

# Fair Use Markets: On Weighing Potential License Fees

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## INTRODUCTION

Justice Breyer began his classic article, *The Uneasy Case for Copyright*,<sup>1</sup> with a line from Lord Macaulay, that copyright is “‘a tax on readers for the purpose of giving a bounty to writers.’”<sup>2</sup> Our society and its law values both writers *and* readers; the law cannot favor one side too much without losing some of the benefits the other side could have contributed. Make reading expensive and it will decrease, and readers might substitute less socially productive behaviors to take its place.<sup>3</sup>

In the years since Macaulay, our perception of what is at stake on the “reader” side has drastically expanded. We know that “readers” are often themselves creative people, creating follow-on works of social import, from fan fiction to compatible software to mashups to works of serious cultural demeanor. We also know that apparently noncreative replication can be an expressive and important act,<sup>4</sup> as we see when we witness schoolchildren iteratively repeating the Pledge of Allegiance or religious groups repeating age-old prayers. A contemporary audience thus interprets Macaulay’s references to go well beyond the literal act of reading.

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<sup>1</sup> Stephen Breyer, *The Uneasy Case for Copyright: A Study of Copyright in Books, Photocopies, and Computer Programs*, 84 HARV. L. REV. 281 (1970).

<sup>2</sup> *Id.* at 281 (quoting Thomas B. Macaulay, *The First Speech on Copyright, February 5, 1841*, in MACAULAY’S SPEECHES ON COPYRIGHT AND LINCOLN’S ADDRESS AT COOPER UNION 18, 25 (Charles Robert Gaston ed., 1914)).

<sup>3</sup> As Lord Macaulay said, copyright “is a tax on one of the most innocent and most salutary of human pleasures; and never let us forget, that a tax on innocent pleasures is a premium on vicious pleasures.” Macaulay, *supra* note 2, at 25.

<sup>4</sup> See Rebecca Tushnet, *Copy This Essay: How Fair Use Doctrine Harms Free Speech and How Copying Serves It*, 114 YALE L.J. 535 (2004).

In addition, today, Macaulay's word "writers" (like the word "writings" in the Constitution<sup>5</sup>) must be broadly construed. In the United States, copyrightable "writings" include music, works of visual art, and many other fixed but nonverbal forms of creativity.<sup>6</sup>

One might thus substitute for "writers," copyright owners "who stand to profit in the short run from enforcement of copyright," and for "readers," one might substitute "those who stand to lose in the short run from enforcement of copyright."<sup>7</sup> By doing this, "reading" becomes a broad category—it includes all effort that makes use of previously created work, such as by copying, reading, adapting, criticizing, or using for inspiration.<sup>8</sup> Particularly as technology makes it easier for the nonprofessional to create new works of authorship, it has become ever clearer that copyright law needs to be concerned not only with the incentives of copyright owners but also with the incentives of those Macaulay would call "readers." If readers' costs are too high or their rewards too small, human flourishing may diminish and cultural progress may stall.<sup>9</sup>

The structure of copyright rhetoric has been ill adapted to focus the attention of courts and Congress on the needs of "readers." That is beginning to change. For example, instead of the "public domain" being viewed merely as the recipient of what's left when copyright scope ends or copyrights expire, the public domain is increasingly recognized, through the efforts of scholars such as Professor Jessica Litman, as the source of new creativity.<sup>10</sup> Instead of "readers" being

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<sup>5</sup> U.S. CONST. art. I, § 8, cl. 8.

<sup>6</sup> 17 U.S.C. § 102 (2006) (listing categories covered by copyright); *Burrow-Giles Lithographic Co. v. Sarony*, 111 U.S. 53, 56–59 (1884).

<sup>7</sup> In the long term, of course, readers may gain a great deal from copyright law. The short-term perspective is the perspective of someone wanting to use a work already created, sometimes called the *ex post* perspective. The long-term perspective is *ex ante*; it looks to the future and asks, what rules will make for good results, including more works of authorship?

<sup>8</sup> Ideas are not copyrightable, so, admittedly, "inspiration" will not trigger copyright liability. But to be inspired, one needs access to inspiring material. If copyright makes the price of a book too high, some people may lack access to it, and its ideas may not find adequate expression elsewhere. Therefore, high prices can restrict both the circulation of expression and the circulation of ideas.

<sup>9</sup> See Rebecca Tushnet, *Economies of Desire: Fair Use and Marketplace Assumptions*, 51 WM. & MARY L. REV. 513, 537–39 (2009) ("[C]reativity is a positive virtue, not just because of its results but because of how the process of making meaning contributes to human flourishing.").

<sup>10</sup> See, e.g., Jessica Litman, *The Public Domain*, 39 EMORY L.J. 965, 968 (1990) ("The public domain should be understood not as the realm of material that is undeserving of protection, but as a device that permits the rest of the system to work by leaving the raw material of authorship available for authors to use.").

viewed as undifferentiated consumers, Professor Julie Cohen's notion of "situated users" helps remind us of the diverse needs and capacities of persons who employ copyrighted works.<sup>11</sup> These and other advances from the scholarly literature are slowly changing the rhetorical framework. This Article focuses on a *judicial* contribution to copyright's rhetorical evolution, namely, the Second Circuit's invention of the concept known as "fair use markets."<sup>12</sup>

As is further explained below, the fair use doctrine<sup>13</sup> enables the public to engage in uses of copyrighted works that would otherwise constitute infringement. One of the many grounds for granting fair use can be the lack of functioning markets through which potential users of copyrighted works can buy licenses.<sup>14</sup> Some scholars believe that this means that the *presence* of a functioning market would doom fair use.<sup>15</sup> As invented and deployed by the Second Circuit, a "fair use market" is a market that can coexist with fair use. The Second Circuit thus makes explicit that a technology for exchange between copyright owners and users can be present without destroying the possibility that a defendant might be acting properly when she uses someone else's copyrighted work without permission or compensation.

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<sup>11</sup> See Julie E. Cohen, *Creativity and Culture in Copyright Theory*, 40 U.C. DAVIS L. REV. 1151 (2007); Julie E. Cohen, *The Place of the User in Copyright Law*, 74 FORDHAM L. REV. 347 (2005); see also, e.g., Jessica Litman, *Lawful Personal Use*, 85 TEX. L. REV. 1871, 1879 (2007) ("I urge that reading, listening, viewing, watching, playing, and using copyrighted works is at the core of the copyright system.").

<sup>12</sup> The phrase comes from *Castle Rock Entertainment, Inc. v. Carol Publishing Group, Inc.*, 150 F.3d 132 (2d Cir. 1998), and was given weight in *Bill Graham Archives v. Dorling Kindersley Ltd.*, 448 F.3d 605 (2d Cir. 2006). See *infra* Part I.

<sup>13</sup> "[T]he fair use of a copyrighted work . . . is not an infringement of copyright." 17 U.S.C. § 107 (2006). See *infra* Part II.C.

<sup>14</sup> Professor Sara Stadler states that modern courts recognize only two forms of fair use: market failure, and uses that are transformative. Sara K. Stadler, *Copyright as Trade Regulation*, 155 U. PA. L. REV. 899, 905 (2007). Professor Stadler has a somewhat narrow view of what courts will view as a market failure, see *id.* at 905–06 & n.37; a somewhat broader view of market limitations generates a multitude of bases for fair use, as does the caselaw. See 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, 159–60 (2003) [hereinafter Gordon, *Excuse and Justification*]; 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*] (arguing that a market failure sufficient to require a court to balance costs and benefits may be found on the bases of, inter alia, the presence of positive externalities generated by defendants, nonmonetizable interests, and non-commercial activities).

<sup>15</sup> See, for example, the discussion of this trend in 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), treated at length below.

This may seem unexceptional; after all, because the absence of markets is only one of many grounds for fair use, of course an unconsented and uncompensated use might be “fair” whether or not a license for the use could be purchased. But because the courts and commentators have not been altogether clear about that proposition,<sup>16</sup> the Second Circuit’s pronouncement is significant.

Of even more significance is the second step taken by the Second Circuit. It refused to weigh against a defendant’s fair use claim the license fees that she practicably could have paid for the contested use.<sup>17</sup> This is one of many approaches that could be taken to accommodate “fair use markets.”<sup>18</sup> The latter portions of this Article take as their focus the conditions under which foregone fees should be weighed.

Recognizing the existence of that “fair use market” territory implies a need to further define its reach and articulate its imperatives. Fair use is more than an amorphous area beyond “copyright markets”; it may be a socially justified or rights-mandated<sup>19</sup> territory capable of pushing back against copyright’s ever-expanding borders. Therefore the concept of “fair use market” may help to focus attention on what “readers” need and can contribute.

Like copyright, the common law also continually faces conundrums where both sides’ incentives matter. One side may *look* like the person with something to contribute, but he may not be the only one whose behavior the law should affect. To cite one classic example, when a railroad’s sparks ignite hay stacked at the side of the tracks, it is a live question whether the sparks were too many, or whether the farmer placed his bales too close to the railroad tracks.<sup>20</sup>

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<sup>16</sup> Before the advent of “fair use markets,” courts used other methods of indicating that markets and fair use can coexist. For example, the Supreme Court noted that “[t]he market for potential derivative uses includes only those that creators of original works would in general develop or license others to develop.” *Campbell v. Acuff-Rose Music, Inc.*, 510 U.S. 569, 592 (1994).

<sup>17</sup> *Dorling Kindersley*, 448 F.3d at 615.

<sup>18</sup> Another approach to shelter valuable uses from suppression might be to experiment with remedial structures. See Mark A. Lemley, *Should a Licensing Market Require Licensing?*, 70 *LAW & CONTEMP. PROBS.* 185, 190–202 (2007). Yet another approach might be to restrict the rights and markets to which copyright owners are entitled. See Stadler, *supra* note 14 (suggesting a redefinition of copyright infringement).

<sup>19</sup> Although social welfare lies at the core of the instant Article, it is hardly the whole story; fair use territory is also supported by rights. For a partial rights-based account justifying portions of the public domain and fair use, see Wendy J. Gordon, *A Property Right in Self-Expression: Equality and Individualism in the Natural Law of Intellectual Property*, 102 *YALE L.J.* 1533 (1993).

<sup>20</sup> See R. H. Coase, *The Problem of Social Cost*, 3 *J.L. & ECON.* 1, 29–34 (1960).

Immunize the farmer from harm by giving him rights to sue and he may place his crops carelessly close to where the railroad engines pass; immunize the railroad and it may neglect to install spark filters that could inexpensively eliminate the dangers.<sup>21</sup> In order to reliably encourage socially desirable behavior, both parties need to be affected by the anticipated costs or benefits.<sup>22</sup>

That would happen virtually automatically in a world without transaction costs, strategic behavior, imperfect knowledge, or other forms of friction. In such a world, affected parties could always interact in a way that takes one another's welfare into account.<sup>23</sup> There would be no externalities, and, as Justice Breyer intimated in his keynote address, no need for copyright law.<sup>24</sup> But the real world is thoroughly awash in transaction costs and other imperfections. For example, imagine how difficult it could be for the potential fans of any artist to identify themselves, get together, and agree to pay the artist to produce.<sup>25</sup> Copyright law sets up markets in intangibles to help potential "writers" internalize some of the benefits their works give others, thereby encouraging the writers to invest their time, talent, and other resources in creativity.<sup>26</sup> But what of the readers? We cannot trust that a frictionless world will exist to automatically allow

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<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> See generally *id.* (explaining that a party who lacks legal rights can, in a world without transaction costs, offer money to the parties who possess such rights to induce them to waive or transfer those rights). This assertion requires many caveats.

<sup>24</sup> Stephen G. Breyer, Keynote, *The Uneasy Case for Copyright: A Look Back Across Four Decades*, 79 GEO. WASH. L. REV. 1635, 1642 (2011) (acknowledging that copyright would not be needed in a world where computer software is distributed through a centralized toll system).

<sup>25</sup> Consider, for example, the holdout problem. For an illustration, see Wendy J. Gordon, *Of Harms and Benefits: Torts, Restitution, and Intellectual Property*, 21 J. LEGAL STUD. 449, 475–76 (1992) ("In a world without intellectual-property rights . . . , [m]any . . . potential customers may refuse to pay, preferring to gamble on the possibility that others' monies will be sufficient to draw the work into publication, when they can then make a cheap copy. The odds on the gamble may seem good if there is a large group of potential purchasers. Also, the work's contents may be unknown since the author may be trying to trade disclosure for payment; with the benefits uncertain, there is low perceived cost in the event the free-ride gamble fails to pay off. If enough people take this apparently low-cost gamble in the hope of taking a free ride, the requisite funds may not be forthcoming." (footnotes omitted)).

These difficulties are not always insuperable, of course. Much of Justice Breyer's valuable empirical inquiry showed that significant incentives existed outside the copyright system. On the question of holdouts, see Breyer, *supra* note 1, at 303–06 (suggesting ways in which some groups might overcome that problem, and concluding that "without copyright protection[,] organizing buyers to channel needed funds to publishers may sometimes prove difficult but will often prove practical").

<sup>26</sup> Gordon, *supra* note 25.

readers' interests to be taken into account. Copyright markets too have flaws that can make it difficult for works of authorship to reach their highest-valued economic uses, not to mention the noneconomic purposes that copyrighted works might serve.<sup>27</sup>

The common law has many ways of making sure both potential plaintiffs and potential defendants are encouraged appropriately when markets falter. One such device, used in many areas of tort law where the parties lack the advance ability to identify and bargain with each other, is to employ an individualized, normative standard for liability, usually identified as "reasonableness."<sup>28</sup> Thus, in his popular *Introduction to Law and Economics*,<sup>29</sup> Mitchell Polinsky suggests that if both drivers and pedestrians can affect the frequency and intensity of accidents, there are circumstances where a regime of either no liability (which puts all costs on injured pedestrians) or liability without fault (which puts all costs on injurers) is likely to be *less* effective than a regime that incorporates an inquiry into negligence.<sup>30</sup> That is, where it is potentially important to affect both plaintiff and defendant, one device the law can use is to ask whether at least one party behaved "reasonably."

In copyright law, the inquiry into reasonable behavior is embedded in, *inter alia*, the "fair use doctrine."<sup>31</sup> A defendant who is justified or excused<sup>32</sup> in using another's work without permission—a finding arguably analogous to his being found to have behaved "reasonably"<sup>33</sup> in the sense of behaving "in a normatively acceptable man-

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<sup>27</sup> Gordon, *Fair Use as Market Failure*, *supra* note 14.

<sup>28</sup> A plaintiff who knows she will not be reimbursed for her costs unless she proves that the defendant acted "unreasonably" will have a monetary incentive to take care of her own safety. The same is true in a system where strict liability prevails but is subject to a defense of contributory or comparative negligence. In the accident context, of course, monetary incentives may have a small effect in comparison with the natural desire to preserve one's bodily integrity against injury.

<sup>29</sup> A. MITCHELL POLINSKY, *AN INTRODUCTION TO LAW AND ECONOMICS* (3d ed. 2003).

<sup>30</sup> *Id.* at 47–50. A regime that incorporates an inquiry into negligence can take many forms, including strict liability for defendants subject to a defense that the plaintiff was contributorily negligent.

<sup>31</sup> For example, arguably a "reasonableness" inquiry is also built into tests for substantial similarity. *Cf.* Shyamkrishna Balganesh, *Wrongful Copying* 16 (June 5, 2011) (unpublished manuscript) (on file with the George Washington Law Review) (discussing the "ordinary observer" standard in the context of the test for substantial similarity); *id.* at 20–23 (noting that the similarity assessment is a proxy for the legal wrongfulness of the defendant's actions).

<sup>32</sup> See Gordon, *Excuse and Justification*, *supra* note 14.

<sup>33</sup> A link between fault in tort law and "fair use" behavior in copyright law was independently made by Professor Steven Hetcher in an essay for the University of Pennsylvania Law School's Intellectual Property and the Common Law Conference held on May 6, 2011. Steven

ner”<sup>34</sup>—is not liable, on grounds of fair use.<sup>35</sup> Fair use is thus one of the most important ways to encourage a follow-on class of productive people—those whom Macaulay called “readers” and whom we might as easily call “authors and speakers in waiting”—to invest their own time, effort, and resources.

This Article is addressed to two audiences. First, like some of my prior work and the work of many others,<sup>36</sup> this Article addresses scholars who think fair use should not arise where a copyright owner can collect licensing fees from a defendant’s use. Second, the Article addresses those who think that courts in fair use cases should not look at physically foregone license fees<sup>37</sup> at all because such an inquiry leads inexorably to a defeat for fair use.<sup>38</sup> To both groups I argue that it is perfectly possible within the rhetoric of markets to make the case for fair use even when licensing revenues for the contested use are physically available, and that sometimes it is appropriate and not circular to count the incentive effects to which those fees can give rise.

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Hetcher, *Copytort’s Fault Liability Standard*, in *COMMON LAW & INTELLECTUAL PROPERTY* (Shyamkrishna Balganesh ed., forthcoming 2012).

The “reasonableness” of fair use actually does more—and thus should probably be broader—than the “reasonableness” of negligence law. For example, some tort defenses like self-defense and necessity aim not at decreasing carelessness, but at avoiding overdeterrence. They work to encourage defendants not to take *too much* care. Fair use similarly aims to avoid overdeterrence of valuable work by a defendant. Further, copyright markets are inherently imperfect; short of impractical schemes such as perfect price discrimination, even well-functioning markets for copyrighted works leave deadweight loss; not everyone who values the work above its marginal cost will be able to purchase a copy. The fair use doctrine may be necessary to make the market tolerable. See, e.g., Glynn S. Lunney, Jr., *Fair Use and Market Failure*: Sony Revisited, 82 B.U. L. REV. 975, 1030 (2002) (“Even with market success, there remains a fundamental tension between copyright’s system of exclusive rights and the public good [nonrivalrous] character of copyrighted works. . . . [F]air use exists in order to resolve this tension.”).

<sup>34</sup> Note that this approach to “reasonableness” is far broader than the usual economic characterization of “nonnegligent” behavior. An economically nonnegligent actor takes all cost-justified precautions. The language of precautions does not exactly fit the copyright context.

<sup>35</sup> The dissent in *American Geophysical Union v. Texaco Inc.*, 60 F.3d 913 (2d Cir. 1995), stated: “A use that is reasonable and customary is likely to be a fair one.” *Id.* at 934 (Jacobs, J., dissenting). The majority, however, intimated that the advent of permissions systems in the journal-publishing industry had made prior notions of “reasonable” photocopying irrelevant. *Id.* at 924 (majority opinion). The *Texaco* case is discussed further *infra* Part I.C.

<sup>36</sup> See, e.g., Matthew Africa, *The Misuse of Licensing Evidence in Fair Use Analysis: New Technologies, New Markets, and the Courts*, 88 CAL. L. REV. 1145 (2000); Gordon, *Excuse and Justification*, *supra* note 14; Loren, *supra* note 15.

<sup>37</sup> By “foregone license fees” I mean fees that a defendant physically could pay, in the sense that a market for licensing existed, but which he did not pay. If the use is “fair,” there is no legal obligation to pay even where a licensing market exists. Thus it may be both lawful and proper to forego payment even when payment is a physical possibility.

<sup>38</sup> See the discussion in Loren, *supra* note 15, at 32–48.

More importantly, this Article also explores what role the Second Circuit's concept of "fair use market" might play. Conceivably, the concept could help to further the fair use doctrine's ability to serve the interests of Macaulay's "readers" in two ways: by serving as a vehicle for identifying when markets do not foreclose fair use, and by serving as a tool for distinguishing when foregone license fees should not be counted against the defendant as part of the fair use calculus. I conclude this Article by considering the commodification literature and other sources as a guide to factors that can serve these two functions of the "fair use market" category. Although my list is hardly exhaustive, I hope it will stimulate others to assist in fleshing out this intriguing doctrinal tool.

## I. AN ANALYSIS OF THE FOURTH FAIR USE FACTOR

### A. *Background to the Fair Use Doctrine*

Fair use is a judicially created doctrine that is still open to judicial evolution, despite being statutorily recognized in the Copyright Act.<sup>39</sup> Fair use permits free use of copyrighted materials even when the use superficially appears to fit one of the categories that the statute places within the copyright owner's control.<sup>40</sup> Traditional examples of fair use include a critic copying quotations from a book being reviewed, a musical parody borrowing some of the melody from a song being ridiculed, and an English teacher getting a new idea for her class and spontaneously photocopying a short literary excerpt to illustrate the idea to her students.<sup>41</sup> Technological advances have opened up a wide variety of additional possibilities for fair use; for example, the Internet and inexpensive reprography and video equipment make it easier for members of Macaulay's "reader" group to become authors and publishers themselves.<sup>42</sup> Preserving good incentives for this group, there-

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<sup>39</sup> 17 U.S.C. §§ 101–1332 (2006); *see also id.* § 107 (recognizing fair use and providing a nonexclusive four-factor test to evaluate fair use claims); H.R. REP. NO. 94-1476, at 66 (1976), *reprinted in* 1976 U.S.C.C.A.N. 5659, 5679 ("Beyond a very broad statutory explanation of what fair use is and some of the criteria applicable to it, the courts must be free to adapt the doctrine to particular situations on a case-by-case basis.").

<sup>40</sup> *See, e.g.,* Gordon, *Fair Use as Market Failure*, *supra* note 14.

<sup>41</sup> The fair use statute gives as illustrative purposes, "[p]urposes such as criticism, comment, news reporting, teaching (including multiple copies for classroom use), scholarship, or research." 17 U.S.C. § 107.

<sup>42</sup> At the same time, as technology has empowered ordinary users, the scope and length of copyright has expanded. *See, e.g.,* Jessica Litman, *The Exclusive Right to Read*, 13 CARDOZO ARTS & ENT. L.J. 29 (1994); Loren, *supra* note 15.



fore, becomes ever more important,<sup>43</sup> and the fair use doctrine aims at, *inter alia*, preserving such “reader” incentives.

Copyright law primarily operates through two aspects: a “private rights” component and a “commons” component.<sup>44</sup> In its “private rights” component, copyright law creates markets in which copyright owners are given veto power over potential uses of their work.<sup>45</sup> In its “commons” component, copyright law creates areas free for public access and use by declining to provide or modifying exclusionary rights. Through temporal and subject-matter boundaries, and a host of specific and general limits, Congress gives a set of liberty rights (Hohfeldian “privileges”)<sup>46</sup> to the public—liberties that are so strong that the “federal right to copy and to use”<sup>47</sup> can sometimes preempt state law attempts to re-enclose the common. Fair use operates to allow the “commons” side of copyright to govern in appropriate cases.

To the extent that problems exist in any particular market—either because of economic considerations like transaction costs and externalities, or because of the market’s inherent inability to mediate all values of social importance—deferring to the copyright owner cannot be relied upon to best serve the social interests at stake.<sup>48</sup> Among other things, I have suggested that if no market existed for a given use because transaction costs were high, then enforcing the copyright would cause harm without any countervailing benefit, and fair use should be granted.<sup>49</sup> That was only one way in which markets could fail; another mode of market failure is the presence of nonmonetizable interests;<sup>50</sup> another, emphasized later by Professor Lydia Loren as one of the most important,<sup>51</sup> would arise if a defendant generated

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<sup>43</sup> See, e.g., Molly Shaffer Van Houweling, *Distributive Values in Copyright*, 83 TEX. L. REV. 1535 (2005). Professor Van Houweling also points out that the need for the “writer” side to have copyright protection may be less, as technological advances reduce their cost of dissemination. *Id.* at 1539.

<sup>44</sup> Brett M. Frischmann & Mark A. Lemley, *Spillovers*, 107 COLUM. L. REV. 257, 285 (2007).

<sup>45</sup> See generally Gordon, *Excuse and Justification*, *supra* note 14, at 157–58; Gordon, *Fair Use as Market Failure*, *supra* note 14, at 1619.

<sup>46</sup> See generally Wesley Newcomb Hohfeld, *Fundamental Legal Conceptions as Applied in Judicial Reasoning*, 26 YALE L.J. 710 (1917).

<sup>47</sup> *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 165 (1989) (internal quotation marks omitted) (preempting state law that granted exclusion rights in unpatented boat hulls). The Court’s opinion addressed patent law, but later in the same paragraph, in one of the supporting quotations, the opinion referred to copyright law as well. *Id.*

<sup>48</sup> See Gordon, *Fair Use as Market Failure*, *supra* note 14, at 1613–14.

<sup>49</sup> *Id.* at 1618.

<sup>50</sup> *Id.* at 1630–32.

<sup>51</sup> Loren, *supra* note 15, at 26, 49–57. Professor Loren’s article not only emphasizes the

social benefit that he could not capture monetarily.<sup>52</sup> In these instances, we cannot rely on copyright markets to reach socially desirable outcomes.

The approach just described begins with markets and asks when they fail to work well. An alternative approach to market suitability would be to start with nonmarket orderings and ask when they succeed. Thus, one might explicate the circumstances under which one or another nonmarket ordering (such as a realm of sharing or gift where payment for unauthorized use is not compelled by law, or setting up a commons regulated by its members) might thrive, and compare its failures and successes with that of alternative orderings including markets. This Article joins others in the scholarly community to begin the task of combining the market and nonmarket starting points.<sup>53</sup>

The Copyright Act itself lists four nonexhaustive factors to consider when deciding whether a use is “fair.”<sup>54</sup> Of these, arguably the most important is the fourth factor, “the effect of the use upon the

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category of “defendants who generate positive externalities”; it also deepens our understanding of the category by, *inter alia*, emphasizing the difficulty courts would have in measuring diffuse benefits. For a discussion of related topics, see, for example, Frischmann & Lemley, *supra* note 44, at 279–80, 285.

<sup>52</sup> Gordon, *Fair Use as Market Failure*, *supra* note 14, at 1630–32. I refer here to persons who generate positive spillover effects, or “positive externalities.” This differs from “nonmonetizable interests.” A nonmonetizable interest is an interest like free speech whose value we do not want to measure in money, and is therefore unsuitable for trading on a market. A positive externality is a benefit someone creates for which he is not recompensed; the recompense might or might not be monetary in nature.

<sup>53</sup> The ultimate choice should be comparative among various institutional options.

<sup>54</sup> The Copyright Act defines fair use as follows:

Notwithstanding the provisions of sections 106 and 106A, the 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.

The fact that a work is unpublished shall not itself bar a finding of fair use if such finding is made upon consideration of all the above factors.

17 U.S.C. § 107 (2006).

Note that the statute uses the word “include.” The Copyright Act defines the term “including” as “illustrative and not limitative.” *Id.* § 101.

potential market for or value of the copyrighted work.”<sup>55</sup> This Article focuses on that fourth factor and the impact of physically foregone license fees on the fair use calculus.

### B. *The Concern with the Market Failure Test*

The market failure test for fair use has been misinterpreted as implying that fair use should exist only where high transaction costs completely bar a market from arising.<sup>56</sup> As transaction costs decrease, some argued, fair use should begin to disappear. Justice Blackmun, dissenting in a 1984 Supreme Court case, *Sony Corp. of America v. Universal City Studios, Inc.*,<sup>57</sup> implicitly articulated such an approach: “[T]he infringer must demonstrate that he had not impaired the copyright holder’s ability to demand compensation from (or to deny access to) any group who would otherwise be willing to pay to see or hear the copyrighted work.”<sup>58</sup> By implication, the presence of any market avenues that might allow a “group” to pay would foreclose fair use.<sup>59</sup>

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<sup>55</sup> *Id.* § 107. Debate over the factor’s importance is rife. One of the most intriguing observations is Professor Barton Beebe’s:

Ultimately, the paradox of the fourth factor is that it is everything in the fair use test and thus nothing. To assert, as a descriptive matter, that it is the most important factor—or, as a normative matter, that it is too important—is meaningless, primarily because it is no factor, no independent variable, at all. Instead, regardless of what we might hope—or fear—it would be, the actual doctrine of the fourth factor consists in practice of a few propositions of law that judges should keep in mind as they synthesize the various factual findings that they have made under the previous factors . . . . In practice, judges appear to apply section 107 in the form of a cognitively more familiar two-sided balancing test in which they weigh the strength of the defendant’s justification for its use, as that justification has been developed in the first three factors, against the impact of that use on the incentives of the plaintiff. Factor four provides the analytical space for this balancing test to occur, and the various doctrinal propositions under factor four are merely there to tilt the scales one way or the other.

Barton Beebe, *An Empirical Study of U.S. Copyright Fair Use Opinions, 1978-2005*, 156 U. PA. L. REV. 549, 620–21 (2008) (footnotes omitted).

<sup>56</sup> I have been incorrectly interpreted as arguing that “the impossibility of arriving at bargains [is] the essential justification for the doctrine of fair use.” David Lindsay, *The Future of the Fair Dealing Defense to Copyright Infringement* 62 (Centre for Media, Comm’n & Info. Tech. Law, The Univ. of Melbourne, Research Paper No. 12, 2000); see also Wendy J. Gordon, *Market Failure and Intellectual Property: A Response to Professor Lunnay*, 82 B.U. L. REV. 1031, 1031–32 (2002); cf. 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, 130–31 (1997) (describing transaction-cost barriers between owners and users as having become “the prevailing view” of fair use, but distinguishing my view as being broader).

<sup>57</sup> *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417 (1984).

<sup>58</sup> *Id.* at 485 (Blackmun, J., dissenting).

<sup>59</sup> In my interpretation of Justice Blackmun and his impact, I am indebted to Frank Pas-

Some saw no great evil in substituting “fared use” for “fair use,”<sup>60</sup> but most disagreed sharply. That a use *could* be paid for did not mean it *should* be.<sup>61</sup>

The Supreme Court’s interpretation of fair use in a later case, *Campbell v. Acuff-Rose Music, Inc.*,<sup>62</sup> made it clear that fair use could survive a drastic reduction of transaction costs between a copyrighted work’s owner and its user. In *Campbell*, the copyright owner and defendant were in communication with each other,<sup>63</sup> so whatever transaction costs existed between them could not have swamped a mutually beneficial transaction. The Court held that, despite the potential for face-to-face bargaining, fair use for a parody could exist.<sup>64</sup>

Yet the *Campbell* opinion gave only limited comfort to those who were legitimately concerned that mere reductions in transaction costs could be misapplied to doom fair use. For in *Campbell*, there was a reason other than transaction costs to suspect that no market existed. The Court based its decision in large part on a finding that there was no market for criticism: “[T]he unlikelihood that creators of imaginative works will license critical reviews or lampoons of their own productions removes such uses from the very notion of a potential licensing market. People ask . . . for criticism, but they only want praise.”<sup>65</sup> So after *Campbell*, we knew that transaction costs between owner and user were not the only barrier to markets that counted, but we still did not have a definitive Supreme Court holding that fair use was applicable even where a market appeared. Both logic and history

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quale, *Breaking the Vicious Circularity: Sony’s Contribution to the Fair Use Doctrine*, 55 CASE W. RES. L. REV. 777 (2005).

<sup>60</sup> The phrase “fared use” is Professor Tom Bell’s. 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) (describing benefits of fared use).

<sup>61</sup> This formulation is Matthew Africa’s. Africa, *supra* note 36, at 1148–49 (“[I]t is a mistake to think that just because a use could have been licensed it should have been licensed.”); see also, e.g., Pasquale, *supra* note 59, at 779 n.9 (citing Gordon, *supra* note 56, for the proposition that “[Professor Gordon] clearly does not take the position that all uses that can be paid for should be paid for”).

Also, assuming that all physically collectible license fees should be charged is akin to the problem of confusing “value” with “property.” See Rochelle Cooper Dreyfuss, *Expressive Genericity: Trademarks as Language in the Pepsi Generation*, 65 NOTRE DAME L. REV. 397, 404–12 (1990) (discussing and critiquing the supposed logic of the “if value, then right” paradigm).

<sup>62</sup> *Campbell v. Acuff-Rose Music, Inc.*, 510 U.S. 569 (1994).

<sup>63</sup> *Id.* at 572.

<sup>64</sup> *Id.* (holding that a “parody’s commercial character is only one element to be weighed in a fair use enquiry”).

<sup>65</sup> *Id.* at 592 (internal quotation marks omitted).

suggested that the Supreme Court in fact would take this position (namely, that fair use can exist despite the presence of licensing), but lower court developments raised the apparent stakes.

### C. Case Developments After Campbell

Two circuit court cases, *American Geophysical Union v. Texaco Inc.*,<sup>66</sup> decided by the Second Circuit, and *Princeton University Press v. Michigan Document Services, Inc.* (“MDS”),<sup>67</sup> decided by the Sixth Circuit, strengthened many observers’ concerns that fair use could shrink or disappear as markets spread. The courts’ holdings imposed liability for photocopying performed by a scientific researcher and a producer of academic course packs, respectively, largely on the ground that some avenues for licensing existed.<sup>68</sup> The cases were usually taken to suggest that even the presence of a partial market (in MDS, for example, the Copyright Clearance Center covered some, but not all,<sup>69</sup> of the material affected) could doom fair use.<sup>70</sup> Many commentators accused the courts of circularity<sup>71</sup>: treating physically foregone license fees as a ground for liability on the basis of an unstated assumption that such license fees were owed for the contested use.<sup>72</sup>

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<sup>66</sup> *Am. Geophysical Union v. Texaco Inc.*, 60 F.3d 913 (2d Cir. 1995).

<sup>67</sup> *Princeton Univ. Press v. Mich. Document Servs., Inc. (MDS)*, 99 F.3d 1381 (6th Cir. 1996) (en banc).

<sup>68</sup> *MDS*, 99 F.3d at 1388; *Texaco*, 60 F.3d at 930–31.

<sup>69</sup> *Texaco*, 60 F.3d at 936–39 (Jacobs, J., dissenting) (“There is nothing workable, and there is no market.”).

<sup>70</sup> See Loren, *supra* note 15, at 6 (“In *Princeton University Press v. Michigan Document Services, Inc.*, and *American Geophysical Union v. Texaco, Inc.*, the courts rejected claims of fair use because the copyright owners had established permission systems for licensing the types of uses at issue.” (footnotes omitted)). Professor Loren identifies a “narrow[ ]” interpretation of fair use, under which, “if a copyright owner can establish an efficient ‘permission system’ to collect fees for a certain kind of use, then a copyright owner will be able to defeat a claim of fair use.” *Id.* at 7.

Professor Loren continues by explaining that “[t]his limited view of fair use has the potential to allow copyright owners to control *all* uses of their works.” *Id.* This latter claim of course is an overstatement; fair use does not *expand* the scope of rights beyond what is facially granted by the Copyright Act.

<sup>71</sup> See Christina Bohannon, *Copyright Harm, Foreseeability, and Fair Use*, 85 WASH. U. L. REV. 969, 971 (2007); Christina Bohannon & Herbert Hovenkamp, *IP and Antitrust: Reformation and Harm*, 51 B.C. L. REV. 905, 973–74 (2010); Mark A. Lemley, *The Law and Economics of Internet Norms*, 73 CHI.-KENT L. REV. 1257, 1277 n.98 (1998); Lunney, *supra* note 33; Pamela Samuelson, *Unbundling Fair Uses*, 77 FORDHAM L. REV. 2537, 2620 (2009) (discussing the controversy); Sara K. Stadler, *Incentive and Expectation in Copyright*, 58 HASTINGS L.J. 433, 457–59 (2007).

<sup>72</sup> See Loren, *supra* note 15, at 38–41; Pasquale, *Toward an Ecology of Intellectual Prop-*

In my view,<sup>73</sup> the Second Circuit has tried to respond to this concern.<sup>74</sup> In *Texaco* itself, the opinion recognized the circularity danger, but denied that its own analysis was circular. The opinion stated that “[t]he vice of circular reasoning arises only if the availability of payment is conclusive against fair use.”<sup>75</sup> Although virtually no commentator acquitted the court of the charge of circularity,<sup>76</sup> this Article attempts to show that the charge was overstated.

In addition to directly addressing the circularity issue, the *Texaco* opinion emphasized that any license fees the defendant could have paid should be held against such defendant under the fair use statute’s fourth factor only in “normal” markets.<sup>77</sup> That fourth factor, “the effect of the use upon the potential market for or value of the copyrighted work,”<sup>78</sup> would not take foregone license fees into account if the fees came from a market that was abnormal or nontraditional.

That stance also failed to persuade the commentators that fair use could effectively guard the interest of copyright defendants. Among other things, the commentators saw the possibility that publishers and other copyright owners could strategically manipulate any new use to look as if a normal permissions market existed.<sup>79</sup>

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erty: *Lessons from Environmental Economics for Valuing Copyright’s Commons*, 8 YALE J.L. & TECH. 78, 91 & n. 53 (2006) (citing Loren, *supra* note 15).

<sup>73</sup> In presenting my view of various cases, I am not arguing my interpretation is compelled; rather, I argue that my interpretation constitutes one permissible reading.

<sup>74</sup> I do not know whether the judges were influenced by the commentators; in the *Texaco* opinion and elsewhere, the judges showed that they were sensitive to similar matters as those that concerned the commentators. See *Blanch v. Koons*, 467 F.3d 244, 258 n.9 (2d Cir. 2006) (“[I]t is of course circular to assert simply that if we were to hold in [plaintiff’s] favor she could then charge [defendant] for his further use of [the copyrighted work].”).

The clearest indicator of the Second Circuit’s concern with preserving fair use against undue shrinkage from foregone-fee analysis probably came in *Dorling Kindersley*, discussed *infra* Part I.D.

<sup>75</sup> *Am. Geophysical Union v. Texaco Inc.*, 60 F.3d 913, 931 (2d Cir. 1995).

<sup>76</sup> See, e.g., Frischmann & Lemley, *supra* note 44, at 290; Loren, *supra* note 15, at 38–39.

<sup>77</sup> Wrote the court:

[N]ot every effect on potential licensing revenues enters the analysis under the fourth factor. Specifically, courts have recognized limits on the concept of potential licensing revenues by considering only markets that are traditional, reasonable, or likely to be developed markets when examining and assessing a secondary use’s effect upon the potential market for or value of the copyrighted work.

*Texaco*, 60 F.3d at 929–930 (footnote and internal quotation marks omitted).

<sup>78</sup> 17 U.S.C. § 107 (2006).

<sup>79</sup> See, e.g., Loren, *supra* note 15, at 41–44. She writes:

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.

The Second Circuit then went out of its way, in *Castle Rock Entertainment, Inc. v. Carol Publishing Group, Inc.*,<sup>80</sup> to argue that such manipulative behavior would be ineffective. Some uses could not be made unfair by the copyright owner offering licenses;<sup>81</sup> the court gave as examples “parody, news reporting, educational or other transformative uses of its own creative work,” and characterized these uses as belonging to “fair use markets.”<sup>82</sup> The court wrote that “copyright owners may not preempt exploitation of transformative markets, which they would not *in general* develop or license others to develop, by actually developing or licensing others to develop those markets.”<sup>83</sup> That language was encouraging, but it, too, was less than fully persuasive.

First, the language was in a footnote, as dicta in a case holding that there was *no* fair use; it was not binding. Second, the language overstates the ability of a market’s presence to foreclose fair use. It is an extremely rare case indeed where the only basis for fair use is the

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*Id.* at 41.

<sup>80</sup> *Castle Rock Entm’t, Inc. v. Carol Publ’g Grp., Inc.*, 150 F.3d 132 (2d Cir. 1998).

<sup>81</sup> Presumably some such uses could be made unfair (infringing) by considerations other than the copyright owner’s new creation of a market. Examples of such other considerations might include the defendant’s bad faith, or his use causing substantial substitutionary damage to the plaintiff’s pre-existing markets.

<sup>82</sup> Wrote the court:

[C]opyright owners may not preempt exploitation of transformative markets, which they would not “*in general* develop or license others to develop,” by actually developing or licensing others to develop those markets. Thus, by developing or licensing a market for parody, news reporting, educational or other transformative uses of its own creative work, a copyright owner plainly cannot prevent others from entering those *fair use markets*. See 4 Nimmer § 13.05[A][4], at 13-181 to -182 (recognizing “danger of circularity” where original copyright owner redefines “potential market” by developing or licensing others to develop that market); *Texaco*, 60 F.3d at 930 (“Only an impact on potential licensing revenues for traditional, reasonable, or likely to be developed markets” is relevant to fourth factor.).

*Castle Rock*, 150 F.3d at 145 n.11 (second emphasis added).

Footnote eleven in the *Castle Rock* opinion ended with a citation to *Texaco*, as if insisting that this new view was consistent with that prior case. (Recall that *Texaco* stated that “[o]nly an impact on potential licensing revenues for traditional, reasonable, or likely to be developed markets” is relevant to the fourth factor. *Texaco*, 60 F.3d at 930.) It is unclear whether the *Castle Rock* court was merely papering over a real change—as Professor Beebe argues the Supreme Court has often done on fair use matters, Beebe, *supra* note 55, at 596—or whether the court was accurately explaining part of what it meant in *Texaco*. Professor Beebe has argued about Supreme Court practice by which “the Court has repeatedly sought to reconstrue what it should have explicitly rescinded and replaced. This practice has proven to be a disaster for fair use doctrine.” *Id.* at 596–97.

The question of reconstruction versus replacement also arises concerning the way the Second Circuit in *Dorling Kindersley* manipulated its quotation of *Castle Rock*. See *infra* Part I.D.

<sup>83</sup> *Castle Rock*, 150 F.3d at 145 n.11 (internal quotation marks omitted).

lack of markets between the copyright owner and user; it is hard to imagine one. Even in the classic cases typically cited as using a market failure approach to fair use, additional factors were relevant that might have favored the unauthorized uses at issue even had there been a market.<sup>84</sup>

Third, the reference to copyright owners “preempting” markets intimated that the court’s only concern may have been to block copyright owners’ efforts at strategic behavior. But the court’s concern should have been broader. As Professor James Gibson later pointed out, even innocent nonstrategic behavior by risk-averse users of copyrighted material could result in de facto markets expanding.<sup>85</sup>

Fourth, and probably most important, the *Castle Rock* language was not only dicta, but murky: did the special treatment apply to *all* transformative uses, or only those transformative uses not embraced by normal and customary markets?<sup>86</sup> Custom has been urged as a guide to fair use by some,<sup>87</sup> but has been questioned as an often unreliable guide by many others.<sup>88</sup> An ambiguous comma left open the

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<sup>84</sup> For example, in *Williams & Wilkins Co. v. United States*, 487 F.2d 1345 (Ct. Cl. 1973), *aff’d by an equally divided Court*, 420 U.S. 376 (1975) (per curiam), the photocopies at issue were made for the sake of medical research. Given the positive spillovers such uses generate but which researchers are unlikely to fully capture, many users may have been unable to purchase licenses even if licenses had been available. The importance of medical progress might have persuaded the court in favor of fair use regardless of market presence, particularly if the court perceived, as it seemed to, that the publishers did not need additional fees in order to continue. Similarly, in *Sony*, home users were making VCR recordings of copyrighted television programs. Even if there had been a license available, factors existed that favored fair use such as concerns with maintaining the privacy of the home and concerns with the fact that the shows had been freely broadcasted. *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417, 454 (1983).

<sup>85</sup> James Gibson, *Risk Aversion and Rights Accretion in Intellectual Property Law*, 116 YALE L.J. 882, 900–01 (2007) (“One of the interesting things about the doctrinal feedback phenomenon is that it works an expansion of the copyright entitlement in an inadvertent, accretive manner . . . . It is an independent phenomenon that works its expansion regardless of whether courts and legislatures favor that outcome and regardless of whether copyright owners engage in rent-seeking behavior.”).

<sup>86</sup> Note the way *Castle Rock* cited *Texaco*. See *Castle Rock*, 150 F.3d at 145 n.11, discussed in note 82, *supra*.

<sup>87</sup> Lloyd L. Weinreb, *Fair’s Fair: A Comment on the Fair Use Doctrine*, 103 HARV. L. REV. 1137, 1140 (1990) (“Although I agree that the general purpose of copyright importantly affects the question whether a use is fair, a number of other factors also have to be taken into account, among which customary practice and the prevailing understanding of what constitutes fair conduct in the circumstances are the most important.”). Weinreb was not primarily concerned with the foregone license fee issue, however. *Id.*

<sup>88</sup> For cautions on the use of custom in fair use, see Africa, *supra* note 36, at 1173–75; Gibson, *supra* note 85, at 897–98; Loren, *supra* note 15, at 41; Jennifer E. Rothman, *The Questionable Use of Custom in Intellectual Property*, 93 VA. L. REV. 1899, 1905, 1930–67 (2007). Investigating the use and misuse of custom as a guide to law has a copious literature. See, e.g.,



question of custom's importance even for transformative works.<sup>89</sup>

#### D. Dorling Kindersley and Fair Use Markets

In 2006, the Second Circuit took a definitive turn from the largely descriptive (“normal,” “customary,” “traditional,” “reasonable,”<sup>90</sup> or “likely to be developed” markets) to the normative. In *Bill Graham Archives v. Dorling Kindersley Ltd.*,<sup>91</sup> a dispute arose over whether the publisher of a history of the Grateful Dead could rely on fair use to reprint thumbnail-size reproductions of copyrighted concert posters.<sup>92</sup> The Second Circuit announced that such uses of existing works were transformative and that transformative works belonged in “fair use markets.”<sup>93</sup> This time the pronouncement came not as dicta, but as part of a holding, and it truncated the ambiguous language (with its ambiguous comma) from *Castle Rock* to announce what seemed to be a clear rule based not on common practice or custom or the availability of markets, but rather on a normatively significant characteristic of the use, its transformativeness: “[A] copyright holder cannot prevent others from entering *fair use markets* merely by developing or licensing a market for parody, news reporting, educational or other transformative uses of its own creative work.”<sup>94</sup>

However, there are problems in the *Dorling Kindersley* concept of “fair use markets,” not the least of which being that a finding of “fair use market” was triggered by the defendant having made a

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Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765 (1996).

Custom may have a unique role when it comes to commodification issues. See the discussion in Part.II.C, *infra*.

<sup>89</sup> Note the comma after “markets” in this phrase from *Castle Rock*: “[C]opyright owners may not preempt exploitation of transformative markets, which they would not ‘in general develop or license others to develop’ . . . .” *Castle Rock*, 150 F.3d at 145 n.11.

The comma suggests that the court meant that copyright owners cannot block (“preempt”) fair use whenever there is a transformative market. Yet the substance of the clause after the comma suggests that the court meant something narrower: that copyright owners cannot block fair use when there is a transformative market that is *also* a market that the owners would not “in general develop or license others to develop.” *Id.* (emphasis omitted). That is, the comma left unclear whether special treatment was triggered by transformativity alone, or by transformativity coupled with an abnormal market.

<sup>90</sup> The notions of “reasonable” or “normal” markets have obvious potential for normative development as well.

<sup>91</sup> *Bill Graham Archives v. Dorling Kindersley Ltd.*, 448 F.3d 605 (2d Cir. 2006).

<sup>92</sup> *Id.* at 607.

<sup>93</sup> *Id.* at 615.

<sup>94</sup> *Id.* at 614–15 (emphasis added) (internal quotation marks omitted).

“transformative” use of the plaintiff’s copyrighted work.<sup>95</sup> Conceptually, that posed quite a conundrum. Because section 106(2) of the Copyright Act<sup>96</sup> gives the copyright owner exclusive control over derivative works, and because derivative works explicitly include transformative use of others’ copyrighted work,<sup>97</sup> it looked as if the Second Circuit’s new approach might threaten to distort the derivative work right.<sup>98</sup> Whether for this reason or others, Professor Barton Beebe’s empirical study of fair use cases shows that although transformativeness as a fair use factor remains important, it has gradually dropped in popularity among judges.<sup>99</sup> As for “fair use market” as a doctrinal category, the concept has surfaced occasionally in the cases since it was introduced, but has done little work there.

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<sup>95</sup> *Id.* at 615. The defendant produced a book about the history of the Grateful Dead; in doing so, it had reduced the size of the plaintiff’s copyrighted images (posters and concert tickets for the Grateful Dead), coupled them with other material, and used them for a purpose different from the original. *Id.* at 607.

<sup>96</sup> 17 U.S.C. § 106 (2006) (“Subject to sections 107 through 122, the owner of copyright under this title has the exclusive rights to . . . prepare derivative works based upon the copyrighted work.”).

<sup>97</sup> *Id.* § 101.

<sup>98</sup> See 2 PAUL GOLDSTEIN, GOLDSTEIN ON COPYRIGHT § 12.2.2(c), at 12:40 (3d ed. Supp. 2011). But see R. Anthony Reese, *Transformativeness and the Derivative Work Right*, 31 COLUM. J.L. & ARTS 467, 494 (2008) (arguing that the fair use notion of “transformativeness” does not “inappropriately interfere with copyright owners’ right to control ordinary derivative works”). Professor Reese examines the cases between the Supreme Court’s 1994 decision in *Campbell* and the end of 2007. He finds that, with one exception, the accumulated opinions accommodate a distinct meaning for “transformative” in fair use cases: the courts treat as key to transformativeness “the purpose of the defendant’s use.” *Id.* By contrast, in derivative work cases, the courts typically emphasize not a change in purpose, but whether the content of the work has been creatively altered.

Even if this trend in fair use law continues, unanswered questions attach to transformativeness, both as to its normative basis and its descriptive clarity. *Id.* at 494–95; see also 2 GOLDSTEIN, *supra*, § 12.2.2(c), at 12:32–:40 (questioning the use of transformativeness in general, and suggesting that the “change of purpose” inquiry is dangerously expansive). That transformativeness remains problematic in fair use is emphasized in Thomas F. Cotter, *Transformative Use and Cognizable Harm*, 12 VAND. J. ENT. & TECH. L. 701 (2010). Professor Cotter urges courts judging fair use cases to deemphasize “transformativeness.” It may be that the emphasis on transformation is responsible, as a background source of strain, for some odd developments in both fair use and derivative work doctrine. See, e.g., *Ty, Inc. v. Publ’ns Int’l Ltd.*, 292 F.3d 512, 517–18 (7th Cir. 2002) (controversial application of the notion of complementarity in a fair use case); *Warner Bros. Entm’t Inc. v. RDR Books*, 575 F. Supp. 2d 513, 538–39 (S.D.N.Y. 2008) (controversial new test for derivative works); see also Cotter, *supra*, at 708–30.

I argue below that transformativeness is incomplete as a criterion for disregarding foregone license fees, whether understood as alteration of content, or as alteration of purpose. I suggest that there are some bases for disregarding license fees that have nothing to do with transformativeness under either definition. See *infra* Part II.C, II.F.

<sup>99</sup> Beebe, *supra* note 55, at 603–06.

In *Dorling Kindersley*, the Second Circuit—one of the two most influential circuits on matters of fair use<sup>100</sup>—seems to have been trying to make a clear space for fair use even in the presence of potential licensing. Conceivably, the notion of “fair use markets” has made little progress because the Second Circuit not only made the point that fair use can coexist with licensing markets, but went on to eliminate consideration of foregone license fees in an extremely wide group of cases. That second step may have been too extreme for later courts to emulate.

This Article suggests some revised criteria for identifying a *subset* of fair use markets that warrant such disregarding of license fees. These criteria go beyond (and reach within) the troubling criterion of “transformativeness” that the Second Circuit itself used when creating the “fair use markets” category.<sup>101</sup>

#### E. Reexamining *Texaco*

To better understand the role that “fair use markets” might play, let us turn to the question of whether *Texaco*’s approach to physically foregone license fees really forecloses fair use whenever markets appear. As mentioned, the Second Circuit in the *Texaco* majority opinion itself argued that it was not “circular” to count license fees for a contested use against the defendant for factor four purposes.<sup>102</sup> Wrote the court:

[I]t 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. *The vice of circular reasoning arises only if the availability of payment is conclusive against fair use.*<sup>103</sup>

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<sup>100</sup> *Id.* 567–68.

<sup>101</sup> For discussion of the difficulties raised by transformativeness, see *supra* note 98, *infra* notes 151, 191–92 and accompanying text.

<sup>102</sup> Factor four is “the effect of the use upon the potential market for or value of the copyrighted work.” 17 U.S.C. § 107(4). For discussions of courts’ treatment of factor four, see, for example, Beebe, *supra* note 55, at 557–64, and Pasquale, *supra* note 59.

<sup>103</sup> *Am. Geophysical Union v. Texaco Inc.*, 60 F.3d 913, 930–31 (2d Cir. 1995) (emphasis added). The court continued:

Whatever the situation may have been previously, before the development of a

As noted, the Second Circuit's opinion has nevertheless been strongly criticized by virtually all commentators on the ground of circularity.<sup>104</sup> In the words of Professor Loren's excellent article: "The argument that 'lost' permission fees are proof of fourth factor harm has as its premise the legal conclusion at issue: that the use at issue is not a fair use . . . ."<sup>105</sup> Or as the Court of Claims stated in a 1973 decision, "[T]o measure the detriment to plaintiff by loss of presumed royalty income . . . assume[s] at the start the merit of the plaintiff's position."<sup>106</sup> But is this right? Does the *Texaco* court, as a logical matter, necessarily assume that the copyright owner has the best of the argument from the start?<sup>107</sup>

Similar criticisms based on circularity were addressed to the Sixth Circuit for its decision in *MDS*.<sup>108</sup> In both *Texaco* and *MDS*, the courts weighed heavily against the defendants the possibility that they could have purchased licenses for the material they photocopied.<sup>109</sup>

Although there are many problems with *Texaco*, it is not necessarily true that the court began by assuming the copyright owner had an entitlement to control the contested use. There may have been circu-

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market for institutional users to obtain licenses to photocopy articles, it is now appropriate to consider the loss of licensing revenues in evaluating "the effect of the use upon the potential market for or value of" journal articles. It is especially appropriate to do so with respect to copying of articles from . . . a publication as to which a photocopying license is now available. We do not decide how the fair use balance would be resolved if a photocopying license . . . were not currently available.

*Id.* at 931 (citation omitted).

<sup>104</sup> See *supra* note 71.

<sup>105</sup> Loren, *supra* note 15, at 38.

<sup>106</sup> *Id.* at 39 (quoting *Williams & Wilkins Co. v. United States*, 487 F.2d 1345, 1357 n.19 (Ct. Cl. 1973), *aff'd by an equally divided Court*, 420 U.S. 376 (1975) (per curiam)).

<sup>107</sup> The dissent also accused the majority of circularity, but of a "self-fulfilling prophecy" sort rather than as a logical error. See *Texaco*, 60 F.3d at 937 (Jacobs, J., dissenting). Wrote the dissent:

In this case the only harm to a market is to the supposed market in photocopy licenses. The CCC scheme is neither traditional nor reasonable; and its development into a real market is subject to substantial impediments. *There is a circularity to the problem*: the market will not crystallize unless courts reject the fair use argument that *Texaco* presents; but, under the statutory test, we cannot declare a use to be an infringement unless (assuming other factors also weigh in favor of the secondary user) there is a market to be harmed. At present, only a fraction of journal publishers have sought to exact these fees. I would hold that this fourth factor decisively weighs in favor of *Texaco*, because there is no normal market in photocopy licenses, and no real consensus among publishers that there *ought to be one*.

*Id.* (emphases added).

<sup>108</sup> *MDS*, 99 F.3d 1381 (6th Cir. 1996) (en banc).

<sup>109</sup> *Id.* at 1387; *Texaco*, 60 F.3d at 930–31.

larity, but not of that form. (There are many forms of circularity, not all of which are necessarily bad.<sup>110</sup> A less pejorative form of circularity, for example, is the familiar notion of “feedback loops.”<sup>111</sup>) A bad circular argument is commonly defined as one that “commits the logical fallacy of assuming what it is attempting to prove.”<sup>112</sup> 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. The following numerical example will illustrate.

#### F. Numerical Illustration

“Foregone license fees” is simply another term for part of the value that the defendant’s use generates.<sup>113</sup> But who should capture that value? The copyright owner, the defendant, the public in general, or some mixture thereof?<sup>114</sup> And what if the plaintiff’s enforcement of fees means that the defendant’s use will not occur? How is that loss (and the loss of what would be built on the defendant’s work) to be calculated? Note that in the following analysis, foregone incentives of the *defendant*<sup>115</sup> and the community play as large a role as the plaintiff’s foregone incentives.

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<sup>110</sup> I am indebted here to Professor Mike Meurer.

<sup>111</sup> See, e.g., Douglas N. Walton, *The Essential Ingredients of the Fallacy of Begging the Question*, in FALLACIES: CLASSICAL AND CONTEMPORARY READINGS 229 (Hans V. Hansen & Robert C. Pinto eds., 1995). Walton writes of feedback loops:

It’s like the situation of a diabetic who, as he becomes more overweight, builds up more insulin in his blood, which makes him eat more, and consequently store up more fat. The process is circular, but there is no fallacy in it. That’s the way reality sometimes is. Similarly in mathematical reasoning, proving conclusion A from starting point B, and then proving B from A, could be a quite legitimate equivalence proof. From the circular reasoning alone, it doesn’t follow that a fallacy has been committed.

*Id.* at 233–34 (internal quotation marks omitted).

<sup>112</sup> Richard Nordquist, *Circular Argument*, ABOUT.COM, <http://grammar.about.com/od/c/g/circargterm.htm> (last visited July 19, 2011). The nature and definition of logically circular arguments (also known as the fallacy of “begging the question”) are quite controversial, see Walton, *supra* note 111, but this definition suits the question we are asking: whether a court will necessarily deny fair use whenever it faces a contested use for which a market exists.

<sup>113</sup> I am indebted to Brett Frischmann here.

I say that foregone license fees are “part of” the value that the defendant generates because I assume that the defendant and the public will be able to keep some of the value even after the defendant pays a license fee. But this assumption is fact dependent.

<sup>114</sup> Sometimes allocating the value to the plaintiff better serves social goals, but sometimes allocating the value to the defendant or splitting the value between the plaintiff and defendant does so. Copyright remedies allow for the latter possibility. See 17 U.S.C. § 504(b) (2006) (allowing the copyright owner to recover the infringer’s profits that are attributable to the copyrighted work, and not some other factors).

<sup>115</sup> By defendant’s “foregone” incentives, I mean the incentives that a plaintiff’s contested

Assume that *X* is a use (such as a reproduction or public distribution) that appears to fall within the facial grant of the copyright owner's rights.<sup>116</sup> One can imagine a kind of analysis which asks, is the world better off where use *X* is found fair, or where use *X* is found infringing? Fair use analysis sometimes approaches that kind of general inquiry.<sup>117</sup> For example, the Second Circuit has said more than once that "[t]he ultimate test of fair use . . . is whether the copyright law's goal of promoting the Progress of Science and useful Arts would be better served by allowing the use than by preventing it."<sup>118</sup>

What would we take into account if our goal were promoting "Progress?" We would probably take into account the intrinsic satisfactions of creativity; we might take into account semiotic democracy; we would take into account a host of considerations relevant to "Progress" as the concept could best be defined. No matter how "Progress" is defined, however, we would almost certainly include the effect on the plaintiff's incentives to create,<sup>119</sup> sometimes called the

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copyright enforcement would block. Such blockage can arise in several ways. For example, a defendant may be unwilling or unable to pay for a socially desirable license if she is unable to capture the benefits that her use will generate, or a defendant might be willing to pay but the payment might disrupt a pattern of creative endeavor. See *infra* Part II.B.

<sup>116</sup> 17 U.S.C. § 106(1), (3) (reproduction and distribution, respectively).

<sup>117</sup> See Beebe, *supra* note 55, at 620–21 (describing the nature of the balancing test that courts actually engage in). Note that I treat this mathematical example as a part of the ultimate balance in which courts need to engage, rather than as a narrow factor-four inquiry.

<sup>118</sup> *Bill Graham Archives v. Dorling Kindersley Ltd.*, 448 F.3d 605, 608 (2d Cir. 2006) (internal quotation marks omitted). Commentators (including myself) have suggested even more wide-ranging tests for fair use.

The court's reference to "Progress" comes from the constitutional clause granting Congress power to enact patents and copyrights "[t]o promote the Progress of Science and useful Arts." U.S. CONST. art. 1, § 8, cl. 8.

There is much debate on the meaning of "Progress" and the nature of copyright's goals, but investigating those issues would take us too far beyond this Article's confines. It is my hope that even if "Progress" is left undefined—an evocative "black box"—one can make a preliminary assessment of whether "fair use markets" might prove a valuable category to add to fair use jurisprudence.

<sup>119</sup> Doctrinally, many courts performing a factor-four analysis claim to look at a narrower issue, namely, harm to the plaintiff rather than the effect on the public interest that such individual harm might cause. The analysis illustrated here is public oriented. Professor Beebe argues that courts do not actually divide the fourth-factor inquiry from the overall fair-use inquiry. Beebe, *supra* note 55, at 620–21.

Ironically, the case that brought the "fair use market" concept closest to maturity, namely *Dorling Kindersley*, adopted a focus on the plaintiff's private interest when it came to the fourth factor. "This [fourth factor] analysis requires a balancing of 'the benefit the public will derive if the use is permitted and the personal gain the copyright owner will receive if the use is denied.'" *Dorling Kindersley*, 448 F.3d at 613 (quoting *MCA, Inc. v. Wilson*, 677 F.2d 180, 183 (2d Cir. 1981)). When it came to the overall question of fair use, however, *Dorling Kindersley* utilized a public-oriented test. *Id.* at 608. For an explanation of why I view the inquiry into public rather

“supply-side question,”<sup>120</sup> and foregone license fees are part of that inquiry. We should also include the effect on the defendant’s incentives to use and create, sometimes called the “demand-side question.”<sup>121</sup> Therefore, we would take into account the additional creative contributions users of copyrighted works could make if freed of the obligation to obtain permissions.

In short, the impact on creativity that might arise from giving copyright owners fees from the contested use could be examined, along with a host of other considerations, in deciding whether to place the defendant’s use within the *prima facie* entitlement of the copyright holder.<sup>122</sup>

How would that portion of the analysis be conducted? Assume the court sought to perform a public-oriented consequentialist analysis that weighs social costs and benefits. (I am not urging a triumph for consequentialism in this Article; my goal is a modest one of outlining how a particular kind of consequentialist argument might go.<sup>123</sup>) For the sake of exposition let us say that we are before a court that wanted to do a consequentialist analysis of this kind, either as part of or as the sum of its fair use analysis.

Assume the court has before it something like this simplified example: The cost of enforcing copyright against the photocopying of course pack teaching materials might include a loss of “Progress,” particularly if the higher prices for the best material made professors assign fewer and less useful works to their students. Assume that the copyrighted material’s contribution to the community and to the indi-

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than private interest as more appropriate, see Gordon, *Fair Use as Market Failure*, *supra* note 14, at 1607–18.

<sup>120</sup> Frischmann & Lemley, *supra* note 44, at 271 & n.51.

<sup>121</sup> *Id.*; see also *id.* at 280 (discussing the “demand manifestation problem”). Defendants produce works that can be analyzed from a supply-side perspective as well, of course.

<sup>122</sup> In the midst of almost unanimous criticism of *Texaco*’s circularity in the law reviews, one sees a few papers that hint at the same point I am making. See, e.g., Michael G. Frey, Casenote, *Unfairly Applying the Fair Use Doctrine: Princeton University Press v. Michigan Document Services*, 99 F.3d 1381 (6th Cir. 1996), 66 U. CIN. L. REV. 959 (1998); James V. Mahon, Comment, *A Commentary on Proposals for Copyright Protection on the National Information Infrastructure: An Analysis of Proposed Copyright Changes and Their Impact on Copyright’s Public Benefits*, 22 RUTGERS COMPUTER & TECH. L.J. 233 (1996); see also Andrea Ottolia & Dan Wielsch, *Mapping the Information Environment: Legal Aspects of Modularization and Digitalization*, 6 YALE J.L. & TECH. 174, 267 (2003–2004) (“The circularity of the market failure model arises not when it is used as a descriptive model for calculating the role of given values, but when it is suggested as a tool capable of focusing and choosing among those values.” (footnote omitted)).

<sup>123</sup> The analysis is all-things-considered, rather than an inquiry just into the fourth fair use factor.

vidual “Progress” of the teacher, students, and those they affect, if the use was deemed fair and copyright was *not* enforced, is 1000. (I am using an arbitrary metric; whether the affected values are actually commensurable is an open question.) Nine percent of that 1000 value resides in a parody that a student makes and publishes on YouTube, based on one of the expensively priced works that would be omitted if licenses were required. The student would not be able to reap profits from the parody, so those profits would have no effect on his willingness and ability to pay for the course pack.

Finally, assume that the value to “Progress” of reading the less-expensive alternative materials that a license-fee-paying professor would assign is 700 (and that no parody would be made). Enforcement against the makers of course packs in this case would inflict short-term “Progress” costs of 300. These are foregone incentive effects that could be achieved only by allowing a defendant’s uncompensated use to go forward.

So far it looks like fair use should be granted. But what about the extent to which enforcement would *benefit* “Progress”? Are there long-term positive supply-side incentive effects from enforcement? Let us examine two possible states of the world.

At one pole of factual possibility, it might turn out that the more desirable materials could only be produced with the promise of collecting fees from course packs. If so, then fair use would not yield the value of 300 (because the superior materials would not exist to be used). And if any other users would have valued the now-absent material above its alternatives, the benefits of finding infringement would outweigh the cost of granting fair use, unless of course additional criteria were relevant<sup>124</sup> (as they should be; the example examines only a subset of relevant factors).

By contrast, at the opposite pole of factual possibility, it might turn out that the copyrighted materials at issue would be produced even without the copyright owner anticipating the licensing fees from course-packs. Then “Progress” would be furthered (by the amount of 300) by not enforcing the copyright.<sup>125</sup> In such a case fair use would be appropriate, even though the foregone license fees were included as part of the calculus. Counting the fees as relevant did not make fair use necessarily unavailable.

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<sup>124</sup> Additional criteria might involve, for example, consideration of rights.

<sup>125</sup> Remember that enforcing copyright against photocopiers increases price and thus makes the value of the materials to users lower than it would be if an alternate subsidy for the materials’ production were available.



The example may be abstract and simple, but it illustrates that counting license fees as part of a fair use calculus does not leave us condemned to a particular result. Instead one can ask “what would happen if we enforced the copyright” and “what would happen if we did not?” Depending on the factual state of the world, it may be worthwhile to force people in the defendant’s position to bear the fees, or it may not. The above example employs the presence of potentially available license fees not as a premise that justifies the imposition of liability, but rather as an independent variable within the factual calculus. This avoids full circularity because a premise of “count license fees” does not inevitably lead to the conclusion of “no fair use.” As the *Texaco* court recognized,<sup>126</sup> fatal circularity can be avoided by treating physically foregone license fees as a part of the analysis rather than conclusive on fair use.<sup>127</sup>

*G. Professor Loren’s Analysis and Beyond*

We began with a respected professor’s accusation of circularity. This Article offers a refinement of her intriguing, careful analysis and extends it in a new direction.

As you will recall, Professor Loren argues that “[t]he argument that ‘lost’ permission fees are proof of fourth factor harm has as its premise the legal conclusion at issue: that the use at issue is not a fair use and, therefore, the owner is allowed to charge permission fees for such use.”<sup>128</sup> This observation arguably conflates the factual investigation with the legal conclusion. As I hope the numerical illustration has shown,<sup>129</sup> there is no need to decide ahead of time whether an entitlement exists prior to investigating what the *effects* of such an entitlement would be. The lack of fair use is thus not a “premise” of the factual investigation; the *Texaco* argument, as I interpret it at least, does not, as Professor Loren suggests, “assume at the start the merit of the plaintiff’s position,”<sup>130</sup> nor does it lead conclusively to a finding

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<sup>126</sup> *Am. Geophysical Union v. Texaco Inc.*, 60 F.3d 913, 929–30 (2d Cir. 1995).

<sup>127</sup> The numerical example illustrates a possibility for understanding the *Texaco* majority’s approach. However, note that in focusing on incentive effect, rather than mere private loss, the numerical example more closely approaches a balancing of all four factors rather than an analysis of just factor four. See *supra* note 119.

On the distinction between rights analysis and consequentialist analysis in fair use, see, for example, Gideon Parchomovsky, *Fair Use, Efficiency and Corrective Justice*, 3 *LEGAL THEORY* 347 (1997). The role that rights should play in the fair use analysis is outside the scope of this Article.

<sup>128</sup> Loren, *supra* note 15, at 38.

<sup>129</sup> See *supra* Part I.F.

<sup>130</sup> Loren, *supra* note 15, at 39 (quoting *Williams & Wilkins Co. v. United States*, 487 F.2d

of no fair use. Yet there is something substantial to Professor Loren's charge of circularity when she uses it not as a logical claim, but rather to comment on the practical tendency of courts. The Article returns to this issue below, especially in Part II.B.

Professor Loren also sees the *Texaco* and *MDS* opinions as taking the position that courts should "restrict[ ] fair use to only those situations where an efficient mechanism for obtaining permission does not yet exist."<sup>131</sup> Using more technical language to make the same point, she argues that the *Texaco* court improperly "narrowed the market failure theory to include only one type of market failure," namely, transaction-cost barriers barring any market at all from arising in the contested use, and then the court "applied the theory in reverse, finding no fair use because [that] type of market failure was not present."<sup>132</sup> If the courts indeed engaged in that procedure, she and I would agree it was error.<sup>133</sup>

Moreover, Professor Loren relies not only on the accusation of circularity, but also on how courts interpret fair use doctrine.<sup>134</sup> Her focus on the latter ground is an important contribution. As Professor Loren says, courts do tend to overemphasize the monetary and the concrete, and often are reluctant to go beyond the visible interests of the parties before them.<sup>135</sup>

And in *MDS*, the Sixth Circuit did seem unduly insensitive to the external benefits involved, namely, the benefits not reflected in the students and professors' current pocketbooks and thus not reflected in their ability to pay fees.<sup>136</sup>

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1345, 1357 n.19 (Ct. Cl. 1973), *aff'd by an equally divided Court*, 420 U.S. 376 (1975) (per curiam)).

<sup>131</sup> *Id.* at 38. At some points Professor Loren stops short of this characterization. Thus, she recognizes that there are several steps between an ultimate finding of infringement (no fair use) and an initial step of letting foregone license fees help plaintiff prevail on the fourth factor fair use inquiry. See *id.* at 38–44. Further, she usually does not insist that the permission systems were conclusive on the final issue of infringement in *MDS* and *Texaco*, noting instead that the permission systems "heavily influenced the outcome" of those cases. *Id.* at 32–33. Nevertheless, she also reaches the ultimate conclusion that the *MDS* and *Texaco* courts "f[ound] no fair use because one type of market failure was not present." *Id.* at 33. As it is the latter interpretation of *Texaco* that best illustrates the difference in our conceptions of circularity, it is useful to focus on it.

<sup>132</sup> *Id.*

<sup>133</sup> See, e.g., Gordon, *Excuse and Justification*, *supra* note 14 (arguing that only in some cases should the absence of market barriers lead to findings of infringement).

<sup>134</sup> See Loren, *supra* note 15, at 50–51.

<sup>135</sup> *Id.*

<sup>136</sup> See *MDS*, 99 F.3d 1381, 1386 (6th Cir. 1996) (focusing on the commercial use of the course-pack creator rather than the noncommercial use by students and professors).

By contrast, it is not as clear that external benefits were improperly undervalued in *Texaco*. Admittedly, all research probably generates positive externalities. Nevertheless it is arguable that the commercial nature of the defendant company (the copier's employer) made it more likely that many of the benefits of the copier's scientific research would be internal, rather than external, to the entity that would have to pay any licensing fees that the copyright holder might charge.<sup>137</sup> If so, there would be proportionately fewer positive externalities to take into account than in *MDS*, and less danger in disregarding them. The court's discussion of "commercial use" can be interpreted as taking this position.<sup>138</sup> (Of course the court used the usual statutory factors instead of the language of "externalities." The familiar four-factor test, if well applied, offers expression for many or most of the important consequentialist factors.)<sup>139</sup> Both on its face and substantively, *Texaco* thus does not rule out an analysis where the negative effects of foregone fees could be outweighed (as by, for example, defendant's external benefits).<sup>140</sup>

Yet the dangers that Professor Loren points out remain present and quite evident in *MDS* and perhaps in other cases.<sup>141</sup> If the courts refuse to weigh social benefits of the defendant's potentially fair use when the market is unable to do so, we are left with no one making the relevant decision as to what course—use or nonuse, payment or no payment—best serves copyright's goals. If current copyright law

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<sup>137</sup> See *Am. Geophysical Union v. Texaco Inc.*, 60 F.3d 913, 915 (2d Cir. 1994) (describing *Texaco*'s corporate research efforts). Some positive externalities are always unable to be captured. Just as a growing literature suggests it is unwise for copyright owners to capture all positive externalities, see, e.g., Mark A. Lemley, *Property, Intellectual Property, and Free Riding*, 83 TEX. L. REV. 1031 (2005), it is also unwise to structure the law to enable copyright users to capture all positive externalities.

<sup>138</sup> *MDS*, 99 F.3d at 1386.

<sup>139</sup> See Gordon, *Fair Use as Market Failure*, *supra* note 14.

<sup>140</sup> "Notwithstanding harmful effect, the use may be a fair use." On *Davis v. GAP, Inc.*, 246 F.3d 152, 176 (2d Cir. 2001) (*dicta*). Note that in my numerical example above, fair use could be found even without reference to the defendant's positive externalities.

<sup>141</sup> But see Pamela Samuelson, *supra* note 71. Professor Samuelson writes that, "After *Campbell*, courts have generally avoided this circularity problem, especially in transformative and productive use cases." *Id.* at 2620. In support of this observation, she cites, *inter alia*, *Dorling Kindersley*, *id.* at 2620 n.583, a case which in my view has been underutilized. Moreover, *Texaco* and *MDS*—both decided after *Campbell*—remain valid law with a strong impact on the practices of copying and continued influence on judicial analysis. See, e.g., *Murphy v. Millennium Radio Grp. LLC*, No. 10-2163, 2011 WL 2315128 (3d Cir. June 14, 2011) (citing *Texaco* and *MDS*). She also argues that recent cases have been sensitive to factors that mitigate the circularity problem. Samuelson, *supra* note 71, at 2620. Nevertheless, the issue of what counts as plaintiff's market has continued importance both conceptually and doctrinally, and is a matter of continued debate. See, for example, Bohannon & Hovenkamp, *supra* note 71, at 973–74.

rests on an uneasy basis, as Justice Breyer's article<sup>142</sup> suggests, and if copyright is too strong on the "writer" side as a host of commentators argue,<sup>143</sup> it would be dangerous to let a lack of substantive decision-making result in a verdict of infringement. One way to stop such practices might be for courts to follow the lead of *Dorling Kindersley*<sup>144</sup> and dictate by doctrine that some criteria warrant treating foregone license fees differently.

## II. WHAT CRITERIA SHOULD ESTABLISH A "FAIR USE MARKET"?

The Second Circuit in *Dorling Kindersley* implicitly held two things regarding "fair use markets." First, the court held that in a fair use market, the possibility of fair use was not foreclosed by the possibility that the defendant might have been able to license the contested use.<sup>145</sup> Second, it held that in a fair use market, which it defined as a market for "transformative" uses, foregone license fees would not count against the defendant in the factor-four analysis.<sup>146</sup> The court wrote that "[s]ince [defendant's] use of [plaintiff's] images falls within a transformative market, [plaintiff] does not suffer market harm due to the loss of license fees."<sup>147</sup>

In the following Section, I suggest that different criteria are appropriate for the two holdings. An immensely large category of factors make it appropriate for markets not to foreclose fair use; a more

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<sup>142</sup> Breyer, *supra* note 1. Justice Breyer's topic was the advisability of adopting what became the 1976 Copyright Act, with its various expansions of copyright scope and duration. That expansion has occurred, with more added since 1976. Copyright law today gives a duration not of fifty-six years (as under the 1909 Act) but of life of the author plus seventy years. New subject matters, such as architectural works, have been added, as has a limited digital performance right for sound recordings, and a paracopyright control over access to works. For a description of some of copyright's expansions, see, for example, Litman, *supra* note 42.

<sup>143</sup> See, e.g., Lawrence Lessig, *The Creative Commons*, 65 MONT. L. REV. 1, 4 (2004).

<sup>144</sup> See *infra* Part II.

<sup>145</sup> The court wrote that "a publisher's willingness to pay license fees for reproduction of images does not establish that the publisher may not, in the alternative, make fair use of those images." *Bill Graham Archives v. Dorling Kindersley Ltd.*, 448 F.3d 605, 615 (2d Cir. 2006). At least one commentator has interpreted this language as a statement "that the mere existence of a licensing market does not mean that a secondary user cannot use the work fairly." Jeannine M. Marques, Note, *Fair Use in the 21st Century: Bill Graham and Blanch v. Koons*, 22 BERKELEY TECH. L.J. 331, 344 (2007).

<sup>146</sup> *Dorling Kindersley*, 448 F.3d at 615.

<sup>147</sup> *Id.* Note that the *Dorling Kindersley* court did not reach the question of how to treat a work that has both transformative and substitutionary aspects. In *Campbell*, the Supreme Court separated out the harm done by the *parodic* nature of defendant's song as not cognizable, *Campbell v. Acuff-Rose Music, Inc.*, 510 U.S. 569, 591–92 (1994), but the Court remanded to take cognizance of any substitutionary harm the same song might have done to the potential market for nonparody rap derivatives. *Id.* at 593–94.

limited number of factors—of which I provide a tentative and suggestive partial list—are appropriate for triggering a court’s willingness to remove foregone license fees from the fair use calculus.

A. *Markets That Can Coexist with Fair Use*

Let us refine the *Dorling Kindersley* court’s definition of “fair use market” in regard to its first function: identifying markets that can coexist with fair use. The court apparently defined “fair use market” in terms of one criterion: whether the use for which a fee might be charged was “transformative.”<sup>148</sup> That choice is problematic. In addition to the difficulties with that criterion discussed earlier,<sup>149</sup> and despite the prevalence of courts willing to count a shift in the defendant’s *purpose* as a transformation,<sup>150</sup> the English word “transformative” inevitably connotes a *physical* change. Courts that demand physical alterations would not treat exact copies for new purposes as “transformative”; such courts could come close to repeating the mistake that the Ninth Circuit once made in attempting to restrict fair use to productive authorial uses.<sup>151</sup>

I would instead define “fair use market” as a market in which we cannot rely on the decisions of copyright holders to take into account all the relevant values and interests,<sup>152</sup> or as a setting where available nonmarket interactions and institutions are likely to do a better job in advancing “Progress.”<sup>153</sup> Whether transformative or nontransformative use is at issue, markets that meet either of these tests should not foreclose the possibility of fair use.

When circumstances give us no reason to trust that the market that the Copyright Act enabled will serve social goals, or if there is affirmative reason to trust nonmarket modes of circulation and productivity to do a better job, then those factors should help persuade toward fair use. What criteria could lead a court to find market failures or nonmarket successes? What circumstances would make a

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<sup>148</sup> See *supra* Part I.D.

<sup>149</sup> See *supra* Part I.D and note 98.

<sup>150</sup> See Reese, *supra* note 98.

<sup>151</sup> *Universal City Studios, Inc. v. Sony Corp. of Am.*, 659 F.2d 963, 970 (9th Cir. 1981), *rev’d*, 464 U.S. 417 (1984). My first article on fair use was targeted at this restrictive aspect of the Ninth Circuit’s holding. See Gordon, *Fair Use as Market Failure*, *supra* note 14.

<sup>152</sup> See Gordon, *Excuse and Justification*, *supra* note 14.

<sup>153</sup> A preliminary inquiry into nonmarket modes appears below in Part II.B–G (discussing when to disregard license fees).

court distrust the capacity of market actors to take account of social interests, or to trust the capacity of nonmarket actors to do so?<sup>154</sup>

Legal scholarship already suggests a wide range of factors that markets might be unable to take into account. These include market flaws in general,<sup>155</sup> concerns with the distribution of expressive opportunities,<sup>156</sup> works whose creation might be impossible because too many conflicting claims overlap,<sup>157</sup> copyrighted works whose creation is motivated by nonmonetary concerns,<sup>158</sup> uses that occur later in a work's life<sup>159</sup> or which are so unforeseeable<sup>160</sup> that payment for them would not contribute meaningfully to incentives to create a work, uses that are not monetarily motivated,<sup>161</sup> uses that help to give voice to marginalized groups<sup>162</sup> or otherwise further democracy,<sup>163</sup> uses that fa-

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<sup>154</sup> See Gordon, *Fair Use as Market Failure*, *supra* note 14, at 1612–13.

<sup>155</sup> See *id.* at 1614–15; see also Gordon, *Excuse and Justification*, *supra* note 14, at 152.

<sup>156</sup> Van Houweling, *supra* note 43; see also Tushnet, *supra* note 9, at 538–39 (“Creativity, including remix creativity, is part of a good life . . . [W]e should aim for policies that maximize participation.”).

<sup>157</sup> See, e.g., Michael A. Heller & Rebecca S. Eisenberg, *Can Patents Deter Innovation? The Anticommons in Biomedical Research*, 280 SCIENCE 698 (1998); cf. Tim Wu, *Jay-Z Versus the Sample Troll: The Shady One-Man Corporation That’s Destroying Hip-Hop*, SLATE (Nov. 16, 2006), <http://www.slate.com/id/2153961/> (“Thousands or even hundreds of samples . . . mean thousands of copyright clearances and licenses. Today, Public Enemy’s breakout album, *It Takes a Nation of Millions to Hold Us Back*, would cost millions to produce or, more likely, would never have been made at all.”). Although these sources were discussing issues distinct from fair use, their observations could be applicable to fair use as well.

<sup>158</sup> See Lydia Pallas Loren, *The Pope’s Copyright? Aligning Incentives with Reality by Using Creative Motivation to Shape Copyright Protection*, 69 LA. L. REV. 1, 3 (2008).

<sup>159</sup> Justin Hughes, *Fair Use Across Time*, 50 UCLA L. REV. 775 (2003); Joseph P. Liu, *Copyright and Time: A Proposal*, 101 MICH. L. REV. 409 (2002). When the question is how much to value a future use, the market can indeed discount the value with reference to time. But when the future comes and a use of an old work occurs, the attendant right to exclude is usually given as much strength as that held by a newly minted copyright. One exception applies to some library uses. 17 U.S.C. § 108(h)(1) (2006) (allowing certain uses “during the last 20 years of any term of copyright”).

<sup>160</sup> Bohannon, *supra* note 71, at 981–85; see also Shyamkrishna Balganesh, *Foreseeability and Copyright Incentives*, 122 HARV. L. REV. 1569, 1605 (2009) (arguing that as part of making out a prima facie case of copyright infringement, a plaintiff should be required to prove that the defendant’s use was foreseeable at the time of creation).

<sup>161</sup> Tushnet, *supra* note 9, at 543 (“[W]hen copyright’s incentive story breaks down and people create works that they do not intend to circulate in the money economy, then claims that such works make fair uses of existing works should be assessed differently, because fair use’s economic model fails.”).

<sup>162</sup> See Anupam Chander & Madhavi Sunder, *Everyone’s a Superhero: A Cultural Theory of “Mary Sue” Fan Fiction as Fair Use*, 95 CAL. L. REV. 597 (2007); see also Rebecca Tushnet, *Scary Monsters: Hybrids, Mashups, and Other Illegitimate Children* (unpublished manuscript) (on file with the George Washington Law Review).

<sup>163</sup> Neil Weinstock Netanel, *Copyright and a Democratic Civil Society*, 106 YALE L.J. 283 (1996) [hereinafter Netanel, *Copyright and a Democratic Civil Society*]. It may be that such

cilitate social benefits that are not reflected in the potential licensee's ability to pay,<sup>164</sup> and uses that employ copyrighted works as factual evidence.<sup>165</sup>

Though markets fail, will nonmarkets succeed? The question is immensely difficult. Nevertheless, as the next Section indicates, existing literature already suggests some ways in which nonmarket modes can do what markets cannot.<sup>166</sup>

*B. Factors That Could Lead a Court to Drop Foregone License Fees from the Fair Use Calculus*

The numerical example<sup>167</sup> above suggests that it is sometimes useful to take into account the impact of foregone license fees. Why would the *Dorling Kindersley* decision rule out their consideration for transformative works? Part of the reason might be that “transformative” works are associated with creating benefits for society,<sup>168</sup> many of which are hard to measure.<sup>169</sup> Striking out any consideration of potential license fees might compensate for the difficulty of taking into account the positive effects that defendants can generate with their transformative uses of the copyrighted work. That is, perhaps the Second Circuit perceived the difficulty of weighing a prodefendant

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concerns are incommensurable, or should be immune from balancing considerations on the ground that they constitute rights. On First Amendment rights, see, for example, C. Edwin Baker, *First Amendment Limits on Copyright*, 55 VAND. L. REV. 891 (2002); Neil Weinstock Netanel, *Locating Copyright Within the First Amendment Skein*, 54 STAN. L. REV. 1 (2001). On the public's Lockean rights, see, for example, Gordon, *supra* note 19; Wendy J. Gordon, *Render Copyright unto Caesar: On Taking Incentives Seriously*, 71 U. CHI. L. REV. 75 (2004).

<sup>164</sup> See discussion *supra* Part I.F, I.G.

<sup>165</sup> Wendy J. Gordon, *Reality as Artifact: From Feist to Fair Use*, 55 LAW & CONTEMP. PROBS. 93 (1992) (arguing that factual uses of copyrighted works merit fair use treatment); Pierre N. Leval, Commentary, *Toward a Fair Use Standard*, 103 HARV. L. REV. 1105, 1111, 1114 & n.43, 1115–16 (1990). Neither ideas nor facts can be owned under the Copyright Act, although the “expression” portion of works of authorship *can* be owned. 17 U.S.C. § 102 (2006).

<sup>166</sup> See, e.g., Michael J. Madison, Brett M. Frischmann & Katherine J. Strandburg, *Constructing Commons in the Cultural Environment*, 95 CORNELL L. REV. 657 (2010); see also Niva Elkin-Koren, *Tailoring Copyright to Social Production*, 12 THEORETICAL INQUIRIES L. 309, 318 (2011).

<sup>167</sup> See *supra* Part I.F.

<sup>168</sup> To quote Judge Pierre Leval:

[T]he secondary use adds value to the original—if the quoted matter is used as raw material, transformed in the creation of new information, new aesthetics, new insights and understandings—this is the very type of activity that the fair use doctrine intends to protect for the enrichment of society.

Leval, *supra* note 165, at 1111.

<sup>169</sup> See BRETT M. FRISCHMANN, *INFRASTRUCTURE: THE SOCIAL VALUE OF SHARED RESOURCES* (forthcoming 2012) (manuscript at ch. 12) (on file with the George Washington Law Review). See generally Frischmann & Lemley, *supra* note 44.

subfactor (here, external benefits that the defendant's use gives the public), and reacted by removing from consideration a proplaintiff subfactor (such as foregone license fees). The argument is as follows: if the external social benefits from the defendant's receiving fair use treatment are too "diffuse" to be weighed,<sup>170</sup> then perhaps foregone license fees should not be counted either.<sup>171</sup>

But how would we know whether the two omitted subfactors will balance out? Perhaps we can identify criteria that would make it more likely that the diffuse demand-side benefits of the defendant's use will bring more to the world—either in terms of economics or in terms of human flourishing—than enforcing the copyright would bring.

Or perhaps, in some cases, assessing economic incentives will be beside the point. There may be circumstances in which license fees would not be relevant to the values society seeks to pursue, or in which the fees would not give appropriate incentive messages.

This Article briefly explores these possibilities and seeks to identify some of the criteria courts could use for determining when it is appropriate to disregard foregone license fees. The following Section draws lightly on the literature on rights, on commonses, and on discussions of commodification.<sup>172</sup> The last-mentioned category is perhaps most in need of explanation.

Much of the scholarship on commodification focuses on whether the law should *forbid* or *allow* markets in particular "things" that might be bought or sold, such as babies,<sup>173</sup> blood,<sup>174</sup> votes,<sup>175</sup> and

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<sup>170</sup> See Frischmann & Lemley, *supra* note 44, at 279–82; Loren, *supra* note 15, at 50–51. Whether the spillovers that defendants receive and the further benefits they generate are too diffuse for courts to consider is a debatable question. See, e.g., *id.* at 49–56; Pasquale, *supra* note 72, at 110–35.

<sup>171</sup> Professor Loren urges courts to refuse to weigh foregone license fees, in part because they are likely to be given undue weight. See, e.g., Loren, *supra* note 15, at 32–34, 38–48, 57. She also urges a more complete weighing of external benefits generated by a defendant's use. See *id.* at 54–56. However, she does not suggest that both solutions should be adopted at the same time (counting external benefits, and refusing to count foregone fees). See *id.* at 56 & n.216.

<sup>172</sup> The commodification literature has been utilized by copyright scholars before. See, e.g., THE COMMODIFICATION OF INFORMATION (Niva Elkin-Koren & Neil Weinstock Netanel, eds., 2002). An early version of the article, Gordon, *Excuse and Justification*, *supra* note 14, appeared in that volume.

<sup>173</sup> See, e.g., Patricia J. Williams, *Spare Parts, Family Values, Old Children, Cheap*, 28 NEW ENG. L. REV. 913, 914–21 (1994) (examining the role of money in adoption).

<sup>174</sup> Margaret Jane Radin, *Market-Inalienability*, 100 HARV. L. REV. 1849, 1850 (1987) (citing RICHARD M. TITMUSS, *THE GIFT RELATIONSHIP: FROM HUMAN BLOOD TO SOCIAL POLICY* (1971)).

<sup>175</sup> Prohibition on the sale of votes has obvious implications for equality. See *infra* note



human organs.<sup>176</sup> Although copyright law is concerned with the related issue of where markets should or should not be encouraged, copyright and commodification do not map directly onto one another. Copyright law has some provisions that restrain alienation,<sup>177</sup> and some of its liberties may reflect inalienable rights of the public,<sup>178</sup> but copyright is not generally about *forbidding* markets (except for markets in infringing goods).<sup>179</sup> Rather, copyright generally permits markets to arise whether or not the items sold are copyrightable. Copyright preemption sometimes renders contracts unenforceable,<sup>180</sup> but not criminal.<sup>181</sup>

Another difference might seem to be that, although copyright places some “things” into permanent categories, the whole point of fair use is that some things ordinarily backed by exclusion rights should in some contexts receive different treatment.<sup>182</sup>

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205. It can also be analyzed from other perspectives. See Richard A. Epstein, *Why Restrain Alienation?*, 85 COLUM. L. REV. 970, 988 (1989) (using a largely economic perspective).

176 National Organ Transplant Act § 301(a), 42 U.S.C. § 274e(a) (2006) (prohibiting sale of organs).

177 Most notably, section 106A of the Copyright Act makes an author’s moral right waivable but nontransferable, 17 U.S.C. § 106A(e) (2006), and sections 203 and 304 give authors outside the work-for-hire context a partly inalienable right to terminate prior grants, *id.* §§ 203, 304. The termination right can be alienated or bindingly waived only under special circumstances. See *id.* As I have previously explained,

it should be noted that for “fair use,” we are addressing only one part of the commodification conundrum: whether an owner should have a right to exclude others from the resource. Whether an owner should have a power to exclude herself from the resource—the issue of inalienability—is a separate question.

Gordon, *Excuse and Justification*, *supra* note 14, at 168.

178 Thus, inalienability can be relevant to fair use, if the *public* has an inalienable liberty with which copyright enforcement would interfere. See Gordon, *supra* note 19.

179 17 U.S.C. § 501(a).

180 Contracts are matters of state law, and are thus subject to federal preemption, though preemption of contracts is fairly rare. For example, data that is not protected by copyright can nevertheless be lawfully bought and sold by persons who seek the convenience and accuracy of dealing with known suppliers. See, e.g., *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996) (holding that a shrinkwrap “contract” barring the commercial reuse of public-domain data is not preempted). Under some circumstances, however, purported contracts might be preempted by copyright law. See *Vault Corp. v. Quaid Software Ltd.*, 847 F.2d 255, 268–70 (5th Cir. 1988) (holding that state statute validating contracts that would restrain a liberty granted by federal copyright was preempted, and corresponding contractual clauses were held unenforceable).

181 The classic treatments of commodification often involve the criminalization of sale (e.g., criminalizing the sale of sex or the sale of human organs).

182 What is at issue in fair use is removing from the usual owner his ability to require sale and purchase in some contexts. See Arjun Appadurai, *Commodities and the Politics of Value*, in *RETHINKING COMMODIFICATION: CASES AND READINGS IN LAW AND CULTURE* 34, 37 (Martha M. Ertman & Joan C. Williams eds., 2005) (“[T]hings can move in and out of the commodity state . . . .”); Gideon Parchomovsky & Kevin A. Goldman, *Fair Use Harbors*, 93 VA. L. REV. 1483 (2007).

Nevertheless, many of the same sorts of reasoning apply in fair use as in the classic commodification debates. For example, most commodification scholars do not insist that all “things” have the same categories despite their context; rather, they recognize that “things” go through many stages concerning commodification and that context matters greatly.<sup>183</sup> If there are particular “transactions,” or uses, for which use of a market would be unreliable or counterproductive, it may be desirable for the law to substitute another and nonmonetary metric in those contexts, perhaps by refusing to enforce the usual market mechanisms. Moreover, although commodification scholars inquire mainly into the effects of *allowing* things to be bought and sold,<sup>184</sup> their insights also help us examine the effects of *requiring* things to be bought when their owners are unwilling to share. And that is the focus of fair use: whether courts should require a defendant to obtain a copyright owner’s consent before making use of a copyrighted work.

What follows are factors potentially useful for finding a “fair use market,” not only in the limited sense that fair use and a licensing market can coexist, but in the more demanding sense of *Dorling Kindersley* that foregone license fees should be ignored in making the fair use calculus.

### C. What Do We Make of “Transformativeness”? A New and Narrower Criterion

Professor Lewis Hyde has persuasively argued that there are many artistic communities in which giving or sharing serves the group and the individual far better than does commodification; those who copy then make, give, or share their own works in response.<sup>185</sup> He suggests that free receipt brings a desire to reciprocate,<sup>186</sup> to receive a

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<sup>183</sup> Arjun Appadurai, *Introduction: Commodities and the Politics of Value*, in *THE SOCIAL LIFE OF THINGS: COMMODITIES IN CULTURAL PERSPECTIVE* 3, 13–15 (Arjun Appadurai ed., 1986).

<sup>184</sup> See generally Radin, *supra* note 174 (discussing various approaches to commodification theory).

<sup>185</sup> LEWIS HYDE, *THE GIFT: IMAGINATION AND THE EROTIC LIFE OF PROPERTY* (1983).

<sup>186</sup> The instinct of reciprocity is likely to generate creative gifts back to the community, or paid forward to future generations, rather than gifts directly to the source of the initial inspiration. But if as an overall result “givers” become “receivers” in equal measure, such payment “in kind” may make monetary payment unnecessary and even undesirable for incentives. (Reciprocity is a familiar argument in law and economics: if benefits and burdens are likely to even out, then it is a social loss to engage in costly compensation practices.) The reciprocity notion also has roots in theories of fairness and corrective justice; Professor Gideon Parchomovsky has used the notion of reciprocity as part of a corrective justice approach to fair use. See

creative work is to be motivated to make a new work in response or in return.<sup>187</sup> Payment can cut off this generative, transformative response.<sup>188</sup> Perhaps when all these characteristics describe a community, license fees might decrease rather than increase incentives. If so, it would be odd indeed to assume that potential license fees should be weighed *against* the defendant.

Related to the possible role of gratitude in the making of art is the importance to creative persons of intrinsic motivation and the potential vulnerability of that motivation. Professor Theresa Amabile's experiments suggest that promising rewards to children can reduce the creativity of their art.<sup>189</sup> In a related vein, Professors Uri Gneezy and Aldo Rustichini and others have investigated whether the introduction of money can discourage cooperative behavior.<sup>190</sup> In such areas, markets can be counterproductive.

Might this concern with identifying intrinsically motivated individuals and reciprocal, organic communities be a legitimate reason for

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Parchomovsky, *supra* note 127; see also George P. Fletcher, *Fairness and Utility in Tort Theory*, 85 HARV. L. REV. 537 (1972).

<sup>187</sup> HYDE, *supra* note 185, at 47–52.

<sup>188</sup> Thus, in writing about spiritual conversions sold for a fee, Professor Hyde makes a point he also makes about art, namely, the importance of gratitude:

[A] fee for service tends to cut off the force of gratitude. . . . Gratitude requires an *unpaid* debt, and we will be motivated to proceed only so long as the debt is *felt*. If we stop feeling indebted we quit, and rightly so. To sell a transformative gift therefore falsifies the relationship; it implies that the return gift has been made when in fact it can't be made until the transformation is finished. A prepaid fee suspends the weight of the gift and de-potentiates it as an agent of change.

*Id.* at 51–52. For being reminded of this apt passage, I am indebted to JoAnn Schwartz's review of Hyde's book, *The Gift*. See JoAnn Schwartz, *Book Review: The Gift: Imagination and the Erotic Life of Property—by Lewis Hyde*, SOUTHERN CROSS REVIEW, <http://southerncrossreview.org/4/schwartz.html> (last visited August 1, 2011).

This is part of Hyde's theory of the “‘transformative’ gift, in which gratitude for inspiration, or for the change that a gift has caused, prompts the impulse to do the work on it and pass the inspiration on to others . . . . It is . . . the impulse that he takes to lie behind most artistic creation worth having.” Tim Martin, *The Gift by Lewis Hyde: Lone Scribblers, Treasure Your Gift*, INDEPENDENT (London), Nov. 12, 2006, <http://www.independent.co.uk/arts-entertainment/books/reviews/the-gift-by-lewis-hyde-424028.html>.

<sup>189</sup> THERESA M. AMABILE, CREATIVITY IN CONTEXT: UPDATE TO *THE SOCIAL PSYCHOLOGY OF CREATIVITY* 163 (1996).

<sup>190</sup> Uri Gneezy & Aldo Rustichini, *A Fine Is A Price*, 29 J. LEGAL STUD. 1 (2000), reported that fining parents for not picking up their children from daycare on time resulted in *more* parental lateness rather than less. Further, they found that the lateness persisted after the fine was removed.

It is remarkably difficult to determine precisely why such behaviors occur. The authors speculate on various reasons for the parents' change; it may be that the parents' set of internal norms did not change, but that the parents' perception of the situation changed from one invoking norms of mutual consideration to one invoking market norms. *Id.* at 10–16.

being concerned with “transformativeness”? After all, the concerns I mention here are drawn from “within” transformativeness, because intrinsically motivated persons and artistic and scientific communities typically do “transform” prior works into new works. Transformativeness, however, is drastically overinclusive.

For example, many kinds of transformation, such as making movies from books, are done in commercial markets where reciprocity and intrinsic motivation might play relatively little role, or in contexts where gratitude and its cousins have demonstrated their robustness<sup>191</sup> in the face of monetary temptations. And in *Dorling Kindersley*, the Second Circuit made clear its view that alteration is unnecessary for a “fair use market”—a mere change of context or purpose can make a use “transformative.”<sup>192</sup> So interpreted, transformativeness may have little to do with the concerns of intrinsic motivation and the triggering of emotional desires to produce new creative work.

But if we were trying to identify criteria for “fair use markets,” factors might include the existence of an interdependent community, a place where gift is fecund and markets yield barrenness, and the presence of intrinsic motivation vulnerable to “crowding out” by the presence of explicit monetary payment. We would need to inquire if the presence of copyright enforcement as a legal possibility would erode these communities or their intrinsic motivations or if the two could coexist.<sup>193</sup> To the extent that coexistence is unlikely (a question Margaret Jane Radin examines under the rubric of the “domino effect”—whether money crowds out other modes of social interaction and valuation<sup>194</sup>), fair use would be increasingly appropriate. If allowing someone in that group to charge another member for use would trigger a collapse in intrinsic motivation, that might be a good reason for fair use. And if someone from outside the group charged a group member for use, the group member might then have to charge some of his compatriots in order to obtain the money needed to pay, again threatening the strength of the gift-repayment motive, and threatening intrinsic motivation.

There are obvious difficulties in implementing a search for such hard-to-measure qualities. I suggest, however, that we open ourselves

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<sup>191</sup> For the robustness point, I am indebted to Professor Stacey Dogan.

<sup>192</sup> *Bill Graham Archives v. Dorling Kindersley Ltd.*, 448 F.3d 605, 609–11 (2d Cir. 2006).

<sup>193</sup> The Hyde gift community is hardly the only kind of nonmarket alternative. See generally Elkin-Koren, *supra* note 166.

<sup>194</sup> MARGARET JANE RADIN, *CONTESTED COMMODITIES* 95–96 (1996) (arguing that the “domino effect” is not inevitable but the danger it poses should be evaluated contextually).

to the possibility.<sup>195</sup> Hyde's community described in *The Gift* might be a place where the demand-side benefits of free use would be more productive than the supply-side license fees would be. That is, if a plaintiff's license fees are likely to be *destructive* to creative patterns, and if the extent of the destruction is hard to measure, then arguably the foregone fees should not be weighed against the defendant in a fair use calculus.

*D. Nonmarkets that Preserve Product Quality Better than Markets*

In *The Gift Relationship*, Professor Richard M. Titmuss argued that allowing blood to be purchased degraded the blood supply.<sup>196</sup> This resulted, he argued, from two phenomena. First, making blood a commodity could "crowd out" altruism, decreasing some donors' willingness to contribute for free.<sup>197</sup> Second, people who sold blood may come from high-risk populations and money gives sellers a reason to conceal otherwise-undetectable parts of their health history that would make the blood a health risk to recipients.<sup>198</sup> Therefore, Titmuss argued, there is a real danger that the quality of the blood supply would decrease when blood is allowed to be sold.<sup>199</sup>

Judge Richard Posner has often made an analogous argument about criticism, suggesting that criticism is one such area where instituting a market would destroy or diminish the product's value.<sup>200</sup> Judge Posner has contended that if critics had to pay for the right to quote or summarize, audiences would stop believing that criticism was objective, and all parties—readers, writers, publishers, and critics—

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<sup>195</sup> Consider the optimism and resolve in this statement: "Choices about property entitlements are unavoidable, and, despite the incommensurability of values, rational choice remains possible through reasoned deliberation. That deliberation should include non-deductive, non-algorithmic reflection. It should be both principled and contextual, and should draw upon critical judgment, tradition, experience, and discernment." Gregory S. Alexander et al., *A Statement of Progressive Property*, 94 CORNELL L. REV. 743, 744 (2009). Even if one doubts the ultimate capacities of deliberation, cf. CASS R. SUNSTEIN, *INFOTOPIA: HOW MANY MINDS PRODUCE KNOWLEDGE* (2006) (questioning the effectiveness of deliberation, and identifying sources of deliberative failure and modes of improvement), exploring methods of disinterested inquiry is the law's home ground.

<sup>196</sup> TITMUSS, *supra* note 174.

<sup>197</sup> *Id.* at 95, 198.

<sup>198</sup> *Id.* at 114.

<sup>199</sup> Whether or not Titmuss was factually correct that the blood supply would degrade overall if markets were instituted, his argument alerts us to the possibility that *some* products might degrade if markets for their production or sale were instituted.

<sup>200</sup> See, e.g., *Ty, Inc. v. Publ'ns Int'l Ltd.*, 292 F.3d 512, 517 (7th Cir. 2002) (Posner, J.).

would lose out as the perceived quality and reliability of criticism went down.<sup>201</sup>

But that does not mean that criticism is sacrosanct, at least under a functional and consequentialist analysis. Facts could change.<sup>202</sup> In addition, of course, the First Amendment might categorically demand that criticism be given fair use treatment.<sup>203</sup> Nonetheless, Titmuss' functional analysis also suggests another or alternative ground for finding a "fair use market": that allowing sale will degrade the quality of the product.<sup>204</sup>

*E. What of the Use of "Normal" or Customary Areas of Free Use as a Source to Identify "Fair Use Markets"?*

In one of the classics of the commodification literature, Michael Walzer sought the origin of the lines that the law drew between the things that could be sold (products) and those whose sale the law prohibited (such as votes, babies, bodies, and sports championships).<sup>205</sup> He concluded that the source of the boundary set was inevitably contested and movable and that its origin could not be deduced from a formal set of principles.<sup>206</sup> "Boundaries . . . are vulnerable to shifts in

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<sup>201</sup> *Id.*

<sup>202</sup> Under some states of the world, criticism might not be a good example of a self-degrading market. For example, perhaps all book publishers could form a collective rights organization that sold no-questions-asked licenses to criticize anything in their inventory. In such a case, readers might not fear that critics would alter their reviews to obtain cheaper or free licenses.

Of course, blanket licenses might not solve all the difficulties. For example, some critics may write for free, and not having the wealth their social benefit would warrant, could not purchase a blanket license. Moreover, a governmental subsidy of the licensing might itself cause First Amendment difficulties. Gordon, *Fair Use as Market Failure*, *supra* note 14, at 1627–33; *see also* Loren, *supra* note 15, at 26, 49–57 (noting the existence of defendants who generate positive externalities); Van Houweling, *supra* note 43, at 1560 (noting the First Amendment difficulties that accompany government distribution of expressive opportunities).

<sup>203</sup> The interplay between fair use and the First Amendment remains controversial, but the connection between them was strengthened by the *Eldred v. Ashcroft*, 537 U.S. 186 (2003), decision's reliance on fair use to help the Copyright Term Extension Act, Pub. L. No. 105-298, 112 Stat. 2827 (1998) (codified in scattered sections of 17 U.S.C.), pass constitutional muster. *Eldred*, 537 U.S. at 219–20. Exploring the First Amendment issue is necessary for full treatment of fair use, but is outside this Article's particular scope.

<sup>204</sup> Arguably the Hyde analysis of gift-based communities could also be classified under this heading. *See supra* Part II.C.

<sup>205</sup> Walzer argues that the search for equality demands that no one criterion, such as money, should bind all spheres. Some things must remain not for sale, such as political office or athletic championships, to maintain equality; so long as no one metric governs all spheres, different leaders and different sources of respect and influence can arise in different spheres. *See* MICHAEL WALZER, SPHERES OF JUSTICE: A DEFENSE OF PLURALISM AND EQUALITY (1983).

<sup>206</sup> *Id.* at 319.

social meaning, and we have no choice but to live with the continual probes and incursions through which these shifts are worked out.”<sup>207</sup>

As implied earlier, our concern is similar but not identical to Walzer’s. He looked at how a society should decide when its law should *prohibit or permit sales*.<sup>208</sup> We are concerned with an analogous issue: when should the law *require or not require* use to be preceded by purchase. Things that are appropriately privately owned in one context—so that people should be required to purchase rights to use or take it from the owner—might be better treated as unowned in another context.<sup>209</sup>

So that is our question: when the law ordinarily requires purchase as a prerequisite for using something—here, requiring a copyist to purchase the liberty to copy a work of authorship—when should it instead allow the owned thing to be used by strangers without permission or payment? Although our underlying issues are distinct from those that concerned Walzer, his approach is, at this point, part of my approach as well: in trying to decide when a market is simply inappropriate, we may not be able to deduce the answer from a formal or determinate set of principles. We would probably be greatly assisted by looking to “shifts in social meanings,”<sup>210</sup> or one might call it “politics writ large.”

Custom may provide one of the acceptable reference points for this search for social meaning. Such an argument is bolstered because some behaviors *do* arise out of feelings of justice, not just of narrow self-interest.<sup>211</sup> So for all the problems in relying on custom, looking to uses that are customarily free of charge might be an appropriate starting place in distinguishing which uses belong in a “fair use market”<sup>212</sup>—so long as the problems in using custom are kept in mind.<sup>213</sup>

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<sup>207</sup> *Id.* It is hard to predict how the boundaries between different spheres will evolve. *Id.*

<sup>208</sup> *Id.* at 4–9.

<sup>209</sup> Thus, when a copyrighted work is copied as evidence in a court or controversy, the copying is likely to receive fair use treatment. One of the reasons is that an expressive work, something that copyright usually treats as a commodity, is acting in defendant’s context like a fact, something copyright treats as a noncommodity. See generally Gordon, *supra* note 165.

<sup>210</sup> WALZER, *supra* note 205, at 319.

<sup>211</sup> See, e.g., Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CAL. L. REV. 1051, 1136 (2000) (“[T]he desire to treat others fairly can cause deviations from self-interested behavior just as the desire to be treated fairly can do the same.”).

<sup>212</sup> For useful warnings on the proper use of custom, see Rothman, *supra* note 88. Professor Rothman argues that “[t]here are three main justifications for incorporating custom into the law that have been asserted in other areas of the law . . . [N]one of them justifies the incorporation of custom into IP law.” *Id.* at 1946. Yet there are other justifications for custom to which

Customs of licensing can be *absent* for normatively insufficient reasons,<sup>214</sup> just as licensing can be *present* for normatively insufficient reasons.<sup>215</sup> The legal literature already gives some cautionary suggestions on how to employ evidence from custom,<sup>216</sup> and as Walzer indicates custom is just part of a more complex inquiry.<sup>217</sup> If nothing else, a custom of free use can serve as a flag planted in new territory: here is a place with a unique ecosystem whose interplay deserves attention.<sup>218</sup>

#### F. *Rights, Nonmonetizable Interest, and Self-Defense*

License fees are more likely to be relevant when the important questions are economic. But sometimes our society does not care about economic value, but rather about matters that cannot be measured in fungible currency. One such category is, of course, rights. Professor Neil Netanel has properly taught that sometimes even substantial injury to a copyright owner's incentives must be tolerated; all values should not be subordinated to the economic.<sup>219</sup> If substantial injury must sometimes be tolerated, then, a fortiori, there are occasions when it is inappropriate to consider the incentive effects of foregone fees.

We also have other interests that cannot be adequately measured by money. We may value creativity, criticism, and dialogue for their own sake, and we may not be willing to let money crowd them out. When this is the case, the presence of nonmonetizable interests could well lead a court to refuse to consider the effect of a plaintiff's foregone license fees.

Human dignity is another such value. Courts permit persons who are attacked in print or picture to reprint the copyrighted material as

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she gives more respect. *See id.* at 1971 ("When a custom develops with an aspirational purpose in mind, it has more value.").

<sup>213</sup> *See, e.g.,* Gibson, *supra* note 85, at 897–98 (discussing the proper role of custom in IP law); Rothman, *supra* note 88, at 1967–82 (suggesting an analytic model for assessing particular customs' usefulness).

<sup>214</sup> Gordon, *Fair Use as Market Failure*, *supra* note 14, at 1621.

<sup>215</sup> *See supra* Part I.A.

<sup>216</sup> *See supra* note 213.

<sup>217</sup> WALZER, *supra* note 205, at 4–6.

<sup>218</sup> For a wide-ranging exploration of how social patterns and practices can bear on fair use and on the creativity fostered by nonmarket connections, see generally Michael J. Madison, *A Pattern-Oriented Approach to Fair Use*, 45 WM. & MARY L. REV. 1525 (2004).

<sup>219</sup> It was Netanel, *Copyright and a Democratic Civil Society*, *supra* note 163, at 330–31, that caused me to reconsider the "substantial injury hurdle" of my original fair use test. Gordon, *Excuse and Justification*, *supra* note 14, at 188.



part of efforts to rebut it.<sup>220</sup> In such cases, the license fees that the “victim” could have paid should be legitimately disregarded.<sup>221</sup>

*G. Coincidence or the “Orthogonal” Use*

When we want to count license fees, it is because they give a good message about what kinds of creative works are desired and with what intensity society desires them. But sometimes what the defendant has done gives no relevant “incentive message” to the copyright owner.

Consider the unauthorized copyist who mass-duplicates sheet music, not to sell to musicians, but to sell as wallpaper.<sup>222</sup> It is pure coincidence that the sheet music looks attractive; the composer intended to create sound, not visual art. The relationship between the copyist’s purpose and the message society wants to give to encourage composers is, in Professor Pam Samuelson’s apt term, “orthogonal.”<sup>223</sup> The extreme shift in purpose suggests that giving the composer rewards for the wallpaper would not give any relevant incentive messages.<sup>224</sup>

In tort law, the doctrines of proximate cause and duty often function to rule out liability for such merely coincidental effects.<sup>225</sup> Fair use can do the same, and in making the fair use calculus, there is no reason to include the license fees that the wallpaper-maker could have made.

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<sup>220</sup> See, e.g., *Hustler Magazine, Inc. v. Moral Majority, Inc.*, 796 F.2d 1148, 1153 (9th Cir. 1986) (permitting Reverend Jerry Falwell to make mass copies of an ad parody that held him up to ridicule in order to raise money to rebut the personal attack upon him) Admittedly, just as the tort privilege of physical self-defense is limited to that violence which is reasonably necessary, the self-defense justification for fair use has limits as well.

<sup>221</sup> There is also a rights-based argument for allowing such fair use to go forward regardless of supply-side incentive effects. See Gordon, *supra* note 19.

<sup>222</sup> This is not as fanciful as it sounds. Many websites sell sheet music as part of “wall paper” for websites, and some home decorators apparently have a similar idea. See Jessica Turner, *How to Wallpaper with Sheet Music*, HOWTODOTHINGS.COM, <http://www.howtodothings.com/how-to-wallpaper-with-sheet-music> (last visited Aug. 11, 2011) (recommending a “do-it-yourself” method involving the use of existing sheet music rather than copying).

<sup>223</sup> See Samuelson, *supra* note 71, at 2557–59. “Orthogonal” means “intersecting or lying at right angles,” and suggests a lack of statistical correlation. *Orthogonal Definition*, MERRIAM-WEBSTER, <http://www.merriam-webster.com/dictionary/orthogonal?show=0&t=1312674127> (last visited Aug. 6, 2011). Professor Samuelson classifies the self-defense category under “orthogonal uses” rather than under “dignity uses,” but it could fit in either place.

<sup>224</sup> The goal here is to make “the harm element in fair use” more closely “tied to copyright’s purpose of encouraging innovation.” Bohannon & Hovenkamp, *supra* note 71, at 974.

<sup>225</sup> See Wendy J. Gordon, *Copyright and Tort as Mirror Images: On Not Mistaking for the Right Hand What the Left Hand Is Doing*, in *INTELLECTUAL PROPERTY, INNOVATION AND COMPETITION* (A. Nicita, G. Ramello & F.M. Scherer eds., forthcoming 2012).

Shift in purpose has long been a part of fair use doctrine; as mentioned previously, it has even become for many courts the primary basis for finding that a use is “transformative.”<sup>226</sup> But the definitions are slippery and many questions are unresolved.<sup>227</sup> The inquiry into purpose could be sharpened by asking if there is a relationship between, on the one hand, the reasons the defendant might want a right to copy, and, on the other hand, the qualities society seeks to encourage in the plaintiff’s efforts.<sup>228</sup>

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The above Section suggests that the category of “fair use markets” would be more useful if its two functions were separated. One function is to identify markets that can coexist with, and not foreclose, fair use. The criteria for that function are broad and immensely wide ranging because there are so many ways in which copyright markets can fail to serve public ends. The other function of “fair use markets” is to identify uses for which foregone license fees should not be counted into the fair use calculus. The criteria for that function are much narrower. It is hoped that the partial list of criteria that appears here will help courts distinguish between situations in which foregone fees should and should not be counted as part of the fair use inquiry.

## CONCLUSION

Newly emerging markets for copyrighted works pose difficulties for social policy. Before a market for a particular use evolves—at a

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<sup>226</sup> Professor Reese sees the inquiry into purpose as the dominant meaning of “transformativeness” from 1994 through 2007. See Reese, *supra* note 98; see also discussion of *Dorling Kindersley* *supra* text accompanying note 192.

<sup>227</sup> Professor Reese helpfully outlines many questions about “purpose” that would need to be resolved before it could be decided what weight, as a normative matter, should be placed on a defendant’s purpose, and how inquiries into that purpose should be formulated. Reese, *supra* note 98, at 494–96. See also Marques, *supra* note 145, at 347–48 (suggesting that the *Dorling Kindersley* court went beyond an inquiry into “functional purpose” to a more questionable inquiry into “expressive purpose”).

<sup>228</sup> Professor Samuelson suggests that orthogonal uses tend to be treated as “fair” only in the presence of other favorable factors. Samuelson, *supra* note 71, at 2557–59. My argument is somewhat different: the presence of a thoroughly orthogonal use can by itself mandate dropping foregone license fees from the factor-four fair use calculus. There is, of course, more to fair use than the factor-four inquiry, so the approaches of Professor Samuelson and myself might converge on this point.

Lack of foreseeability has been urged by some to serve as a basis for fair use. See, e.g., Christina Bohannon, *supra* note 71; Bohannon & Hovenkamp, *supra* note 71. That proposal is very much worth exploring, but it is sometimes criticized because of the elastic nature of the “lack of foreseeability” concept. As compared to “unforeseeability,” orthogonality is less malleable and thus more reliably unrelated to incentives.

stage when no license fees could be practicably collected—allowing a defendant to go forward without permission and payment would advance the defendant’s social goals, and there might be little harm to weigh against the public interest that the defendant serves.<sup>229</sup> But as new licensing markets begin to appear through institutional developments, such as the Copyright Clearance Center,<sup>230</sup> technological advance, or otherwise, the question becomes harder. Should the courts count against fair use—even as one part of a complex calculus—the incentive effects of license fees that the defendant and others like him could practicably have paid, but did not pay?

In prior work, I have emphasized that the absence of a market between copyright owner and user can play a key role in fair use,<sup>231</sup> that the presence of a market need not eliminate fair use,<sup>232</sup> and that knowing if a market is the preferred institution requires inquiry along a number of factual and normative fronts.<sup>233</sup> This Article has taken an additional step of asking how foregone fees should be treated for purposes of assessing the fourth factor of the fair use inquiry. When a market is present, it may be possible for the copyright owner to acquire a portion of the value generated by a defendant’s use—but should the law empower the owner to do so? This Article suggests that it would be overbroad to strike all foregone fees from being considered in the fair use calculus, but that in a subset of cases it could indeed be improper to weigh foregone fees against a defendant. Under today’s state of precedent, the risk remains alive that nascent markets and foregone fees will tend to improperly reduce the scope of the fair use doctrine. If that happens, it may reduce the liberty, quality of life, and productivity of Macaulay’s “readers.” That is, undue restriction of fair use could threaten all of us except at the moment we are asserting one of our copyrights. As one possible response to that risk, this Article suggests we revive and explore giving new meanings to the Second Circuit’s category of “fair use markets.”

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<sup>229</sup> See Gordon, *Fair Use as Market Failure*, *supra* note 14.

<sup>230</sup> See generally *About Us*, COPYRIGHT CLEARANCE CTR., <http://www.copyright.com/content/cc3/en/toolbar/aboutUs.html> (last visited July 18, 2011).

<sup>231</sup> Gordon, *Fair Use as Market Failure*, *supra* note 14.

<sup>232</sup> See Gordon, *Excuse and Justification*, *supra* note 14; Gordon, *supra* note 56.

<sup>233</sup> Gordon, *Fair Use as Market Failure*, *supra* note 14.