a copyrighted work that adds new expression, meaning, or message to the original work,<sup>208</sup> or changes its character or purpose is considered a transformative use.<sup>209</sup> The more transformative a work is, the greater the prospect that the use is fair, reducing the weight of a finding of commercial nature in the analysis.<sup>210</sup> Courts must determine whether the work is employed commercially, for profit-making purposes while avoiding paying acceptable license fees to the rightholder, or for a nonprofit educational purpose.<sup>211</sup> While predominantly commercial purpose has traditionally cut against a finding of fair use,<sup>212</sup> in some cases commercial uses may still enjoy fair use privileges.<sup>213</sup>

The second fair use factor evaluates the nature of the protected work. Fair use will be harder to establish when the work at use is “closer to the core of intended copyright protection.”<sup>214</sup> When analyzing the second factor, courts make two distinctions: whether the work is of creative, fictional and expressive nature or rather it is purely factual, and whether the work was published or rather unpublished.<sup>215</sup> Copyright law generally acknowledges the importance of disseminating factual works, thus a finding that the underlying work is factual, weighs in favor of fair use.<sup>216</sup> Similarly, as the law honors the

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<sup>204</sup> 17 U.S.C. § 107 (2006).

<sup>205</sup> *Id.*

<sup>206</sup> *Campbell v. Acuff-Rose Music, Inc.*, 510 U.S. 569, 578 (1994); *Castle Rock*, 150 F.3d at 141; 4 Melville B. Nimmer & David Nimmer, *NIMMER ON COPYRIGHT* § 13.05[[A], at 13-152 to -155.

<sup>207</sup> 17 U.S.C.A. § 107 (1).

<sup>208</sup> *Campbell*, 510 U.S. at 579 (citing *Justice Story in Folsom v. Marsh*, 9 F. Cas. 342, 348 (C.C.D. Mass. 1841)).

<sup>209</sup> *Id.*, at 579.

<sup>210</sup> *Id.*

<sup>211</sup> *Harper & Row*, 471 U.S. at 562.

<sup>212</sup> *Id.* See also *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417, 451 (1984).

<sup>213</sup> *Sony Corp.*, 464 U.S., at 449. See also *Harper & Row*, 471 U.S. at 562.

<sup>214</sup> *Campbell*, 510 U.S. at 586.

<sup>215</sup> *Id.*

<sup>216</sup> *Campbell*, 510 U.S. at 586, and *Stewart v. Abend*, 495 U.S. 207, 237 (1990).

rightholder's right of first publication, a fair use argument is weakened when the original work is an unpublished work.<sup>217</sup>

To analyze the third factor,<sup>218</sup> courts consider whether the “amount and substantiality” of the alleged infringing use was reasonable and in relation to the purpose of the copying. The courts consider both the quality and the quantity of the portion used.<sup>219</sup> While, as a general rule, copying entire works or substantial portions would not qualify as fair use,<sup>220</sup> courts have deviated from this rule when justified by other considerations.<sup>221</sup>

The fourth factor requires a court to look at the effect of the infringing use on the rightholder's market for her work. As the proposal advanced in this Article involves considering existing licensing options under the fourth factor of a fair use analysis, the next subsection elaborates on this factor and the way it has been applied by the Courts.

*ii. Licensing and Transaction Costs Under the Fourth Factor*

Of the four fair use factors the fourth factor has been traditionally considered the climax of the fair use analysis.<sup>222</sup> Since copyright is granted to economically incentivize authors to produce useful works for the common public good,<sup>223</sup> and since a secondary use that impairs the market value of the original work generally decreases incentives to create further works,<sup>224</sup> courts infrequently find such secondary use to be fair. In accordance with this logic, fair use should shield acts that do not cause market harm – uses that are either sufficiently transformative so they are unlikely to substitute for the original work, or uses that otherwise avoid interfering with the original work's market.<sup>225</sup> In addition to the possible harm to the market for the original work the fourth factor also considers potential harm to the logical markets for derivative works, even if such markets have not yet materialized.<sup>226</sup> Only markets that rightholders would develop or license others to develop are

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<sup>217</sup> *Blanch v. Koons*, 467 F.3d 244, 256 (2d Cir. 2006).

<sup>218</sup> 17 U.S.C. § 107 (2006).

<sup>219</sup> *Campbell*, 510 U.S. at 586-87; *Harper & Row*, 471 U.S. at 565-66.

<sup>220</sup> William F. Patry, *THE FAIR USE PRIVILEGE IN COPYRIGHT LAW* 449 (1985).

<sup>221</sup> *Sony Corp. v. Universal City Studios*, where the court found fair use in time shifting notwithstanding the fact that the copyrighted works were reproduced in their entirety, is an important example for such exception, *Sony Corp. v. Universal City Studios*, 464 U.S. 449-450 (1984).

<sup>222</sup> The superior importance of this factor was stated in a great number of cases. *See* for example: *Harper & Row*, 471 U.S. at 566; *Cable/Home Communication Corp. v. Network Prods., Inc.*, 902 F.2d 829, 845 (11th Cir. 1990); *Hustler Magazine, Inc. v. Moral Majority, Inc.*, 796 F.2d 1148, 1155 (9th Cir. 1986); and *Triangle Publ'ns, Inc. v. Knight-Ridder Newspapers, Inc.*, 626 F.2d 1171, 1177 (5th Cir. 1980). However, The Supreme Court in *Campbell* held that all of the factors are given equal consideration, *Campbell*, 510 U.S. at 578.

<sup>223</sup> *Harper & Row*, *id.*, at 558-59.

<sup>224</sup> *Campbell*, 510 U.S. at 593.

<sup>225</sup> *Sega Enters. v. Accolade, Inc.*, 977 F.2d 1510, 1523 (9th Cir. 1993). Copyright law, however, does not secure against uses that only reduce demand for the rightholder's work, *see Campbell*, 510 U.S. at 591-92.

<sup>226</sup> *Campbell*, 510 U.S. at 592; *Harper & Row*, 471 U.S. 568.

included in the relevant derivative markets.<sup>227</sup> Furthermore, courts must consider whether widespread conduct similar to the alleged infringer's use would have an adverse effect on the copyright owner's ability to market the work.<sup>228</sup> If the secondary use is noncommercial, the burden to prove such harm might be placed on the copyright owner.<sup>229</sup>

While the subject of the market harm analysis under the fourth factor is only a market that is traditional, reasonable, or likely to be developed, this definition has proved to be fairly expansive. The underlying confusion stems from the fact that "market harm" is an abstract legal concept, which entails reference to an established entitlement.<sup>230</sup> Copyright entitlement undoubtedly encompasses the owner's right to profit from the sales of her work, but the aggregation of all possible harm that could stem from a widespread use together with the inclusion of markets for derivative works within the scope of the relevant market was criticized for deeming any fair use claim unsuccessful.<sup>231</sup> A defendant would never be able to prove that her use, if widely imitated, would not substitute any potential future market in some derivative of the original work.<sup>232</sup> Similarly, the inclusion of lost licensing fees that the defendant should have paid for the use of the original work under the definition of market harm was criticized for collapsing the fourth factor into circularity.<sup>233</sup> there can always be a claim for market harm because the rightholder could have received a license fee for the very use that is at issue, but if the use is fair, the market for that use was not granted to the rightholder, and there was no obligation on the alleged infringer's end to obtain a license for the use.<sup>234</sup>

Courts started to make allowance for lost licensing revenue under a fair use analysis in the 1990s,<sup>235</sup> and most significantly in *American Geophysical Union v. Texaco*.<sup>236</sup> *Texaco's* scientists regularly photocopied journals articles in the company library for personal archival purposes. Although *Texaco* had purchased subscriptions to the journals for an institutional fee that was

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<sup>227</sup> *Campbell*, 510 U.S. at 592. For example, criticism is not recognized as a protectable derivative market since rightholders generally do not license critical assessments. *Id.*

<sup>228</sup> *Id.*, at 591.

<sup>229</sup> *Sony Corp. of Am.*, 464 U.S. at 451.

<sup>230</sup> Christina Bohannon, *Copyright Harm, Foreseeability, and Fair Use*, 85 Wash. U.L. Rev. 969, 977 (2007) (hereinafter *Bohannon, Copyright Harm*).

<sup>231</sup> Matthew Sag, *Copyright and Copy-Reliant Technology*, 103 NW. U. L. REV. 1607, 1653 (2009).

<sup>232</sup> *Id.* Indeed, the Second Circuit in *Texaco* acknowledged that "were a court automatically to conclude in every case that potential licensing revenues were impermissibly impaired simply because the secondary user did not pay a fee for the right to engage in the use, the fourth fair use factor would always favor the copyright holder." 60 F.3d 913, 929 n.17 (2d Cir. 1994).

<sup>233</sup> Mark A. Lemley, *Should A Licensing Market Require Licensing?*, LAW & CONTEMP. PROBS., 185, 189 (2007) (Hereinafter *Lemley, Licensing Market*).

<sup>234</sup> *Bohannon, Copyright Harm, supra* note 230, at 978. See also *Lemley, Licensing Market, id.*, at 190-191.

<sup>235</sup> *Lemley, Licensing Market, id.* (citing Frank Pasquale, *Breaking the Vicious Circularity: Sony's Contribution to the Fair Use Doctrine*, 55 CASE W. RES. L. REV. 777, 778 (2005)).

<sup>236</sup> *Texaco*, 60 F.3d 913 (2d Cir. 1994). Other cases have also used the theory of lost licensing revenue in their fourth factor analysis. See *Princeton Univ. Press v. Mich. Doc. Servs.*, 99 F.3d 1381 (6th Cir. 1996) (en banc); *Basic Books v. Kinko's Graphics Corp.*, 758 F. Supp. 1522 (S.D.N.Y. 1991).



substantially more expensive than the individual licensing fee, it was sued for copyright infringement.<sup>237</sup> Against Texaco's fair use argument, the plaintiffs claimed that the use was unfair as it interferes with the market for the copyrighted articles – if Texaco's scientists were not allowed to make copies of the articles, Texaco would have acquired additional paid copies for its scientists to use.<sup>238</sup> While the publishers failed to show actual lost sales, they succeeded in asserting that they had suffered the loss of *potential* licensing revenue, since Texaco might have been inclined to pay for either additional subscriptions or a photocopying license for its existing journals.<sup>239</sup> The Texaco Court attempted to address the circularity issue, by holding that while the effect on potential licensing revenues should be appraised in reviewing the fourth factor, only licensing of “traditional, reasonable, or likely to be developed markets” is appropriate for consideration.<sup>240</sup>

The Texaco decision was nonetheless widely excoriated; its reasoning failed to appease most critics.<sup>241</sup> Furthermore, many commentators raised concerns about the interests of secondary users alleging fair use, and did not share the Courts' view that the reference to a defined “normal” market could effectually prevent strategic manipulations by rightholders to make any use appear as if a reasonable market for it existed.<sup>242</sup> Licensing can become customary when repeat players or users with deep pockets, who are often copyright owners themselves, are willing to pay for the use, because they know that such payment secures their ability to license their copyright to non-repeat players in the newly created market.<sup>243</sup> A rule that eliminates unpaid uses of copyrighted works because a paid license was offered for the use incentivizes

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<sup>237</sup> Am. Geophysical Union v. Texaco, Inc., 802 F. Supp. 1, 7 (S.D.N.Y. 1992).

<sup>238</sup> Lemley, *Licensing Market*, *supra* note 233, at 190.

<sup>239</sup> Texaco, 60 F.3d, at 931.

<sup>240</sup> *Id.*, at 929-30.

<sup>241</sup> See Mark A. Lemley, *The Law and Economics of Internet Norms*, 73 CHI.-KENT L. REV. 1257, 1277 n.98 (1998); Glynn S. Lunney, Jr., *Fair Use and Market Failure: Sony Revisited*, 82 B.U. L. REV. 975, 1030 (2002) (hereinafter *Lunney, Fair Use*); Bobannan, *Copyright Harm*, *supra* note 230 at 971; Sara K. Stadler, *Incentive and Expectation in Copyright*, 58 HASTINGS L.J. 433, 457-59 (2007); Pamela Samuelson, *Unbundling Fair Uses*, 77 FORDHAM L. REV. 2537, 2620 (2009); Christina Bohannon & Herbert Hovenkamp, *IP and Antitrust: Reformation and Harm*, 51 B.C. L. REV. 905, 973-74 (2010). But See Gordon, *Fair Use Markets*, *supra* note 43, at 1834 (arguing that the circularity criticism is overstated: “A bad circular argument is commonly defined as one that “commits the logical fallacy of assuming what it is attempting to prove.” This the Texaco court does not do, for it is possible to take the incentive effects of physically foregone license fees into account and yet find fair use for the defendant.”).

<sup>242</sup> Gordon, *Fair Use Markets*, *supra* note 43, at 1827-1828; Loren, *Market Failure*, *supra* note 9, at 41-44.

<sup>243</sup> Loren, *Market Failure*, *id.* (“If a copyright owner, or an industry of copyright owners, convince[s] enough users to pay for a certain type of use, then the “price” becomes customary. Often the first users to pay the requested fees are those copyright owners in the industry who, through a gentlemen's agreement, have undertaken to pay fees.”) See also Matthew Africa, *The Misuse of Licensing Evidence in Fair Use Analysis: New Technologies, New Markets, and the Courts*, 88 CAL. L. REV. 1145, 1172 (2000) (noting that “For the consumer or the creator without an inventory of valuable works, this result is more troubling. Not only may she be held accountable for another user's caution, but there is also no corresponding benefit to her from a custom of payment.”)

rightholders to develop such a licensing market for all possible uses.<sup>244</sup> Rightholders can require licensing even for uses that seem clearly fair, simply by threat of litigation.<sup>245</sup> Consequently, a licensing market can be established when users choose to obtain licenses for borderline uses rather than risk the cost of litigation.<sup>246</sup> Users would prefer to pay for three reasons: first, licensing fees are often lower than litigation costs; second, some users (especially in the entertainment industry) would settle for paying for the use to avoid the risk of injunctive relief; third, a user may fear the reputational harm associated with being identified as a copyright infringer.<sup>247</sup> When a licensing fee is paid for noninfringing uses a new licensing market is established, which may weigh heavily against the fairness of a use in subsequent cases where the fee is not paid.<sup>248</sup>

The Texaco decision and its successors have been accused of wrongfully applying the market failure approach to fair use<sup>249</sup> by addressing only one kind of market failure while neglecting to acknowledge other classes of failures.<sup>250</sup> The view that the transaction costs failure caused by the licensing process can be alleviated through a permission system is indeed correct. But the availability of such a system cannot eliminate other market failures, such as, “diffuse external benefits that cannot be efficiently internalized in any bargained-for exchange.”<sup>251</sup> Professor Lydia Pallas Loren points out non-transformative uses in the context of research, scholarship and education, and demonstrates that the threat of a market failure is not removed by reducing the transaction costs.<sup>252</sup> Such analysis does not count the significant external benefits that those uses may have, and can wrongfully deem them unfair.<sup>253</sup>

The consideration of lost potential licensing revenue was also attacked for not distinguishing between the ability to charge for a use and the legal requirement to do so. As articulated by Professor Gideon Parchomovsky:

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<sup>244</sup> Lemley, *Licensing Market*, *supra* note 233 at 190-191 (“And indeed they have done so. Not only has the market for photocopy permissions skyrocketed, but copyright owners are charging for rights to home viewing of television programs, rap-music samples, and even the right to parody their works. One can similarly imagine a copyright owner making claims of lost revenue from being unable to license fan fiction, satire, and even criticism.”)

<sup>245</sup> *Africa*, *supra* note 243 at 1172. See also Lawrence Lessig, *FREE CULTURE: HOW BIG MEDIA USES TECHNOLOGY AND THE LAW TO LOCK DOWN CULTURE AND CONTROL CREATIVITY* 187 (2004); Lemley, *Licensing Market*, *id.* The licensing practice of the Copyright Clearance Center (“CCC”) has been criticized for not considering limitations such as fair use, and because they seek to license every use of a published work. Ray Patterson & Stanley W. Lindberg, *THE NATURE OF COPYRIGHT, A LAW OF USERS' RIGHTS* 181-186 (1991).

<sup>246</sup> *Africa*, *id.*

<sup>247</sup> *Id.*, at 1172-1173.

<sup>248</sup> *Id.* See also James Gibson, *Risk Aversion and Rights Accretion in Intellectual Property Law*, 116 *YALE L.J.* 882, 887 (2007).

<sup>249</sup> The market failure approach of fair use was introduced in 1982. See Gordon, *Fair Use as Market Failure*, *supra* note 6. *Infra* notes 326-345 and accompanying text elaborate on the market failure approach.

<sup>250</sup> Loren, *Market Failure*, *supra* note 9, at 33.

<sup>251</sup> *Id.*

<sup>252</sup> *Id.*

<sup>253</sup> *Id.*

“[T]he ability to charge by itself cannot possibly determine legal rights. A hoodlum might have the ability to charge protection fees, and yet no one would argue that this in itself gives him a right to do that . . . . Absent an underlying theory of rights, the ability to charge is normatively meaningless.”<sup>254</sup>

Indeed, while copyright law grants rightholders control over uses within the scope of their exclusive rights, it does not bestow upon them the power to control every possible use of their works.<sup>255</sup> The fair use defense serves copyright’s ultimate goal of promoting “the Progress of Science and useful Art”<sup>256</sup> by limiting authors’ monopoly rights.<sup>257</sup> Thus, when defining the spectrum of uses that the rightholder may license, courts should not look at what uses the rightholder can or is willing to license, but rather at the character of the use at issue, and its desirability from a public policy perspective.<sup>258</sup>

After *Texaco*, courts have been trying to answer the critics by announcing that the mere offering of a license would not deem a use unfair. In *Castle Rock Entertainment, Inc. v. Carol Publishing Group, Inc.* the court gave the examples of “parody, news reporting, educational or other transformative uses,” as uses that are within “fair use markets,” thus exploitation of the market by fair uses cannot be preempted by offering to license the uses.<sup>259</sup> The same rationale — defining the fair use market based on a normatively substantial character of the use — was restated in *Bill Graham Archives v. Dorling Kindersley Ltd.*<sup>260</sup> In *Dorling Kindersley*, the Second Circuit held that in a market for “transformative” uses (a fair use market) the loss of license fees would not be weighed against the defendant when analyzing the fourth factor.<sup>261</sup> In a different case, the Ninth Circuit Court of Appeals held that the use of thumbnail images in Google’s image search engine was transformative, and found that use to be fair, even though a market for downloading thumbnail images to mobile phone existed.<sup>262</sup> Additional courts have followed suit,<sup>263</sup> while others have insisted on defining the relevant market broadly.<sup>264</sup>

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<sup>254</sup> Gideon Parchomovsky, *Fair Use, Efficiency, and Corrective Justice*, 3 LEGAL THEORY 347, 359 (1997).

<sup>255</sup> *Elkin-Koren*, *supra* note 196, at 292.

<sup>256</sup> U.S. CONST. art. I, s 8, cl. 8.

<sup>257</sup> *Acuff-Rose*, 114 S. Ct. at 1169.

<sup>258</sup> *Elkin-Koren*, *supra* note 196, at 292-293.

<sup>259</sup> *Castle Rock*, 150 F.3d at 145 n. 11.

<sup>260</sup> *Bill Graham Archives v. Dorling Kindersley Ltd.*, 448 F.3d 605, at 614-615 (2d Cir. 2006). *Gordon*, *Fair Use as Market Failure*, *supra* note 6 at 1830-1832, points out that even the clear language of *Dorling Kindersley* is not without problems.

<sup>261</sup> *Dorling Kindersley*, 448 F.3d at 615.

<sup>262</sup> *Perfect 10, Inc. v. Amazon.com, Inc.*, 487 F.3d 701, 724-25 (9th Cir. 2007). This decision overruled the district court’s finding that the use was unfair because a market for thumbnail images existed, *Perfect 10 v. Google, Inc.*, 416 F. Supp. 2d 828, 848-49 (C.D. Cal. 2006).

<sup>263</sup> *See* for example *Bridgeman Art Library, Ltd. v. Corel Corp.*, 36 F. Supp.2d 191 (S.D.N.Y. 1999) (finding that free use of the images was allowed regardless of the spreading practice of licensing photos of public domain images); *Associated Press v. Meltwater U.S. Holdings, Inc.*, 12 CIV. 1087 DLC, 2013 WL 1153979 (S.D.N.Y. Mar. 21, 2013) (announcing that “while a copyright holder’s current participation in a given market is relevant to the determination of

Recently, two cases involving uses by non-profit educational institutions linked the fourth fair use factor to actual licensing practices. In *Cambridge Univ. Press v. Becker*,<sup>265</sup> the court found that the copying of small excerpts from books for teaching purposes by the defendant, Georgia State University, was a fair use.<sup>266</sup> When discussing the effect of the defendant's use on the plaintiffs' market the court estimated whether a practicable licensing option was obtainable for the institution.<sup>267</sup> The court echoed the *Texaco* decision, and held that the availability of licensing has an effect on the value of the copyrighted work: "(i)f available permissions are not paid, the value of the copyright is less than it otherwise would be."<sup>268</sup> According to the court, an appropriate licensing solution only exists when licenses are "easily accessible, reasonably priced, and ... in a format which is reasonably convenient for users"<sup>269</sup> Where such licenses are readily available, and the fees are not paid, there is a powerful argument against finding fair use. The court also noted that while actual licensing practice could be regarded as a separate fair use test, the court treats it within the fourth factor evaluation because it involves nonpayment of permissions fees, thus pertinent to the analysis.<sup>270</sup>

In *Authors Guild Inc. v. HathiTrust*,<sup>271</sup> the court did not find potential market harm in the making of digital copies, for search and print-disabled access purposes, by groups of libraries in cooperation with Google. The crux of the fair use analysis was the transformative nature of the use, despite the fact that the searching, text mining, and print-disabled access opportunities provided by the defendants' use created a distinct market for the plaintiffs' works.<sup>272</sup> Nevertheless, the court also considered the effect of the challenged use upon the market of the work. First, the court rejected the argument that the production of digital copies by the defendants represents lost sales because the copies offered for purchase by plaintiffs would have not allowed the transformative uses advanced by the defendants' copying.<sup>273</sup> The court also found plaintiffs' argument of potential market harm speculative, holding that since the uses at issue are transformative, the harm arises, if at all, to a transformative market, which is not a part of "traditional, reasonable or likely

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whether the market is 'traditional, reasonable, or likely to be developed,' it is not determinative.").

<sup>264</sup> See for example the Sixth Circuit's opinion in *Bridgeport Music v. Dimension Films*, 410 F.3d 792 (6th Cir. 2005). Although the court did not conduct a fair use analysis, its decision highlighted the rightholder's economic right to his work notwithstanding the transformative character of the secondary use. See also *Fox Broadcasting Company, Inc. v. Dish Network, L.L.C.*, 2012 WL 5938653 (C.D. Cal. Nov. 7, 2012), where the court held that the fourth factor weighed against the use, even though there was no evidence of existence of a market for quality assurance copies.

<sup>265</sup> *Becker*, 863 F. Supp. 2d 1190.

<sup>266</sup> *Id.*, at 1223-1240.

<sup>267</sup> *Id.*, at 1235-1240.

<sup>268</sup> *Id.*, at 1237.

<sup>269</sup> *Id.*

<sup>270</sup> *Id.*, at 1239.

<sup>271</sup> *HathiTrust*, 902 F. Supp. 2d 445.

<sup>272</sup> *Id.*, at 457-462.

<sup>273</sup> Meaning either full-text searches or access for the print-disabled individuals, *id.*, at 462.

to be developed markets.”<sup>274</sup> Interestingly, the court also looked at evidence offered by the defendants, according to which it would be prohibitively expensive to develop a market to license the use of works for the purposes at issue and that the potential revenue generated from such uses would not cover the licensing costs.<sup>275</sup> Consequently, the court found that the high costs associated with developing such market would prohibit the formation of a viable market in the first place, thus “there will be no one to buy the goods from.”<sup>276</sup>

*iii. The Nonexistence of a Licensing Choice under the Fourth Factor Analysis*

The previous discussion detailed the considerations that courts have been weighing under the fourth fair use factor, as well as the relevance of existing and potential licensing markets within the analysis. As explained above, courts have been criticized for shrinking the scope of fair use by setting the limits of possible licensing markets for a copyrighted work too broadly and using circular analysis. This Article seeks to introduce an additional observation. Courts have frequently considered the presence of licensing in existing and potential markets for copyrighted works to deny fair use claims. Until recently, however, the argument has not fully extended to the reverse cases. While evidence of a functioning licensing market has traditionally favored the rightholder, the absence of such a market has neither been given similar weight in favor of the secondary user, nor has it been considered an integral part of the inquiry.<sup>277</sup> Indeed, the *Texaco* court indicated that “... it is not unsound to conclude that the right to seek payment for a particular use tends to become legally cognizable under the fourth fair use factor when the means for paying for such use is made easier.”<sup>278</sup> Nearly eighteen years later, and more unequivocally, the *Cambridge* case and *HathiTrust* decisions incorporated the lack of actual and potential licensing practice under the fourth factor to favor the defendant arguing fair use.

These decisions do not signify that a shift into full consideration of missing licensing possibilities under the fourth factor has yet occurred for three reasons: first, since the incorporation of efficient licensing choices into the fair use analysis was introduced in the *Texaco* decision back in 1994, hundreds of decisions engaged in a fair use discussion, but the *Cambridge* and *HathiTrust* cases are the only two decisions that considered the nonexistence of a licensing choice in favor of finding fair use;<sup>279</sup> second, both cases are awaiting currently pending appeals and may yet be overruled;<sup>280</sup> third, the

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<sup>274</sup> *Id.*, at 463. Citing *Texaco*, 60 F.3d at 931.

<sup>275</sup> *Id.*

<sup>276</sup> *Id.*, at 464. The court also notes that “Although Plaintiffs assert that the Copyright Clearance Center (“CCC”) could eventually develop a license for the uses to which Defendants put the works... the CCC has no plans to provide for or develop such a license.” *Id.*

<sup>277</sup> That is, until the recent decision in *Becker*, 863 F. Supp. 2d 1190, 1237, which is discussed in length above.

<sup>278</sup> *Texaco*, 60 F.3d at 898.

<sup>279</sup> A list of all fair use cases since the *Texaco* decision that looked at licensing under the fourth factor to negate fair use is on file with the author.

<sup>280</sup> *Albanese*, *supra* note 40, *JUSTIA Dockets & Filing*, *supra* note 40.

cases share similar factual characteristics which strongly favor a finding of fair use — the defendants in both cases are nonprofit institutions, the use was done for educational purposes, and the works at issue pertain to the market for texts and books. Thus, even if upheld on appeal, those rulings could be rightfully interpreted as applicable only for uses of copyrighted texts within noncommercial settings that are done for educational purposes.

Furthermore, and most importantly, the cases do not provide a complete and accurate statement as to how to include the appropriate licensing choices within the fourth factor analysis. The statement is incomplete in the sense that it does not present the *lack* of such choices as a factor favoring the defendant in a fair use inquiry. To the extent one accepts the Texaco reasoning that the existence of an appropriate licensing mechanism is a consideration *against* fair use, one should acknowledge the absence of such a mechanism as a consideration *for* finding a use fair.

The statements provided by the *Texaco* and *Cambridge* decisions (and to some extent also by the *HathiTrust* court) also err because they consider the *reasonableness* of the licensing *price* as a new element under the fourth factor without explaining either the justification for its presence or its application.<sup>281</sup> As a property right, copyright endows the owner of the right with the power to charge any amount for the use of her work; hence, considering the reasonableness of the licensing fee in a fair use analysis conflicts greatly with the proprietary grant of copyright. The assumption is that in a functioning market rational players would produce the most efficient transaction. Rightholders are in the best position to determine the right price to trigger such a transaction because, when setting the price of the entitlement, they will “transfer it only when infringers value it more highly and are willing to prove it by paying in advance.”<sup>282</sup> Furthermore, even if the license price is set too high at the outset, the effects of market competition are expected to drive down prices to a competitive rate over time.

The *Texaco*, *Cambridge*, and *HathiTrust* courts also neglected to explain to what extent the licensing price should impact the fair use inquiry. Treating

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<sup>281</sup> See *Texaco*, 60 F.3d 930-931 (“Despite Texaco’s claims to the contrary, it is not unsound to conclude that the right to seek payment for a particular use tends to become legally cognizable under the fourth fair use factor when the means for paying for such a use is made easier. This notion is not inherently troubling; it is sensible that a particular unauthorized use should be considered “more fair” when there is no ready market or means to pay for the use, while such an unauthorized use should be considered “less fair” when there is a ready market or means to pay for the use.”); *Beker*, 863 F. Supp. 2d 1190, 1237 (“This Court agrees with *Texaco* that where excerpts are reasonably available, at a reasonable price, it is only fair for this fact to be considered in determining whether Defendants’ unpaid uses of excerpts constitutes a fair use... For loss of potential license revenue to cut against fair use, the evidence must show that licenses for excerpts of the works at issue are easily accessible, reasonably priced, and that they offer excerpts in a format which is reasonably convenient for users.”); *HathiTrust*, 902 F. Supp. 2d 445, 463 (“Defendants offer substantial evidence that it would be prohibitively expensive to develop a market to license the use of works for search purposes, access for print-disabled individuals, or preservation purposes. Waldfoegel Decl. ¶¶ 7, 22–24 (estimating that the costs of such a license as to the works in the HDL would be in the neighborhood of \$569 million and that the potential revenue generated would not cover these costs so it was not a “commercially viable endeavor”).

<sup>282</sup> *Merges, Contracting into Liability Rules*, *supra* note 28, at 1306.

the reasonableness of the price within the fourth factor can help courts recognize strategic behavior by rightholders who license certain uses of their work in order to create the sham of available licensing regimes for litigation purposes,<sup>283</sup> or who refuse to license certain uses in order to uphold their economic, political strength, and/or to avoid undermining the value of their work through secondary uses.<sup>284</sup> For this reason, reference to the price should be made only to frustrate preclusion strategies that use price as a means to prevent licensing in certain markets. In all other cases, however, the power to determine the price should remain in the rightholder's hands.

The decisions also failed to address the question of how a 'reasonable' price should be defined and calculated. The appropriate price setting could be based upon various factors, which are not only hard to determine in the first place, but are also depend on the context of the use and the nature of the market. Aside from the differentiation issue, even once established, the reasonableness factors are highly susceptible to market changes. Consequently, absent an obligatory statutory or administrative guideline there is no way to predict *ex ante* what price would be acceptable as 'reasonable'. Even if such a set of formal rules to inform rightholders could be devised, it is appropriately left to the legislature.<sup>285</sup>

## V. THE SUBTLE INCENTIVE THEORY OF COPYRIGHT LICENSING

As the previous discussion highlights, the availability of licensing choices has already been imported to the application of the fair use doctrine. However, since first introduced by the *Texaco* court, courts have failed to contemplate the reverse side of the inquiry – while the existence of a workable licensing alternative has been accounted to deny fair use, aside from two recent cases involving relatively comparable factual setting, the absence of such choice has not been appropriately evaluated to support a finding of fair use under the fourth factor. Mending this logical error not only would result in better-balanced fair use reasoning, but also would advance a subtle incentive to develop accessible licensing systems – the ultimate goal advocated for by this Article.

Moving to the substance, the subtle incentive theory rewards rightholders who employ licensing markets by weighing the licensing subtest against fair use while motivating rightholders who refrain from licensing in certain markets (or sweepingly) by favoring fair use under the same subtest. The licensing choice that the subtle incentive theory ideally seeks to inspire is one under which prospective users are able, after identifying and locating a rightholder, to get a quote for the desired use or reasonably negotiate towards

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<sup>283</sup> See *infra* notes 297-299 and accompanying text.

<sup>284</sup> Rightholders can use the price as a means to exclude a certain market. For example, they can offer a license to non-commercial users in a price which is prohibitively expensive so such users would not be able to afford it, and so the rightholder would not have to manage licensing in the non-commercial market. Such strategic behavior is considered under the subtle incentive theory, *id.*

<sup>285</sup> "it is not the [court's] job to apply laws that have not yet been written." *Sony*, 464 U.S. at 456, 104 S.Ct. 774.

a license. For this purpose, when determining whether an efficient and accessible licensing alternative exists, courts ought to look at the journey of a prospective user in the relevant market at the time preceding the use. The review should remain objective at all time; for example, the court should look at a prospective reasonable user, as opposed to the defendant in the case, and any manifestation of intent should not be relevant to the inquiry unless that intent was proven factually to promote or hinder the licensing process.

For the licensing subtest to be applied in the fair use analysis, the defendant has to demonstrate an attempt to acquire a license. In other words, only users who made a reasonable effort to obtain a license would benefit from the licensing subtest of fair use under the subtle incentive theory. It is more just for a defendant who endeavored to obtain a license, but was unable to, to receive the shield of fair use, than to give a defendant who never intended to pay for her use the windfall of the licensing failure. Furthermore, rewarding a defendant's licensing pursuit is supported by the market failure theory of fair use – fair use would apply only when the market failure actually impeded licensing.<sup>286</sup> It is important to note that some courts have treated licensing attempts as prejudicial to a defendant's fair use claim.<sup>287</sup> Such approach is clearly not consistent with the subtle incentive theory, or even copyright's intended goals, because weighing licensing attempts against a defendant arguing fair use discourages licensing. While the motivation behind this view is socially desirable — combating the 'clearance culture' that dominates copyright markets these days<sup>288</sup> — it cannot be justified as a general matter in light of fair use's ambiguous standards. Due to the doctrine's equitable, fact-specific, and indeterminate nature, there is no affirmative way for those who want to use a copyrighted work to make an accurate, ex-ante determination of the fairness of their use.<sup>289</sup> Thus, in many cases, it makes better sense to secure a license to shelter one's use from immensely costly legal actions.<sup>290</sup> The arguments against the clearance culture surely have weight,<sup>291</sup> yet it is unwise to fight the clearance culture by treating a licensing attempt as a fair use prejudice because when users face the choice of either making an uncertain fair use or avoiding the use, risk-averse users and even risk-neutral users would opt for the latter, thus lessening beneficial, secondary creation.<sup>292</sup> When a user has to choose between making a use that may be classified as an

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<sup>286</sup> See *infra* notes 326-345 and accompanying text.

<sup>287</sup> Michael W. Carroll, *Fixing Fair Use*, 85 N.C. L. REV. 1087, 1121 (2007). Nevertheless, if the rightholder would in no case agree to negotiate a license, the case for fair use may be strengthened, *id.*

<sup>288</sup> The Clearance Culture is “the shared set of expectations that all rights must always be cleared.” Patricia Aufderheide & Peter Jaszi, CTR. FOR SOC. MEDIA, *Untold Stories: Creative Consequences of the Rights Clearance Culture for Documentary Filmmakers* (2004), [http://www.cmsimpact.org/sites/default/files/UNTOLDSTORIES\\_Report.pdf](http://www.cmsimpact.org/sites/default/files/UNTOLDSTORIES_Report.pdf).

<sup>289</sup> James Gibson, *Risk Aversion and Rights Accretion in Intellectual Property Law*, 116 YALE L.J. 882, 889 (2007)

<sup>290</sup> Not to mention the fact that “the simple reality is that finding out whether permission is required usually costs more than getting permission.” *Id.* at 885.

<sup>291</sup> *Aufderheide & Jaszi, supra* note 288, at 22.

<sup>292</sup> *Gibson, supra* note 289, at 890. Also “the decision-makers in the real world of copyright practice are typically risk-averse”. *Id.* at 891.



infringement, avoiding the use, or paying for a license even if the use may be fair, the last option is the least bad choice and bears the least social loss out of the three.

The strategy proposed by the subtle incentive theory is both logical and practical. The subtle incentive theory is sufficiently bounded to avoid substantial harm to rightholders' creation incentives. Encouraging rightholders to license by modifying the fair use calculus means that the licensing inquiry does not condemn a given case to a particular result; it is only one within a number of criteria considered by the courts.<sup>293</sup> The subtle incentive theory adds an additional balancing variable to be considered that can affect, but not determine, the award of a fair use treatment. In other words, the mere lack of licensing choice would not be sufficient to tip the scale in favor of the defendant when a secondary use fails all or part of the other fair use tests and does not accord well with the essence of fair use.

By incorporating the subtle incentive theory into the fair use calculus, the theory achieves three important policy goals. First, it is expected to stimulate the development of licensing mechanism in the market, especially by corporate rightholders and repeat players, who would, in practice, be most affected by the inclusion of the licensing inquiry in the fair use doctrine. Second, the subtle incentive theory respects two kinds of creation: early creation and secondary creation that builds on protected elements of early creation. Copyright is intended to incentivize both creations, but frequently favors the former at the expense of the latter. By spurring the development of licensing alternatives, the subtle incentive theory better balances the rights and incentives of early creators with those of their secondary successors. Third, the subtle incentive theory sends an important message about the desired policy that copyright seeks to enforce; it is a policy where rightholders are appropriately compensated for the use of their work, while secondary users enjoy a hassle-free or relatively simple way to lawfully use a copyrighted work.

The subtle incentive theory is proposed as a middle ground solution to encourage rightholders to engage in licensing their works. As such, it shares some of the aspects of each of the existing proposals. As opposed to statutory strategies, the subtle incentive theory does not involve aggressive intervention via legislation, a step that has been criticized for its destructive effects on copyright markets, and is very unlikely to occur in the near future. The subtle incentive theory also does not require the repudiation of prior judicial precedents. Instead, it offers a doctrinal modification, which in light of existing case law is better defined as a doctrinal adjustment that can be implemented easily and at zero cost.

Like compulsory licensing proposals, but to a lesser extent, the subtle incentive theory involves intervention in transactions that may have taken place voluntarily in the market. It does not, however, interfere with the proprietary right of copyright owners; it leaves the choice to license (or not)

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<sup>293</sup> Gordon notes that the *Texaco* court used a similar argument to explain how physically foregone license fees can be considered without falling into circular reasoning: "fatal circularity can be avoided by treating physically foregone license fees as a part of the analysis rather than conclusive on fair use." *Gordon, Fair Use Markets, supra* note 43, at 1838.

and the setting of the price in the hands of rightholders. Contrary to the invisible hand perspective, the subtle incentive theory does not leave the market untouched, and indirectly interferes with players' choices. Nevertheless, market solutions may still be developed, encouraged, and sought after by rightholders in accordance with the invisible hand vision because in the interim period, until those solutions are instigated, rightholders are motivated to engage in licensing. Most importantly, the subtle incentive theory enjoys great flexibility – even a rightholder who lost a fair use case because, *inter alia*, she did not offer an accessible and efficient licensing system can change that fate for all future uses by being reasonably responsive to subsequent licensing inquiries in the relevant market.

The consequences produced by the subtle incentive theory may seem conflicting at first. The subtle incentive theory is intended to incentivize licensing, thus increasing the number of licensing transactions in the copyright market. Also as a practical matter, the subtle incentive theory is broadening fair use by considering in the analysis the lack of licensing alternatives coupled with the existence of licensing choices as already introduced into the calculus by the Texaco court. As licensing and fair use are traditionally considered incompatible, the dual motivation seems counter-intuitive: if under the subtle incentive theory more uses would be licensed, then logically the number of fair uses should drop, because fair uses do not require a license. This intuition, however, is predicated on a mistaken premise that there are only two categories of use between early and secondary creators – fair uses and licensed uses, thus a drop in one must be reflected by an increase in the other. There are, however, four categories of use between early and secondary creators are: licensed uses, fair uses, infringing uses, and non-uses.<sup>294</sup> Indeed, fair uses do not require a license, and most licensed uses are probably not fair; however, secondary users have two other choices: infringe on the rightholder's copyright, or avoid the use. The increased number of licensing choices as well as the stretched boundaries of fair use under the subtle incentive theory are expected to attract users who are either engaging in piracy or avoiding the use because they could not obtain a license and were too risk averse to rely on the fair use doctrine. Thus, the increase in the number of licensed uses under the subtle incentive theory is not necessarily because uses that otherwise have been fair are obtaining licenses. It is the other two groups, non-uses and infringing uses, that are expected to shrink when more uses are licensed or deemed fair under the subtle incentive theory.

In the following pages, I offer a set of guidelines to be used by courts when considering the existence of an efficient licensing scheme within their fourth factor review. Before commencing, however, I would like to emphasize that while this Article introduces the subtle incentive theory, it does not, by any means, attempt to provide an exhaustive set of guidelines. Instead, I wish

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<sup>294</sup> There are also uses that are authorized under some exemption or limitation to the author's exclusive rights, and uses that are available under some informal practice. The former can be classified in the same group with fair uses, while the latter can be classified as a licensed use, even though this license is not directly given to the secondary user and can be revoked as the rightholder wishes.

to plant the seeds for a fruitful scholarly discussion as to the best application of the subtle incentive theory to promote better licensing alternatives for secondary users and, by so doing, to encourage further creation.

*Burden of Proof:* To invoke the non-existence of licensing in her favor, a defendant would have to demonstrate a bona-fide attempt to acquire a license. Once such a showing is made, the burden of proof would then shift to the plaintiff to prove that the licenses in the relevant market for the relevant use were offered. By allocating the burden of proof this way, each party is responsible for validating facts that would be more efficiently provable by themselves – the defendant is in the best position to confirm that she attempted to obtain a license and support such claim with relevant evidence, while the plaintiff is in the best position to testify about her existing licensing choices, business model, and policy.

*Identifying and locating rightholders:* More often than not, the ability to effortlessly identify and locate a rightholder would be directly linked to the existence of a licensing choice in the relevant market. Yet, the process of identifying and locating a rightholders should not, as a general matter, be part of the inquiry. Efforts to facilitate the identification and location process should undoubtedly be made in other channels, but the subtle incentive theory does not impose the burden of being easily identified on rightholders, as such obligation makes no practical or theoretical sense.<sup>295</sup> The rule would not apply, however, when evidence suggests that a rightholder was actively attempting to be undiscoverable. Reasons for such concealing behavior can be licensing-related, e.g., strategic behavior for the purpose of foiling a possible fair use defense, but may also be personal or artistic, e.g., seeking to avoid criticism or maintain artistic anonymity. Irrespective of the motivations behind such attempts, when looking at licensing alternatives the court should consider intentionally created obscurity. Rightholders should not pay the price for objective obstacles that may hinder their detectability, but they certainly should bear the consequences of deliberately interfering with the first step of licensing. Accordingly, the defendant bears the burden of proving that she could not identify or locate the rightholder because the latter was deliberately undiscoverable. Once this showing is made, however, the rightholder would have to convince the court that the licensing system she offers was accessible and available notwithstanding the rightholder's obscurity.

At this point, it is also important to note that a user's sincere yet failed attempt to locate a rightholder would also not have an effect on the fair use analysis under the subtle incentive theory. A user's effort in this context may indicate that the user had intent to acquire a license; nonetheless intent has nothing to do with the actual existence of an accessible licensing alternative. As the subtle incentive theory is designed to incentivize the offering of licensing in the market, a user's intent, while could be analyzed under other considerations like good faith,<sup>296</sup> should not be part of the licensing review.

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<sup>295</sup> This is true especially for individuals, non-commercial, semi-commercial, and small-scale corporate rightholders.

<sup>296</sup> Because the listing of fair use purposes and factors is "not intended to be exhaustive," courts are authorized to consider factors other than the four specified in the statute. The

*Contacting the rightholder.* Courts ought to look at the defendant's options for contacting the rightholder – how could the rightholder be reached? The availability of a working email account and/or telephone number may establish that the rightholder is available for licensing inquiries. Continual attempts to contact a rightholder that failed due to unresponsiveness of the latter can provide a strong indication of the lack of a licensing alternative in the market for the challenged use.

*Market Differentiation.* The fourth factor of fair use is predicated on the premise that a rightholder can offer his work for licensing in more than one market. Thus, a use that interferes with a market that is already exploited or that is expected to be normally developed is deemed unfair under the fourth factor. Following the same premise, the subtle incentive theory probes the various markets for the work, including the one in which the challenged use takes place. Offering licensing in one market (or more) does not benefit the rightholder in a fair use analysis unless accessible licensing exists in the relevant market to which the defendant's use appertains. Examples of market differentiation include commercial uses as opposed to non-commercial uses, licensing the work as a whole as opposed to licensing partial uses, medium-related licensing (i.e., licensing only for TV/Newspaper/or specific Internet platforms), licensing the use of a hard copy as opposed to a digital copy, and licensing a work for national use only, as opposed to international licensing.

Rightholders may avoid licensing in a certain market for a variety of reasons. For instance, a decision not to employ a particular market may be grounded in a cost-benefit analysis that concluded the costs would exceed the expected revenue. A similar decision might be based on timing prioritization — a rightholder may plan to eventually employ several markets, but she starts by investing in developing licensing choices in only one or two markets. Rightholders may also choose not to license for ideological reasons, privacy concerns, a desire to avoid large scale distribution of the work, or unfamiliarity with additional markets that could benefit from a licensing alternative. Even though some of those reasons are economically sound, none of them should matter. If a market is lacking an accessible licensing mechanism, users in that market are left with no legal alternative other than fair use or non-use, and it is exactly this scarcity that the subtle incentive theory wishes to curtail.

*Pricing.* When looking at licensing markets for the purpose of fair use, courts should not generally reference the license price. Copyright bestows upon a rightholder a proprietary entitlement, the essence of which is the power to set a chosen price and to gain as large a share of the profit as possible.<sup>297</sup> Furthermore, many of the weaknesses of compulsory licenses are associated with the difficulty of determining the right price for the relevant market.<sup>298</sup> There are countless factors that should be looked at when contemplating a ceiling price for a license, including many that are context-specific. It is highly

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courts have made allowance for additional factors including the defendant's good or bad faith. PATRY ON FAIR USE § 7:1 (2013). See for example, *Harper & Row*, 471 U.S., 562; *Campbell*, 510 U.S., 585, and *Field v. Google, Inc.*, 412 F. Supp. 2d 1106, 1118-23 (D. Nev. 2006).

<sup>297</sup> Lloyd L. Weinreb, *Fair's Fair: A Comment on the Fair Use Doctrine*, 103 HARV. L. REV. 1137, 1148 (1990).

<sup>298</sup> See *supra* notes 124-125 and 128-131, and accompanying text.

speculative and virtually impossible to formulate clear guidelines as to what price would be considered reasonable. Moreover, even if such a list could be devised, it would be prone to market changes, which may make it irrelevant shortly after it was concocted. In other words, once a rightholder offers a license, the goal of the subtle incentive theory is reached. Where a licensing alternative exists, but the price is set too high, users would simply opt not to purchase a license, and the rightholder is expected to either adjust her pricing accordingly or leave it as is, if she values the work more.

The exception to the above rule is if the court finds that a rightholder has been using pricing as a strategy to preclude a certain market. In those cases, the price of the license should be analyzed as part of the court's review of market differentiation. For example, when a rightholder sets the license price for commercial uses and noncommercial uses to be the same, it could be that the rightholder is trying to avoid licensing for noncommercial uses. The courts, thus, would need to look into the causes for the similarity in the pricing, and learn whether those reasons are rooted in a desire to exclude noncommercial uses from the possibility of licensing or if the similarity can be justified on other grounds.

*Product Differentiation:* The above discussion of market differentiation applies to product differentiation as well. Rightholders can decide not to provide a license for a certain use in a certain market, and likewise they can choose not to license one or some of the informational products in their repertoire, but if they do so choose, then fair use will likely be found. For example, a rightholder may license the right to remix a certain musical track, but would, under no circumstances, allow the remix of a different work of hers. In such a case, the rightholder would still exercise the power to refuse licensing, but the licensing subtext would weigh for fair use because a realistic licensing alternative was missing.

*Efficient and Accessible:* The called-for licensing choice would be deemed efficient and accessible if the rightholder, or someone on her behalf, is reasonably available for and responsive to licensing inquiries. The subtle incentive theory does not impose on a rightholder an obligation to maintain a constantly working licensing system, and does not view rightholders as licensing service providers. Naturally, the existence of a licensing system that is efficiently operating to serve secondary users would provide a strong indication against fair use. However, rightholders who are available and responsive for licensing inquiries, in the sense that users can communicate with them and either negotiate a license or get a quote for the specific desired use, would also be successful in showing the existence of a licensing choice in the market. Availability and responsiveness require rightholders to respond to users' requests in a timely fashion with clear answers.

Like any other legal rule, the consideration of availability and responsiveness is also susceptible to creative manipulations by rightholders, who may be available and responsive but nonetheless frustrate licensing of their works. Thus, like the consideration of pricing, the rule about availability and responsiveness would not stand when a rightholder excludes a specific market from her potential licensing markets either by sweepingly rejecting all licensing requests or by offering a similar price for all secondary uses.

Manipulation in this context, however, is unlikely to become common. In most cases licensing is a revenue generator for rightholders. When the cost of licensing exceeds expected returns, rightholders would be motivated to engage in licensing only in rate cases, where the cost of enlarging the pool of fair uses under the subtle incentive theory, together with lost licensing fees that derive from the lack of licensing offering in the market is greater than the cost of maintaining an accessible and efficient licensing choice. Even in those rate cases, rightholders are likely to find manipulation to be more time-consuming and expensive than engagement in licensing.

*Point at Time:* The court ought to direct the licensing inquiry to the time when the user's licensing attempt took place. If, in the meantime, the rightholder initiated a missing licensing system the result should remain the same. One can rightfully argue, however, that if the purpose behind the licensing test is to subtly incentivize licensing, once an accessible licensing choice is offered there is no justification to favor a defendant in a fair use analysis for the past nonexistence of a viable licensing choice. Indeed, the ultimate aim of the licensing subtest is to encourage licensing. Nevertheless, as previously mentioned, the representation of licensing choices is susceptible to manipulations, especially given the long-lasting nature of copyright litigation. To increase their prospects of winning a case, Rightholders might offer a licensing choice as soon as they file a lawsuit or a short time before. Also, rightholders would benefit from pinning the licensing inquiry to a specific point at time in the event that they choose to discontinue a licensing choice which existed when the defendant made her use. In those cases, the licensing subtest would be against fair use, even though the licensing alternative is no longer valid for similar uses in the future.

## VI. THE SUBTLE INCENTIVE THEORY AND FAIR USE JUSTIFICATIONS

Legal commentary has offered many interpretations of the fair use doctrine in an attempt to define the overreaching principles which should guide the analysis.<sup>299</sup> In this section I review three of most prominent justifications for fair use, and analyze their premises to spot potential conflicts with the subtle incentive theory. Before commencing, it is vital to acknowledge the difference between the following interpretations and the subtle incentive theory. The subtle incentive theory, while contemplating copyright objectives, is primarily dedicated to encouraging licensing of

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<sup>299</sup> In addition to the three views I survey in the following pages, there are other commentators who offered various theories of fair use. To name just a few: Michael J. Madison, *A Pattern-Oriented Approach to Fair Use*, 45 WM. AND MARY L. REV. 1525 (2004) (arguing that “favored practices” and “accepted patterns” should be explicitly acknowledged in fair use analysis); Raymond Shih Ray Ku, *Consumers and Creative Destruction: Fair Use Beyond Market Failure*, 18 BERKELEY TECH. L. J. 539 (2003) (fair use acts as a legitimate creative destruction of copyright markets that challenges existing production and distribution models without undermining creation incentives); *Weinreb*, *supra* note 297 (viewing fair use as an appeal for fairness, by considering accepted norms and customary practice), and *Lunney, Fair Use*, *supra* note 241 (claiming that fair use should balance the public benefits and losses derived from the grant of copyright monopoly to the rightholder).

preexisting works to secondary creators or users. The views discussed below, however, are concerned with recognizing the theoretical justifications that warrant the existence of fair use as an exception to the copyright monopoly. As such, those views usually employ a macro perspective to give grounds for the fair use defense that does not concern itself with one specific factor, but rather permeates all or most of the factors. This discrepancy would at some points make the subtle incentive theory look like it opposes those justifications. However, bearing in mind that the licensing inquiry is balanced with additional factors and does not stand alone, the subtle incentive theory is generally in tune with existing fair use interpretations.

In an oft-cited article, Judge Pierre Leval suggested that fair use should apply only to a use that “serves the copyright objective of stimulating productive thought and public instruction without excessively diminishing the incentives for creativity.”<sup>300</sup> In other words, according to Leval, the fair use doctrine should maximize creative expression through looking at the productivity of the secondary use, and minimize harm to incentive by securing the author’s incentive to create. Under this view, the four statutory factors encapsulate all the relevant considerations to be calculated within a fair use analysis, and additional issues (e.g., morality matters and artistic integrity) are false factors “that divert the inquiry from the goals of copyright.”<sup>301</sup> Since this argument revolves around the secondary use — whether it is sufficiently productive and transformative and whether it excessively harms the market for the original — the subtle incentive theory, which analyzes the ability of a would-be creator to obtain a license in the market, is facially at odds with Leval’s understanding of fair use.<sup>302</sup>

Nevertheless, the conflicting views can be reconciled to some extent by looking at Judge Laval’s underlying argument: copyright’s sole purpose is to promote the production and dissemination of creative works, and fair use, for this matter, is “a necessary part of the overall design.”<sup>303</sup> The subtle incentive theory shares this proposition, and by hoping to incentivize licensing through the existing fair use factors instead of as its own determinative factor, agrees that the secondary use must be sufficiently creative, transformative, and socially productive. Against the backdrop of transaction costs in copyright reality, however, homing in exclusively on the nature of the secondary use without making allowance to existing licensing difficulties does not truly follow copyright’s objective. Such view is incomplete because it acknowledges only three categories of secondary uses: licensed (thus authorized), unauthorized (thus infringing), and fair uses (unauthorized but sufficiently productive to justify the expropriation of the owner’s right). There are many potential uses that do not even get to the point of being classified as one of those three

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<sup>300</sup> Pierre N. Leval, *Toward A Fair Use Standard*, 103 HARV. L. REV. 1105, 1110 (1990).

<sup>301</sup> *Id.*, at 1125.

<sup>302</sup> Leval’s approach was criticized for being under inclusive. See for example *Weinreb, supra* note 297, at 1142 (arguing that the list of principles offered by Leval “would neither reflect the full range of concerns embodied in the fair use doctrine nor would they much increase the clarity and predictability of results in concrete cases.”)

<sup>303</sup> *Leval, Id.*, at 1110.

groups because the secondary author chooses to refrain from using the work due to the unavailability of an accessible licensing choice.

In her seminal work, Professor Wendy Gordon presented the market theory of fair use, which in a way complements Judge Laval's approach by appraising market failures that interfere with consensual market transfers.<sup>304</sup> Under this approach, an unauthorized use of copyrighted works should be found fair where:

- (1) defendant could not appropriately purchase the desired use through the market; (2) transferring control over the use to defendant would serve the public interest; and (3) the copyright owner's incentives would not be substantially impaired by allowing the user to proceed.<sup>305</sup>

The opening part of the test prescribes a finding of fair use only when a market bargain is impossible or difficult to obtain due to high transaction costs, externalities, non-monetizable interest, noncommercial activities, or anti-dissemination motives.<sup>306</sup> The second part of the test supports fair use when allowing the unauthorized use produces a net gain in social value.<sup>307</sup> Social value should be estimated with the help of objective measures, a court should ask whether a rightholder would have consented to the transfer had she and the user bargained in a perfect market.<sup>308</sup> If consent could be implied, the use may qualify as fair use.<sup>309</sup>

The concluding element of the assessment safeguards copyright's incentive system by instructing courts not to award fair use if such finding would weaken the incentives of the plaintiff and similarly-situated copyright owners.<sup>310</sup> By offering the third part Gordon acknowledges the differences between a complete market failure and an "intermediate market failure," where the market successfully produces only a portion of all desirable transfers.<sup>311</sup> An intermediate market failure often occurs when a new technology is introduced and a custom of nonpaid uses develops due to the high costs associated with enforcing rights or obtaining permission.<sup>312</sup> In cases of intermediate market failure both enforcement and non-enforcement pose risks – enforcement may prevent desirable exchanges while allowing the use may harm authors' incentives.<sup>313</sup> In her early work, Gordon designed the third test to ensure that even if the unauthorized use would have generated a net social benefit, no fair use would be found where such finding could substantially injure rightholders' incentives.<sup>314</sup> Later, Gordon conceded that the condition

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<sup>304</sup> *Gordon, Fair Use as Market Failure, supra* note 6, at 1615.

<sup>305</sup> *Id.*, at 1601.

<sup>306</sup> *Id.*, at 1628-1633.

<sup>307</sup> *Id.*, at 1615-1618.

<sup>308</sup> *Id.*, at 1614.

<sup>309</sup> *Id.*, at 1616-17.

<sup>310</sup> *Id.*, at 1614. The level of injury is judged on an absolute scale, *id.* at 1619.

<sup>311</sup> *Id.*, at 1618.

<sup>312</sup> *Id.*, at 1618.

<sup>313</sup> *Id.*, at 1618-1619.

<sup>314</sup> *Id.*, at 1619. Accordingly, when a permission system is later offered an unauthorized use is less likely to be found fair. *Id.*



was overly restrictive and that substantial injury should be treated differently when considering different types of market failures.<sup>315</sup> Consequently she distinguishes between two classes of market failures – ‘technical failures’ that prevent perfect competitions such as “endowment effects, high transaction costs between owner and user, transaction costs that prevent a user from internalizing the social benefit she generates, indivisible products, and strategic behavior,”<sup>316</sup> and ‘market failures’ that “addresses all the normative reasons why we might not want to rely on the market, such as dissatisfaction with the pursuit of economic value.”<sup>317</sup> In the former category the unauthorized use is ‘excused’ under the special circumstances of the particular use, while in the latter a finding of fair use is ‘justified’ on non-economic grounds.<sup>318</sup>

The subtle incentive successfully passes Gordon’s trifold test. In accordance with the market failure criterion, the need to incentivize rightholders to offer licensing alternatives arises only when no accessible, lawful choice exists and a prospective user cannot obtain a license for her use. The second criterion, which essentially looks at whether the use is more valuable in the hands of the defendant or in the hands of the rightholder, is more closely tied to the specific circumstances of the use, thus should be evaluated in every case based on the facts at issue and the application of the four, statutory, fair use factors to those facts. The third test appears to initially conflict with the subtle incentive theory, as the former used to treat harm to rightholders’ incentive as a trump card in all cases. Nevertheless, even under the third test, some degree of injury to creators’ incentives is contemplated.<sup>319</sup> Also, even though Gordon is less likely to accept fair use treatment for uses that are excused (as opposed to justified) when the rightholder suffers harm to her incentive, she points out that “it is important to avoid exaggerating the extent to which even ‘excuse’ cases will disappear.”<sup>320</sup>

Gordon rightly identifies that, where fair use is warranted due to high transaction costs between owner and user, technological and institutional changes that reduce those costs should affect the availability of the fair use defense.<sup>321</sup> The subtle incentive theory follows the same rational, and is highly responsive to changes in licensing markets. Most importantly, under the subtle incentive theory, even if a finding of fair use may harm creation incentives, it would not be binding on other rightholders in the same or different market if their works can be efficiently licensed. The same finding would also be inapplicable to the same rightholder if she subsequently established an efficient licensing solution. By then, potential injury to the incentives of the original

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<sup>315</sup> Wendy J. Gordon, *Excuse and Justification in the Law of Fair Use: Transaction Costs Have Always Been Only Part of the Story*, 50 J. COPYRIGHT SOC’Y U.S.A. 149, 154 (2003) (hereinafter *Gordon, Excuse and Justification*).

<sup>316</sup> *Id.*, at 2. See also Wendy J. Gordon, *Market Failure and Intellectual Property: A Response to Professor Lunny*, 82 B.U. L. REV. 1031, 1037 (2002) (hereinafter *Gordon, Market Failure and IP*).

<sup>317</sup> *Id.*

<sup>318</sup> *Gordon, Market Failure and IP*, *supra* note 316, at 1037.

<sup>319</sup> And see also Leval’s view that “The market impairment should not turn the fourth factor unless it is reasonably substantial.” *Leval*, *supra* note 300, at 1125.

<sup>320</sup> *Gordon, Excuse and Justification*, *supra* note 315 at 190.

<sup>321</sup> *Id.*, at 188-9.

rightholder, as well as those of the secondary users wishing to build upon her work, are virtually eliminated. In other words, if transaction costs are the sole impediment to licensing (in the terms of Gordon, the ‘excuse’ class of fair uses),<sup>322</sup> when rightholders act to minimize those costs by being available and responsive to licensing inquiries, the subtle incentive theory would not support a finding of fair use. If, however, a rightholder refuses to license out of a motivation unrelated to copyright objectives, such as blocking criticism (in Gordon’s terms – the ‘justification’ class of fair uses),<sup>323</sup> other considerations would tip the scale in favor of the user and would deem her use fair even if an efficient licensing system were available.

An additional theory of fair use by Professor William Fisher suggests that fair use should be reconstructed via two models, the first of which is based on economic analysis to efficiently allocate scarce resources,<sup>324</sup> and a second “good life” model that aims to advance “a substantive conception of a just and attractive intellectual culture” informed by “a vision of the good life and the sort of society that would facilitate its widespread realization.”<sup>325</sup> Fisher acknowledges some weaknesses in the economic model (e.g., its inability to satisfactorily deal with endogenous changes in preferences),<sup>326</sup> but still generally subscribes to it. He is also cognizant of the flaws in the utopian approach, which “trades precision for practicability in the advancement of the good society.”<sup>327</sup> Similarly to Gordon, Fisher also puts emphasis on the harm caused by the unauthorized secondary use advocating for an expansive definition of ‘harm’ including,

“any predictable adverse impact on the welfare of the producers caused by depriving them of the right either to forbid the activity in question or to charge persons who wish to engage in it should be included.”<sup>328</sup>

The last view could, in some instances, be perceived as contradicting the subtle incentive theory. Similarly to Gordon’s approach, however, Fisher does leave room for the court’s discretion to grant fair use if the harm is either insubstantial or would not significantly diminish the quantity or quality of the rightholder’s output.<sup>329</sup> Moreover, Fisher’s vision of a utopian theory of fair use highlights the importance of the public interest.<sup>330</sup> The subtle incentive theory, in this sense, speaks the same language, by being responsive to the reality of licensing hurdles and wishing to facilitate lawful secondary creation.

Other scholars also designated fair use to privileged classes of specific uses either to encourage secondary creation or to subsidize other important

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<sup>322</sup> *Id.*

<sup>323</sup> *Id.* Also Gordon, *Fair Use as a Market Failure*, *supra* note 6, at 1643.

<sup>324</sup> William W. Fisher III, *Reconstructing the Fair Use Doctrine*, 101 Harv. L. Rev. 1659, 1698 (1988).

<sup>325</sup> *Id.*, at 1744.

<sup>326</sup> *Id.*, at 1736-39.

<sup>327</sup> *Id.*, at 1783.

<sup>328</sup> *Id.*, at 1781.

<sup>329</sup> *Id.*, at 1781-82.

<sup>330</sup> *Id.*, at 1746.

social, cultural, and political interests.<sup>331</sup> While there is no consensus as to which uses should be part of the exemption list, fair use privileges were proposed for scientific and educational research, uses that are sufficiently transformative, uses that advance democratic values, personal or private uses, noncommercial uses and more.<sup>332</sup> Being centered on considerations external to the character of the use, the subtle incentive theory is neutral as to these approaches to fair use.

## VII. CONCLUSION

The licensing shortage in copyright has long been considered conducive to the initiation and maintenance of piracy, as well as detrimental to further creation. Recognizing this state, legal scholarship has polarized into two competing positions: the first calls for the initiation of statutory licensing systems to allow specific uses of copyrighted works in return for administratively-prescribed fair fees, which, contrary to the proprietary nature of copyright, does not leave the licensing choice in the hands of the rightholder. The second approach objects governmental intervention and counts on the invisible hand of the market to respond to licensing demand only when such reaction is necessary through market-based solutions and self-help means to facilitate efficient licensing or licensing bypasses.

This Article advocates for a middle ground approach by propounding the subtle incentive theory of copyright licensing. Under the subtle incentive theory, rightholders would be subtly incentivized to engage in licensing their works if the lack of licensing alternatives in the market for the copyrighted work is considered within a fair use review. More specifically, courts have already made allowances for the existence of licensing possibilities to deny fair use when an efficient licensing scheme was in place. Nevertheless, for nearly eighteen years since the inclusion of the licensing inquiry under the fourth factor of fair use analysis, courts did not use the same rationale to support a finding of fair use when an accessible licensing choice did not exist. Courts have started to move in this direction by partially considering the lack of licensing in the market to support fair use as demonstrated in two recent cases involving non-profit institutions making a copy for educational purposes. Those decisions, however, do not offer a comprehensive strategy for the inclusion of licensing shortages in the fourth factor, and also, importantly, make references to the reasonableness of the price as an indication without justifying or explaining the application of such analysis.

The subtle incentive theory offers a zero cost doctrinal change to alleviate copyright licensing difficulties. The subtle incentive theory gives rightholders the liberty to choose to license –it allows rightholders to avoid licensing if offering such alternative makes no economic sense for them – while it empowers them to possibly change the classification of future uses from fair to unfair merely by offering a licensing choice. Hence, it does not over-interfere with market dynamics and avoids many of the problems

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<sup>331</sup> *Madison*, *supra* note 299, at 1567-68.

<sup>332</sup> *Id.*

associated with compulsory licensing. The subtle incentive theory does not leave the licensing failure to be repaired by the market only, and adds an important policy statement as to the significance of original and secondary creation alike.