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The Economics of Copyright Exemptions: A Comparative Analysis

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1 INTRODUCTION TO THE ECONOMICS OF COPYRIGHT PROTECTION

Economic analysis understands intellectual property laws, including copyright law, as necessary to protect markets for information goods against an appropriation problem.[1] The core value of creative and innovative product is the information on which books, movies, and inventions are based. Information is non-excludable to the extent that once it is distributed to some, it is difficult to prevent access to others.[2]

Additionally, and increasingly also in the digital era, the costs of the imitation of a creative work are substantially lower than the costs of original creation. Since it is difficult to prevent imitators from accessing and distributing a work, prices in a competitive setting may drop to levels that prevent creators from appropriating sufficient value to recover their development costs. As a result, the incentive to create[3] and invest[4] in creative works will be socially suboptimal.[5]

Copyright law addresses the appropriation problem by creating property rights in creative works that enable copyright owners to prevent copying without permission.[6] Copyright law

[1] On the utilitarian philosophical theory of intellectual property law and for an economic account of copyright law more specifically, *see, e.g.*, Paul Goldstein, Copyright's Highway (1994); Gillian Hadfield, *The Economics of Copyright: An Historical Perspective*, 38 Copyright L. Symp. 1 (1992).

[2] Oren Bracha & Talha Syed, *Beyond the Incentive–Access Paradigm? Product Differentiation & Copyright Revisited*, 92 Tex. L. Rev. 1841, 1848 (2014).

[3] A growing literature shows, however, that the driving force of creativity is often motives unaffected by copyright protection. For a collection of recent work, *see* Kate Darling & Aaron Perzanowski, Creativity without Law (2017). Similarly, an ongoing literature points to ways in which authorship is commercialized outside of a copyright framework. Seminal contributions include Robert M. Hurt & Robert M. Schuchman, *The Economic Rationale of Copyright*, 56 Am. Econ. Rev. 421 (1966); Arnold Plant, *The Economic Aspects of Copyright in Books*, 1 Economica 167 (1934). Empirical accounts of the effects of copyright law on creative output include Raymond Shih Ray Ku, Jiayang Sun, & Yiying Fan, *Does Copyright Law Promote Creativity? An Empirical Analysis of Copyright's Bounty*, 62 Vand. L. Rev. 1669 (2009); Joel Waldfogel, *Music Piracy and Its Effects on Demand, Supply, and Welfare*, 12 Innovation Pol'y Econ. 91 (2012).

[4] Jonathan Barnett suggests that copyright law is essential mostly for profit-motivated intermediaries that incur the capital-intensive risks related to the creation and distribution of content. *See* Jonathan M. Barnett, *Copyright without Creators*, 9 Rev. L. & Econ. 389 (2013).

[5] F. M. Scherer, Industrial Market Structure and Economic Performance 444 (2d ed. 1980) ("If pure and perfect competition in the strictest sense prevailed continuously ..., incentives for invention and innovation would be fatally defective without a patent system or some equivalent substitute.").

[6] On the property rights framework for intellectual property rights, *see* Harold Demsetz, *The Private Production of Public Goods*, 13 J.L. & Econ. 293 (1970). The case for strong property rights for intellectual creations is based on the notion

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provides right holders with an exclusive right to copy, sell, and distribute their work. As legal monopolists, copyright owners are free to set the price of their work in a way that enables them to recoup their investments in the production of the work. A copyright holder's ability to increase the price, however, depends on the amount of substitutes for the work that are available to consumers on the market. If the copyrighted work is highly unique and desirable to consumers, the copyright owner will be able to charge a higher price than when there is competitive pressure from similar, yet non-infringing works.[7]

These higher prices, although deemed necessary to enable a creator to recoup his or her investment in the original work, may however reduce access to the work for consumers with more financial constraints. Unless the copyright owner is able to price-discriminate,[8] the overall accessibility of the work is reduced and the copyright creates so-called deadweight losses.[9] This is a first, major potential social cost related to copyright law and intellectual property rights more generally.

Additionally, copyright protection carries a second potential social cost. Because copyrighted materials are nonphysical information goods, the use and enjoyment of a copyrighted work by one does not degrade the ability of others to consume and enjoy it.[10] Due to the "non-rivalrous" nature of the consumption of information goods, the marginal costs of increasing the diffusion of information are zero. Since there is no social cost to sharing creative works, it is preferable from a welfare perspective that information goods are available free of charge.[11]

Overall then, in this utilitarian framework, society's goal is to set the scope of copyright protection so that it effectively fosters incentives without unnecessarily increasing deadweight losses and reducing access. This so-called incentives–access tradeoff has been front and center in the utilitarian philosophical theory that drives much of the academic literature on copyright law.[12]

that markets ensure efficient allocation of resources through market-based, Coasean bargaining. *See* Robert P. Merges, *Of Property Rules, Coase and Intellectual Property*, 94 COLUM. L. REV. 2655 (1994). *See also* Richard P. Adelstein & Steven I. Peretz, *The Competition of Technologies in Markets for Ideas: Copyright and Fair Use in Evolutionary Perspective*, 5 INT'L REV. L. & ECON. 209, 232–33 (1985) (suggesting that markets would find a way to overcome the high transaction costs relating to time-shifting licensing).

[7] The competitive nature of entertainment markets is a topic of contention. *See, e.g.*, DEREK THOMPSON, HIT MAKERS: THE SCIENCE OF POPULARITY IN AN AGE OF DISTRACTION (2017) (describing the blockbuster effect for films and music, suggesting that entertainment markets have a winner-takes-all nature). *But see* CHRIS ANDERSON, THE LONG TAIL: WHY THE FUTURE OF BUSINESS IS SELLING LESS OF MORE (2006) (describing how the Internet has opened up potential markets for any niche product).

[8] On price discrimination in copyright generally, *see, e.g.*, Julie E. Cohen, *Copyright and the Perfect Curve*, 53 VAND. L. REV. 1799 (2000); John P. Conley & Christopher S. Yoo, *Nonrivalry and Price Discrimination in Copyright Economics*, 157 U. PA. L. REV. 1801 (2008); Wendy J. Gordon, *Intellectual Property As Price Discrimination: Implications for Contract*, 73 CHI.-KENT L. REV. 1367 (1998); Glynn S. Lunney Jr., *Copyright's Price Discrimination Panacea*, 21 HARV. J.L. & TECH. 387 (2008); Michael J. Meurer, *Copyright Law and Price Discrimination*, 23 CARDOZO L. REV. 55 (2001).

[9] A deadweight loss is a cost to society created by market inefficiency. In this particular instance, the higher price of the work excludes some willing buyers that the seller loses as potential purchasers. If the seller is able to engage in perfect price discrimination, each consumer would be charged the maximum price they are willing and able to pay. *See generally* PAUL SAMUELSON, FOUNDATIONS OF ECONOMIC ANALYSIS (1947).

[10] *See, e.g.*, Glynn S. Lunney Jr., *Fair Use and Market Failure: Sony Revisited*, 82 B.U. L. REV. 975, 979 (2002) ("When a private good is stolen, the theft necessarily deprives the original owner of possession. Making an unauthorized copy does not.").

[11] Kenneth J. Arrow, *Economic Welfare and the Allocation of Resources for Invention*, *in* THE RATE AND DIRECTION OF INVENTIVE ACTIVITY 609 (Richard R. Nelson ed., 1962).

[12] This paradigm has come under recent challenge by the product differentiation approach. The important insight here is that copyright protection might increase the supply of creative works and access overall, since legal rights stimulate investments in creative industries by competitors. *See, e.g.*, Michael Abramowicz, *A New Uneasy Case for Copyright*, 79 GEO. WASH. L. REV. 1644, 1646–7 (2011); Michael Abramowicz, *An Industrial Organization Approach to Copyright Law*, 46 WM. & MARY L. REV. 33, 38 (2004); Christopher S. Yoo, *Copyright and Product Differentiation*, 79 N.Y.U. L. REV. 212, 221 (2004).

2 COPYRIGHT EXEMPTIONS: ECONOMIC JUSTIFICATIONS

Viewed through the economic lens, copyright exemptions help adjust the scope of copyright protection in the pursuit of a socially optimal tradeoff between access and incentives.

Economic accounts have suggested two primary instances where copyright exemptions are likely to be socially advantageous.[13]

First, given the non-rivalrous nature of information goods, it is socially desirable to provide free access *whenever doing so does not adversely impact the incentives of authors to create*. If there is no positive incentive effect, there is no reason to limit access by way of exclusive right to authors. Examples include situations where market failure is likely to prevent the owner from reaping any benefits from the exploitation of the copyright work.[14]

Second, it is socially desirable to restrict the exclusive right of copyright owners *if the costs of doing so are likely lower than the benefits generated by the exemption*. Examples include situations where an exemption is deemed necessary to safeguard a competing public interest, such as free speech. Exemptions may be desirable if, in the absence of an exemption, the copyright owners would be likely to exercise their exclusive right to block these socially beneficial uses. This is most likely for works that use copyrighted work for the purpose of criticism or parody.[15] Along the same lines, copyright exemptions likely produce net benefits when the incentive effects on the current copyright owners are less than the cost such protection imposes on the creation by another generation of creators.[16]

3 COPYRIGHT EXEMPTIONS AND MARKET FAILURE

The economic analysis of copyright law has focused primarily on the beneficial role of exemptions in mitigating potential allocative inefficiencies that result from copyright protection.

Although economists acknowledge the benefits of clear, strong property rights in market settings,[17] limitations to the property rights are justified when there is market failure.[18] For

[13] The seminal contribution is 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, 1601, 1614 (1982) (explaining how the US doctrine of fair use effectively permits uncompensated uses of copyrighted material where the transaction costs of licensing or other means of exchange would prevent a transfer through the market, and suggesting that copyright exemptions should apply for uses that would otherwise constitute infringement if: "(1) market failure is present; (2) transfer of the use to defendant is socially desirable; and (3) an award of fair use would not cause substantial injury to the incentives of the plaintiff copyright owner."). Economic justifications for limitations in copyright protection include, *e.g.*, Glynn S. Lunney, Jr., *Reexamining Copyright's Incentives–Access Paradigm*, 49 VAND. L. REV. 283 (1996); Peter S. Menell, Tailoring Legal Protection for Computer Software, 39 STAN. L. REV. 1329 (1987); Peter S. Menell, *An Analysis of the Scope of Copyright Protection for Application Programs*, 41 STAN. L. REV. 1045 (1989); Peter S. Menell, *An Epitaph for Traditional Copyright Protection of Network Features of Computer Software*, 43 ANTITRUST BULL. 651 (1998) (analyzing role of limitations in addressing the market failure associated with computer software); Plant, *supra* note 3 (arguing for a narrow scope of protection for copyrighted works (limited to exact or near-exact duplication) on the grounds that broader protection would inefficiently promote investment in copyrightable endeavors at the expense of other activities in the economy); Hurt & Schuchman, *supra* note 3; Robert Kreiss, *Accessibility and Commercialization in Copyright Theory*, 43 UCLA L. REV. 1 (1995).

[14] *Id.*

[15] Robert P. Merges, *Are You Making Fun of Me?: Notes on Market Failure and the Parody Defense in Copyright*, 21 AIPLA Q.J. 305 (1993).

[16] William M. Landes & Richard A. Posner, *An Economic Analysis of Copyright Law*, 18 J. LEGAL STUD. 325 (1989). *See also* Mark A. Lemley, *The Economics of Improvement in Intellectual Property Law*, 75 TEX. L. REV. 989 (1997).

[17] R. H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960).

[18] Wendy J. Gordon, *Excuse and Justification in the Law of Fair Use: Commodification and Market Perspectives*, *in* THE COMMODIFICATION OF INFORMATION 149 (Niva Elkin-Koren & Neil Weinstock Netanel eds., 2002) (distinguishing between excusable cases of use under a "market malfunction" and justifiable cases of use in light of a "market limitation").

instance, markets do not clear if there are obstacles to bargaining, such as prohibitively high transaction costs, informational asymmetries, and negative externalities. When such obstacles prevent otherwise desirable transfers between copyright owners and users, the non-rival nature of information goods may favor abrogating the full exclusionary rights of the copyright owner by way of a copyright exemption.

Much of the scholarship on copyright exemptions has focused on transaction costs as a potential source of market failure and justification for copyright law. Transaction costs may create so-called negative value uses: the costs of obtaining a license might be higher than the value to the individual user. If the use of the work requires permission (for instance, using pictures in a classroom setting), the user (teacher) will elect not to use the work. In many cases, however, the use of the work would create positive externalities (education) without hurting the incentives of the author (who would otherwise not have received licensing income and would not have obtained reputation benefits/exposure).

Several contributions point out, however, that the relationship between copyright exemptions and transaction costs is complex and dynamic. First, generous copyright exemptions might prevent markets from developing the transaction-reducing institutions that could solve market failure, such as copyright collectives.[19] Second, transaction costs fluctuate over time. New technologies (interactive digital rights management technologies, etc.) might reduce transactions costs, suggesting that the importance of market failure–related copyright exemptions might diminish. Other institutional factors, such as legislative changes, might increase transaction costs. For instance, the removal of copyright formalities in the US Copyright Act has made it harder to identify copyright owners and obtain licenses.[20]

Bargaining in markets for copyrighted works is complicated also by the complementary nature of copyrighted works. In order to put together a radio program, album collection or a handbook of academic writings, it may be necessary to collect licenses on a large number of works that fit together. Such bundling requires one to obtain permission from multiple different right holders. Due to the property rule (injunctions) protection, each copyright owner effectively has a veto-right on the ideal collection of works that the licensee has in mind. In these circumstances, the market for copyrighted works has the risk of a potential tragedy of the "anticommons": the complex dynamics of negotiations might prevent mutually beneficial and socially welfare-improving bundling to take place.[21] Negotiations with multiple right holders face the familiar obstacles of transaction costs and strategic behavior. Additionally, if licensors overestimate the value of their individual contributions, a symptom documented in social science research on creators and innovators, the collective asking price might

[19] The seminal contribution on this point is Robert P. Merges, *Contracting into Liability Rules: Intellectual Property Rights and Collective Rights Organizations*, 84 Cal. L. Rev. 1293 (1996). For a discussion in the context of copyright law and copyright collectives, *see* Francesco Parisi & Ben Depoorter, *The Market for Intellectual Property: The Case of Complementary Oligopoly*, *in* The Economics of Copyright 162 (Wendy J. Gordon & Richard Watt eds., 2003).

[20] Wendy J. Gordon, *The Fair Use Doctrine: Markets, Market Failure and Rights of Use*, *in* Handbook on the Economics of Copyright 77 (Richard Watt ed., 2014). On notice costs in intellectual property systems, *see* Peter S. Menell & Michael J. Meurer, *Notice Failure and Notice Externalities*, 5 J. Legal Analysis 1 (2013).

[21] An important insight is that these impediments to bargaining exist even when transaction costs are low – for instance, due to digital technologies. Ben Depoorter & Francesco Parisi, *Fair Use and Copyright Protection: A Price Theory Explanation*, 21 Int'l Rev. L. & Econ. 453 (2003). At heart, the double monopoly problem is one of coordination between monopolists in order to reduce deadweight losses. *See, e.g.*, Norbert Schulz, Francesco Parisi, & Ben Depoorter, *Fragmentation in Property: Towards a General Model*, 158 J. Institutional & Theoretical Econ. 594 (2002).

well exceed the value of the collective work.[22] Finally, when bundling involves works that are highly complementary, a so-called Cournot-duopoly or double monopoly problem exists – if licensors do not coordinate, the increased price they individually charge makes it less likely that the collective project will come about.[23]

Given the nature of anticommons problems, the need for copyright exemptions in markets for creative works increases with (a) the number of copyright holders in it; (b) the degree of complementarity between the copyrighted inputs; and (c) the degree of independence between the various copyright holders in the pricing of their licenses.[24]

4 IMPLEMENTING COPYRIGHT EXEMPTIONS: A COMPARATIVE ECONOMIC ANALYSIS

While there is some consensus on the economic justifications for copyright exemptions, the legal implementation of exemptions is a topic of some contention. Legal systems have incorporated copyright exemptions in radically different ways. Most legal systems are situated somewhere in a continuum between two extremes: open-ended statements of permissible uses, on the one hand, and more closed, enumerated exemptions, on the other hand. These variations align with the foundational distinction in the economic analysis of law between rules and standards: the former containing more detail, where the latter are more general statements of legal norms.[25]

Most open-ended standards, the US fair use doctrine being the most famous example,[26] leave it up to judges to apply the standard to new situations and applications. Copyright exemptions that are implemented by rules usually involve statutorily provided, concrete and lists of exemption.[27]

[22] *See, e.g.*, Christopher Buccafusco & Christopher Jon Sprigman, *The Creativity Effect*, 78 U. Chi. L. Rev. 31 (2011) (describing "creativity effect"); Michael A. Heller & Rebecca S. Eisenberg, *Can Patents Deter Innovation? The Anticommons in Biomedical Research*, Science, May 1, 1998, at 698 (describing "attribution bias").

[23] For an experiment on how overvaluations by right holders can lead to price demands in excess of the total value of the bundling, *see* Ben Depoorter & Sven Vanneste, *Putting Humpty Dumpty Back Together: Experimental Evidence of Anticommons Tragedies*, 3 J.L. Econ. & Pol'y 1 (2006).

[24] Francesco Parisi, Norbert Schulz, & Ben Depoorter, *Duality in Property: Commons and Anticommons*, 25 Int'l Rev. L. & Econ. 578 (2005).

[25] On the distinction between rules and standards: "Legal norms can be precise rules, which are blueprints for action and allow for mechanical decisions by judges and civil servants. Alternatively, they can be vague, mission-oriented standards, which delegate decisions from the maker of the law to the judiciary and the administration. Rules economize on the costs of adjudication and administration. Standards economize on the costs of norm specification." Hans-Bernd Schäfer, *Rules versus Standards in Rich and Poor Countries: Precise Legal Norms As Substitutes for Human Capital in Low-Income Countries*, 14 Sup. Ct. Econ. Rev. 113, 113 (2006). There is not a binary distinction between the two categories. Rather, "[t]he difference between a rule and a standard is a matter of degree – the degree of precision." Richard A. Posner & Isaac Ehrlich, *An Economic Analysis of Legal Rulemaking*, 3 J. Legal Stud. 257, 258 (1974). *See generally* Louis Kaplow, *Rules versus Standards: An Economic Analysis*, 42 Duke L.J. 557 (1992); Pierre Schlag, *Rules and Standards*, 33 UCLA L. Rev. 379 (1985).

[26] "[T]he fair use of a copyrighted work, including such use by reproduction in copies or phonorecords or by any other means specified by that section, for purposes such as criticism, comment, news reporting, teaching (including multiple copies for classroom use), scholarship, or research, is not an infringement of copyright. In determining whether the use made of a work in any particular case is a fair use the factors to be considered shall include: (1) the purpose and character of the use, including whether such use is of a 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." Copyright Act of 1976, 17 U.S.C. §107 (2007).

[27] *See* Article 5(2) of the EU Copyright Directive. 2001 O.J. (L167) at 10–19.

The comparative economic analysis of rules versus standards, as it relates to copyright exemptions, involves three main considerations: flexibility, indeterminacy, and rent seeking.

4.1 *Flexibility*

The unpredictable and fast-changing nature of technology[28] arguably makes open-ended standards more suitable for copyright exemptions.[29]

Open standards have a broader reach and may capture new technologies either implicitly by the broad wording or by judicial clarification in litigation. Precise legal rules, by contrast, are more quickly outdated by innovative applications of copyrighted content.[30]

Moreover, open-ended standards are more effective to counter "legal avoison."[31] Technological innovators sometimes develop novel applications that exploit the gaps between copyright rules and technologies.[32]

Technological innovators often design or create technological applications in a manner that purposefully circumvents copyright liability. For example, when the court in Napster established that copyright law implicates developers of centralized P2P technology by way of contributory liability, developers of file-sharing technology developed decentralized P2P file-sharing applications that were functionally equivalent to those explicitly prohibited in the Napster decision. By removing central servers, which gave rise to contributory liability on behalf of software developers, the developers successfully evaded the legal rule created in Napster.[33] Such acts of what has been termed legal "avoison" do violate legal rules *sensu stricto*, but nevertheless defeat the legislative intention.

[28] Take, for instance, the introduction of video cassette recording (VCR) technology. While private recordings of cable TV shows plainly violated the exclusive right of copyright holders to make copies, the flexibility of the fair use standard enabled courts to exempt the time-shifting features of VCR recorders. By allowing the record function to be maintained on VCR players, the fair use exemption arguably boosted the success of VCR technology, which eventually created a very profitable secondary market in the sale of video home system (VHS) tapes and rental movies. The fact that the VCR technology, with its dual use character, eventually boosted the revenues of copyright holders, plainly illustrates how technologies that are feared initially by copyright holders can turn out to be a blessing in disguise). See Mark A. Lemley, *Is the Sky Falling on the Content Industries?*, 9 Journal on Telecommunications and High Technology Law 125 (2011); Ben Depoorter, *Technology and Uncertainty: The Shaping Effect on Copyright Law*, 157 U. Pa. L. Rev. 1831 (2009) (discussing how it often takes many years before the social and economic consequences of new technologies become clear).

[29] On the necessity of a flexible fair use doctrine, *see, e.g.*, Dan L. Burk, *Muddy Rules for Cyberspace*, 21 Cardozo L. Rev. 121, 140 (1999) ("The 'muddy' four-part balancing standard for fair use allows courts to reallocate what the market cannot."); Michael W. Carroll, *Fixing Fair Use*, 85 N.C. L. Rev. 1087 (2007) (highlighting the context-sensitive nature of fair use); Matthew Sag, *God in the Machine: A New Structural Analysis of Copyright's Fair Use Doctrine*, 11 Mich. Telecomm. & Tech. L. Rev. 381, 435 (2005) (noting that a flexible fair use standard allows courts to adapt copyright protection to new innovations).

[30] *See, e.g.*, Ben Depoorter, *Technology and Uncertainty: The Shaping Effect on Copyright Law*, 157 U. Pa. L. Rev. 1831 (2009) (describing how rapid technological change makes open standards a better fit for copyright legislation than narrowly tailored rules).

[31] Leo Katz, Ill-Gotten Gains: Evasion, Blackmail, Fraud and Kindred Puzzles of the Law 17–30 (1996) (contrasting "avoision" of ethical rules with "avoision" of law).

[32] See in this regard Tim Wu's description of the relation between code and law: "The programmer is not unlike the tax lawyer, exploiting differences between stated goals of the law, and its legal or practical limits. He targets specific weaknesses in legal regimes . . ." Tim Wu, *When Code Isn't Law*, 89 Va. L. Rev. 679, 682 (2003).

[33] *See, e.g.*, Kristina Groennings, *Costs and Benefits of the Recording Industry's Litigation against Individuals*, 20 Berkeley Tech. L.J. 571, 573 (2005). For another notable example of a technology created to circumvent copyright provisions *see* Annemarie Bridy, *Aereo: From Working around Copyright to Thinking inside the (Cable) Box*, 2015 Mich. St. L. Rev. 465 (2015).

Bright line, narrow rules are thus easier for developers to circumvent, as they can create new adaptive technologies that does not fit within the existing rule. Because the new technology does not fit within the existing legal rule, lawmakers will need to play catch-up, reformulating substantive rules in order to capture new technologies that perform the same role in a different manner. By contrast, attempts at circumventing open standards will be more difficult given the broader sphere of application of a flexible standard. Additionally, courts can resolve ambiguities as to the applicability of the existing standard to a newly designed technology more quickly.

The choice between rules and standards also constitutes a tradeoff regarding the timing of the application of copyright exemptions. Rules are designed *ex ante* by regulators. Standards set out broader rules, allowing courts to fill in the details later on. Given the highly evolving, unpredictable innovative landscape of digital technologies, standards are a better fit for copyright exemptions.

4.2 Indeterminacy

The flexibility of open standards inevitably reduces the predictability of their application to new circumstances. For instance, since its inception, the US fair use doctrine[34] has been criticized for being "notoriously difficult to predict."[35] The doctrine is accused of infusing "significant ex ante uncertainty"[36] into copyright law. The lack of statutory guidance and wide discretion afforded to judges[37] are widely understood to cause substantial uncertainty.[38]

Economic analysis has highlighted how standards "trade off greater ex ante certainty for greater ex post context sensitivity."[39] When considering the desirability of flexible standards as

[34] The doctrine of fair use has been under attack for at least seventy years. *See* Dellar v. Samuel Goldwyn, Inc., 104 F.2d 661, 662 (2d Cir. 1939), in which Judge Learned Hand referred to the fair use doctrine as "the most troublesome in the whole law of copyright."

[35] Joseph P. Liu, *Two-Factor Fair Use?*, 31 COLUM. J.L. & ARTS 571, 578 (2008) (proposes reforming the current fair use doctrine by limiting the analysis to only the first and last of the four factors, instead of replacing it altogether as some other scholars have recommended).

[36] Carroll, *supra* note 29, at 1095 (citing 4 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT §13.05 [A][1][b]); 2 PAUL GOLDSTEIN, GOLDSTEIN ON COPYRIGHT §12.2.2, at 12:34 (3d ed. 2005); WILLIAM F. PATRY, THE FAIR USE PRIVILEGE IN COPYRIGHT LAW 45 (2d ed. 1995); Gideon Parchomovsky & Kevin A. Goldman, *Fair Use Harbors*, 93 VA. L. REV. 1483, 1483 (2007) ("would-be fair-users can rarely rely on the doctrine with any significant level of confidence.") (proposing that the implementation of nonexclusive safe harbors, which expressly set forth minimum amounts of copying as fair, would work to eliminate the uncertainty and unpredictability of the current fair use doctrine in copyright law). *See also* James Gibson, *Once and Future Copyright*, 81 NOTRE DAME L. REV. 167, 192 (2005) ("Fair use ... is too indeterminate a doctrine to provide a reliable touchstone for future conduct."); Darren Hudson Hick, *Mystery and Misdirection: Some Problems of Fair Use and Users' Rights*, 56 J. COPYRIGHT SOC'Y U.S.A. 485, 497 ("[S]ince the doctrine, as written, is open to such wide interpretation, the outcome of any legal battle that turns on the doctrine will almost always be in doubt."); Michael J. Madison, *A Pattern-Oriented Approach to Fair Use*, 45 WM. & MARY L. REV. 1525, 1666 (2004) ("Fair use is an *ex post* determination, a lottery argument offered by accused infringers forced to gamble, after the fact, that they did not need permission before."); David Nimmer, *"Fairest of Them All" and Other Fairy Tales of Fair Use*, 66 LAW & CONTEMP. PROBS. 263, 280 (2003) ("Basically, had Congress legislated a dartboard rather than the particular four fair use factors embodied in the Copyright Act, it appears that the upshot would be the same.").

[37] "Judges do not share a consensus on the meaning of fair use." Pierre N. Leval, *Toward a Fair Use Standard*, 103 HARV. L. REV. 1105, 1106 (1990).

[38] Hick, *supra* note 36. *But see* Pamela Samuelson, *Unbundling Fair Uses*, 77 FORDHAM L. REV. 2537 (2009) (showing doctrinal patterns by analyzing fair use case law in light of underlying policy concerns). *See also* Barton Beebe, *An Empirical Study of U.S. Copyright Fair Use Opinions, 1978–2005*, 156 U. PA. L. REV. 549, 554 (2008) ("much of our conventional wisdom about [US] fair use case law, deduced as it has been from the leading cases, is wrong.").

[39] Carroll, *supra* note 29, at 1100.

opposed to strict rules, the fundamental question is whether the benefits of flexibility outweigh the costs of the unavoidable higher degrees of uncertainty.[40]

It is worth noting that the application of novel technologies significantly increases the degree of legal uncertainty in copyright law.[41] Innovative leaps tend to create legal gaps, often making it difficult to rely on prior case law.[42]

Given the potential uncertainty induced by open standards in copyright law, it is important to be considerate of a number of undesirable side effects of legal uncertainty.

On the one hand, uncertainty undermines the deterrent effect of the law. Legal indeterminacy loosens the connection between behavior and enforcement. When the association between certain types of impermissible behavior and the chance of getting caught becomes more remote, individuals may decide that they might as well take the illicit action. Legal uncertainty may create the tipping point toward noncompliance,[43] as witnessed with regard to file-sharing on P2P networks or illegal video streaming.

On the other hand, if there is uncertainty about a legal standard, even individuals who attempt to act in compliance with the law will face the possibility of being held liable because of the unpredictability of the legal rule. Risk-averse individuals may react to this by "overcomplying," that is, modifying their behavior beyond the point that is socially optimal.[44] As a result, users of content that might well qualify for a copyright exemption seek out licenses or avoid using the content altogether in order to avoid the legal risk and costs associated with the uncertain application of the exemption.[45] This may have a chilling effect on creativity and authorship. Artists will avoid incorporating copyrighted materials into their creative works even when incorporating those particular works could well be considered to be fair use and non-infringing.[46] Third, uncertainty

[40] On the tradeoffs between rules and standards, *see generally* Kaplow, *supra* note 25.

[41] Depoorter, *supra* note 28.

[42] *Id.*

[43] *See* Henrik Lando, *Does Wrongful Conviction Lower Deterrence?*, 35 J. Legal Stud. 327, 334–35 (2006); *see also* Richard Craswell & John E. Calfee, *Deterrence and Uncertain Legal Standards*, 2 J.L. Econ. & Org. 279, 299 (1986).

[44] Examples in the literature of overcompliance induced by uncertain application of legal standards include commentary on labor regulation and tax compliance. *See* Debra D. Burke, *Workplace Harassment: A Proposal for a Bright Line Test Consistent with the First Amendment*, 21 Hofstra Lab. & Emp. L.J. 591 (2004) (providing that risk-averse employers' natural reaction to the vague limits of sexual harassment laws, which prohibit employers from creating a "hostile environment," is to overcompensate by prohibiting words or conduct in the workplace that even border on harassment); Ehud Kamar, *Shareholder Litigation under Indeterminate Corporate Law*, 66 U. Chi. L. Rev. 887, 889 (1999) ("[L]egal indeterminacy creates liability risk, which risk-averse fiduciaries are in a poor position to bear. Exposing corporate fiduciaries to this risk makes their services more costly and less productive to shareholders."); Kyle D. Logue, *Tax Law Uncertainty and the Role of Tax Insurance*, 25 Va. Tax Rev. 339, 373 (2005) ("Legal uncertainty can induce taxpayers, especially risk-averse taxpayers, to over-comply with the law in various ways. Taxpayers could manifest over-compliance in a number of ways, such as changing the structure of their transactions, deciding not to engage in the transaction in question, or engaging the transaction as planned but without taking advantage of the more favorable tax treatment to which they are arguably – though by assumption not certainly – entitled."). Note that, when over-deterrence is not a concern, some authors have argued that uncertainty can be beneficial by inducing negotiated solutions or by increasing efficiency in law enforcement efforts. *See, e.g.*, Tom Baker, Alon Harel & Tamar Kugler, *The Virtues of Uncertainty in Law: An Experimental Approach*, 89 Iowa L. Rev. 443 (2004) (positing that uncertain sanctions may be preferable on efficiency grounds because they achieve more deterrence than certain sanctions of the same expected value).

[45] Such chilling effect has also been documented in the context of investment into innovative technologies using copyright content. See Michael A. Carrier, *Copyright and Innovation: The Untold Story*, 2012 Wis. L. Rev. 891.

[46] For example, documentary artists sometimes avoid including any copyrighted materials, even something as remote as a ringtone in the background of a scene. Nancy Ramsey, *The Hidden Cost of Documentaries*, N.Y. Times (Oct. 16, 2005), www.nytimes.com/2005/10/16/movies/the-hidden-cost-of-documentaries.html.

especially disadvantages risk-averse individuals who lack the deep pockets necessary to shoulder the prospective litigation costs involved with a fair use defense.[47]

Although very few American scholars favor disbanding the flexible, open standard approach of fair use doctrine, many have advocated infusing the doctrine with additional certainty. Examples include hybrid approaches of rules and standards where rules provide a statutory "minimal" safe harbor in copyright law in combination with a balancing test that governs potential exempted uses of copyrighted content that are outside of the bright line rules of the safe harbor. By explicitly stating a number of quantifiable permitted uses, predictable outcomes are promoted, while at the same time leaving flexibility for exempted uses outside of the safe harbor.[48]

Other more indirect approaches that seek to moderate the unintended side effects of "copyright exemption uncertainty" include proposals of copyright fee shifting against copyright holders that are unresponsive to licensing requests[49] and to withhold injunctions and limit statutory damage awards in close but unsuccessful fair use cases.[50]

4.3 *Rent Seeking*

The economic insights on standards and rules also highlight a tradeoff between the benefits of open standards (flexibility) and bright line rules (certainty). This comparative analysis is further complicated when considering the susceptibility to rent seeking.

Copyright rule exemptions are determined *ex ante* by legislators. As a result, bright line rules are likely to be subject to more intensive lobbying. The process of enumerating statutory exemptions sets out a specific timeline and target to stakeholders. By contrast, the contours of open-ended standards are set *ex post* by an independent judiciary. This is an important distinction. While the scope of copyright rule–based copyright exemptions is determined by the political influence of copyright stakeholders, copyright exemption standards will evolve based on the dynamics of litigation and the resulting judicial precedent. The influence of any particular stakeholder under either form of copyright exemption will be determined on its ability to manage either the legislative or judicial evolution of copyright exemptions.[51]

[47] Specifically, the argument is that the unpredictability of the doctrine typically induces risk-averse users of copyrighted content to obtain potentially superfluous licenses from content owners in order to minimize the risks associated with statutory damages in copyright law. John E. Calfee & Richard Craswell, *Some Effects of Uncertainty on Compliance with Legal Standards*, 70 Va. L. Rev. 965, 966 ("If the legal standard is uncertain, even actors who behave 'optimally' in terms of overall social welfare will face some chance of being held liable because of the unpredictability of the legal rule."). *See* James Gibson, *Risk Aversion and Rights Accretion in Intellectual Property Law*, 116 Yale L.J. 882 (2007). *See also* Molly Shaffer Van Houweling, *Distributive Values in Copyright*, 83 Tex. L. Rev. 1535 (2005) (discussing distributive side effects of fair use). *See generally* Uri Weiss, *The Regressive Effect of Legal Uncertainty* (Tel Aviv Univ. Law Faculty Papers, Paper No. 30, 2005), https://law.bepress.com/cgi/viewcontent.cgi?article=1030&context=taulwps (arguing that a shift from a certainty legal regime to an uncertainty legal regime transfers wealth from risk-averse parties to risk-neutral parties via settlements).

[48] Parchomovsky & Goldman, *supra* note 36, at 1511. ("We propose that for any literary work consisting of at least one hundred words, the lesser of fifteen percent or three hundred words may be copied without the permission of the copyright holder.") *Id.* at 1528. *See* Lawrence Lessig, Free Culture 295 (2004) (advocating for clearer and narrower lines demarcating the scope of protection for derivative works); Joseph P. Liu, *Regulatory Copyright*, 83 N.C. L. Rev. 87, 151–52 (2004) (suggesting that the Copyright Office could be given the regulatory authority to promulgate rules and safe harbors).

[49] Peter S. Menell & Ben Depoorter, *Using Fee Shifting to Promote Fair Use and Fair Licensing*, 102 Calif. L. Rev. 53 (2014).

[50] Pamela Samuelson, *Possible Futures of Fair Use*, 90 Wash. L. Rev. 815 (2015).

[51] While legislative processes are traditionally considered more biased, litigation and settlement dynamics are also susceptible to capture. The classic treatment is Marc Galanter, *Why the "Haves" Come Out Ahead: Speculations on the Limits of Legal Change*, 9 Law & Soc'y Rev. 95 (1974).