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A Law and Economics Analysis of Fair Use Differences Comparing the US and UK

Antony W. Dnes

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Antony W. Dnes is Professor of Economics, Hull University Business School
United Kingdom, and Visiting Professor, School of Business Administration
University of San Diego, United States. Email: dnes@sandiego.edu

A Law and Economics Analysis of Fair-use Differences between the US and UK

1. Introduction

This paper examines fair-dealing and fair-use copyright exceptions in terms of their economic properties. A particular question in the United Kingdom is whether there would be economic advantages, in terms of promoting economic growth through the encouragement of innovative creative work, from moving to a standard substantially similar to the fair-use copyright exception doctrine[1] that can be accepted by the courts in the United States as a *general* defence to a claim of copyright infringement. Related questions concern difficulties that might be encountered in making such a move and how these could be handled. The UK's „fair dealing' is conventionally regarded as giving much more narrowly defined defences, rather than giving a general defence in an action for infringement. In both countries, fair use or fair dealing coexists alongside other specific copyright exceptions, which may be in place for a variety of reasons, e.g. providing Braille copies for blind people. The paper is not intended to deliver a recommendation but aims to lay out some alternatives and provide an economic commentary.

The analysis in this paper reflects a Prime Ministerial request to the Intellectual Property Office to examine the possibility that fair dealing may have acted to inhibit technological innovation in the UK, particularly in relation to the major characteristics of the emerging digital age, where copying is easier, digitization occurs and markets are enlarged. There is a concern that the introduction of innovative products, particularly such things as caching by search engines (the „Google question'), reverse engineering to permit software products to be used across platforms, and transformative adaptations of music recordings, may have been inhibited in the UK owing to adherence to fair dealing. Innovative practices, such as format shifting when consumers move purchased recordings from one medium to another, also raise concerns over possible damage to commercial markets for derivative works and an apparent inability to enforce UK restrictions. Fair use, possibly among other factors, appears to have allowed innovations to emerge rapidly in the US and also allows innovative practices, such as format shifting, that currently conflict with UK law, but which may be of high value to consumers without generating significant damage to the interests of copyright holders.

At the heart of the fair-use doctrine are the perceived benefits from establishing a flexible approach that can be used by judges in the courts to adjust copyright exceptions to changing, and often unforeseen, developments without a need for further legislation. It seems there is no alternative to fair use if the desire really is to produce a high degree of flexibility in the face of change. The fair-use question also begs some others, particularly concerning the appropriate entitlements of copyright holders, the economic standard to be applied in assessing possible legal change, and the extent to which fair use creates uncertainty for copyright holders and users compared with fair dealing. The focus in this

[1] 'Legal doctrine is the currency of the law. In many respects, doctrine, or precedent, is the law, at least as it comes from courts. Judicial opinions create the rules or standards that comprise legal doctrine' (Tiller and Cross 2006). Since this paper examines judicial opinions it is indeed concerned with doctrine.

paper is on filling some gaps in knowledge by examining the ability of fair use and fair dealing to deal with change, and by examining some key issues concerning possible reform.

The first step is to discuss the UK fair dealing exception and compare it with US fair use, briefly discussing some relevant literature along the way. The fair dealing versus fair use distinction is introduced broadly and then each system is examined in detail. As far as possible throughout the entire paper economic analysis is woven into the legal analysis, and is deliberately kept as simple as possible to encourage wide readership of the discussion. The detailed analysis of the guidelines and sub-factors used in case law is in terms of doctrinal links to the mitigation or amplification of impediments to the efficient use of intellectual property in encouraging growth and innovation. The emphasis is on the economic function of legal doctrine.

The relevant literature on fair use and fair dealing is mostly drawn into the paper as issues are addressed, as are some industry and public perceptions of copyright exceptions. The sampling practices of the modern music recording industry are examined in relation to US fair use and UK fair dealing, and suggestions made in the *Gowers Review* (2006) are assessed. An effort is made to assess the scope for varying fair dealing in the UK, either in the direction of adopting US-style fair use, or for extending the UK approach of enumerating fair-dealing purposes, bearing in mind the increasing digitization occurring in contemporary media. The paper concludes with an assessment of whether the major concerns over inhibiting innovation trump worries about enhancing copyright uncertainty, and the directions in which law could travel. The aim is to contribute to rational, evidenced policy making over copyright exceptions, rather than to come up with definitive recommendations.

2. Copyright and Fair Use

Copyright

Copyright confers time-limited monopoly control over the direct and derivative uses of an expressive work. This is conventionally justified with reference to public goods and transaction costs (Miceli and Adelstein 2006; Cotter 2008; Landes and Posner 2003 &1989; Gordon 1982; Samueson 1954; Arrow 1962), and broadly confers the monopoly so as to encourage the creation of expressive work.[2] In the absence of further considerations, an expressive work would be made freely available to users since the cost of producing copies is essentially zero, which is the public-good element. It is the need to encourage creativity by compensating for the sunk costs of producing the work that leads to copyright supporting licensing and payment of royalties. Economic theory (e.g. the underlying model in Miceli and Adelstein 2006, p.364; or Landes and Posner 1989, p.333) shows that copyright tends to increase social welfare when it is time bound and limited in intensity, as one might expect, which is already well reported elsewhere (Rogers et al 2009, p.18; CIPIL

[2] Yoo (2007) criticize the conventional arguments favouring copyright using the theory of impure public goods (club goods). Breyer's (1970) criticisms are based on institutional observations on alternative policies.

2006, p. 26), and that it does increase the incentives for innovation, albeit at a cost in terms of lost benefits from disallowing immediate uses of copyrighted work including low-cost copying and, more importantly, free further innovation based around the work.

One less obvious implication from the theory (Landes and Posner 1989, p.343) is that conventionally defined maximization of the joint welfare of consumers and producers does not maximize the *volume* of copyright works, because of the need to avoid rising costs imposed on consumers as copyright is intensified to improve incentives for innovation. This theoretical result reveals a difference between conventional welfare economics and an assessment of copyright issues based on the encouragement of innovative work.

A further useful, albeit contested, result (op cit, p.344) is that copyright protection may need to increase over time if the growth of markets and the value of the copyrighted work increase, particularly if the costs of copying decline, although note that this claim supposes changes are fully anticipated. Typical models do not deal with dynamic settings and catching up with change, and a corollary is that increases in the value of derivative uses of copyrighted work could undermine the value of copyright protection. A different result is obtained by Boldrin and Levin (2002) who argue that larger markets can safely be associated with weaker copyright protection. The economic impact of copying works very much depends upon empirical circumstances, particularly depending upon whether one is examining short-run effects, where new work cannot be added, or the long run, when new work is possible (Johnson1985, p.161). Theory tends to ignore the possibility of substituting between different elements in the law of copyright, e.g. copyright term and damages for infringement, in encouraging innovation.

A „first-best' approach to assessing the use of expressive work, which would ignore important institutional constraints, would in fact suggest allowing free use of the expressive work once it has been created, as there is little or no cost imposed by use of what is essentially a public good (Arrow 1962). It is recognizing the need to maintain an incentive for investing in the creation of expressive works, and the practical impossibility of compensating for such sunk investment in any other way, that leads to a „second-best' approach in which the temporary monopoly is conferred: legal protection of the copyrighted work allows the owner to recover returns above the costs of copying and thereby rewards the initial and otherwise irrecoverable costs attached to creativity. From a more institutional perspective, creating enforceable intellectual property (IP) rights reduces the transaction costs attached to *excluding* users and prevents under production of expressive work. Generally, we should expect the desirability of strong copyright protection to fall as the productive subsequent development of creative works increases and as more emphasis is placed on encouraging economic growth rather than cost-effective regulation.

Some critics of copyright, who may be more associated with calls for reform (Boyle, 2008) rather than abolition, argue that the benefits of current copyright law are overstated and that its intensification over the centuries has been counterproductive. In an analysis of the „uneasy case' for copyright, Breyer (1970) notes the historical association between periods of western intellectual expansion and an absence of copyright protection, and notes (p.304) that copyright creates transaction costs for users in obtaining permissions along with reducing enforcement costs for authors. Empirical work by Heald (2008, p. 26) has shown

that a significantly higher proportion of out-of-copyright books remain in print compared with copyrighted ones, although he recognized the problem of maintaining incentives for creating new work in the absence of copyright.

Statistical analysis by Ku, Sun and Fan (2009, p.1708), which also addresses a concern that much earlier work focuses on older, print media, rather than the modern digital economy, shows that changes in general copyright law have had uneven effects across different sectors: in fact, both *increases* and *decreases* in copyright protection could be associated with increased production of new work, as reflected in copyright registrations, which seem to be driven over the long run by other factors. Nonetheless, interestingly from a fair-use perspective, as a part of their US-based analysis, Ku, Sun and Fan examine the impact of expanding several legal rights associated with copyright on copyright registrations (a proxy for innovation) across sectors. They show that 67 per cent of such expansions produced a statistically significant effect, with a preponderance of these positive, and with all categories of copyrightable works showing at least one significant association. Moving to fair use from fair dealing would reduce the legal rights of copyright holders, suggesting a need to be cautious of the possible deterrence of the underlying innovation associated with registration. It would be sensible to replicate the study of Ku et al on UK data, tracing through the impacts of legislative changes since the nineteenth century. In general Ku, Sun and Fan (2009, p.1672) find a dominant influence on registrations coming from population growth in much the manner suggested by Kremer's (1993) contra-Malthusian growth theory, which is consistent with the idea that IP becomes more valuable in a growth process (Landes and Posner (1989, p. 344). An interesting finding of Ku, Sun and Fan (2009, p.1707) is that the US Supreme Court's opinion on parody as fair use[3] resulted in a 30 per cent increase in the registration of serials, consistent with the liberalization of fair use leading to an increase in secondary creative innovation for which authors wished to claim protection.

A direct critic of the US fair-use exception is Cotter (2008), who argues that fair users are deterred by high legal costs for defendants and strategically focused nuisance suits from copyright holders. The argument is consistent with the rights accretion hypothesis of Gibson (2007), but is inconsistent with observable successive attempts by larger companies to extend their fair use of copyrighted material. In a sense, making a fair use suffers from a similar transaction-cost problem that leads to copyright in the first place, and an uncertain „taker' could be easily deterred from developing derivative work if worried about legal sanctions, which include possible criminal penalties in both the UK and US.

A paper by Boldrin and Levine (2002) claimed that extending fair use in the US to allow Napster-like downloading and file-sharing services would be unlikely to reduce the value of copyrighted work. The paper is a variant on ideas put forward by Liebovitz (1985) that developmental spin offs can improve returns to the original work. In Liebovitz's paper this type of result arises through the copyright holder's ability to price discriminate, e.g. by charging libraries more because they facilitate copying or other non-paying uses. Klein, Lerner and Murphy (2002) show that the result in Boldrin and Levine (2002) follows from

[3] *Campbell v. Acuff-Rose Music, Inc.* 510 U.S. 569 (1994) discussed below.

the assumption that the copyright owner faces an elastic demand function so that price reductions, which can be brought about by copying, lead to increased revenues. Baker and Cunningham (2006) found that the equity value of a sample of US copyright firms fell following the introduction of copyright-weakening changes in the law 1985-1998, although note that benefits would have flowed elsewhere including into innovative uses by secondary users and the authors do not do not distinguish between changes in the flow of new works and valuation impacts on existing IP. The extent of fair use and fair dealing is an influence on the intensity of copyright protection, e.g. comparable to a change in copyright term, and the more general studies have implications for liberalizing copyright exceptions.

Copyright exceptions

In cases with small numbers of potential users of a work, and in the absence of strategic behaviour, bargaining over licensing should result in all beneficial uses of the work, such as adaptations or performances, being carried out (Coase 1960; Demsetz 1966). It is commonly claimed, from an economic perspective, that the desirability of exceptions to copyright is indicated in two instances: first, to correct for cases where the secondary user does not have a high enough valuing use to pay for a licence and yet confers external benefits that cannot be captured but are what make the use beneficial; and secondly, where the transaction costs of dealing with the copyright owner would halt a use that is otherwise beneficial (Landes and Posner (1989, p.357). Both of these reasons really concern transaction costs and a parallel may be drawn between copyright exceptions and „takings,' such as exercise of eminent domain, adverse possession and regulatory takings, in other areas of property-rights doctrines, where international treatment also differs and controversies abound. In general it is important to focus on the minimization of transaction costs in considering fair-use laws. At the same time, it is important to note that other reasons, not connected with transaction costs, such as supporting free speech, providing access to works for the blind, or ensuring national archiving, may also justify copyright exceptions aside from fair-use and fair-dealing doctrines. From a general perspective, the task may be well described as drawing monopoly as narrowly as possible so as to maintain incentives for creative activity while simultaneously using exceptions to avoid unacceptable impacts on objectives such as free speech and to avoid incurring overwhelming transactions costs.

A distinct line of criticism concerning conventional, transactions-cost arguments for copyright protection opened up after Heller and Eisenberg (1998) identified „anti-commons' problems in regulation. Economic analysis has long understood the „tragedy of the commons' in which open access resources, such as common land and high-seas fisheries, are overused (Dnes 2005, p.25). The analysis of the anti-commons refers to the case where there is excessive regulation of a resource: effectively there are too many owners, such that no-one can obtain cost-effective permission to use the resource, which is then under used. The idea has been applied (Depoorter and Parisi 2005) to justify fair-use exceptions in copyright as a means for controlling possible strategic behaviour by copyright holders. There could be other approaches to controlling strategic behaviour, which approximately correlates with the exercise of monopoly power that is subject to separate antitrust regulation.

No-one quite knows whether the US fair-use and UK fair-dealing approaches are truly distinct, or what the full economic significance is of any distinctions; these issues are assessed here through an analysis of laws and cases. Contrary to some perceptions, the US fair-use doctrine is not bright-line defined in the US Copyright Act[4], which simply enumerates four non-exclusive factors linked to the nature of the work and its use that courts must consider in assessing fair use, although there is empirical evidence of its narrowing over time (Beebe 2008, 585) possibly in line with a ‚rights accretion' hypothesis (Gibson 2007) discussed further below. The US approach is often regarded nonetheless as wide ranging and flexible with possible advantages for innovation (*Gowers Review,* 2008, p.62; Brenncke 2007; Attorney General of Australia 2005), but flexibility can also be seen as creating uncertainty, although in the US doctrinal differences owe in part to jurisdictional fragmentation, particularly comparing the Ninth and Second Federal Circuits, that could not affect the UK. The fair-dealing doctrine *is* more narrowly defined, in terms of enumerated purposes, in the UK Copyright, Designs and Patents Act 1988 (CDPA) Ch. III, §§ 29-30, but there has still been divided opinion over whether the CDPA lacks principles, contains too many barriers to claiming exceptions, or whether courts adopt a liberal interpretive approach in practice as urged by Lord Denning in *Hubbard v. Vospar*.[5] More recently, increased narrowness of interpretation has been shown by UK courts as they have been increasingly affected by EU directives and jurisprudence (Griffiths 2010, p.87).

The next step in this paper is to examine the broad structure of the respective copyright laws as these bear down upon copyright exceptions, clearly identifying where doctrinal differences exist between fair use and fair dealing. There then follows a more detailed analysis of the guidelines and, particularly, the sub-factors used in case law. The emphasis is on the economic function of legal doctrine, and an economic commentary is maintained throughout in terms of doctrinal links to the mitigation or amplification of impediments to encouraging growth and innovation. It is tempting to claim that legal detail can be kept to a minimum, but it turns out that many of the legal subtleties in the cases revolve around important economic distinctions, and it is important to be clear about the current state of thinking over fair use and fair dealing. The relevant economics literature on fair use and fair dealing is woven into the discussion of doctrinal issues. There is some focus on the (derivative versus transformative) sampling practices of the modern music recording industry, database transformation (in the form of search engines or data processing), and the accessing of underlying ideas in computer programs (reverse engineering) in the examination of legal cases. Music sampling is used as a useful focused study of the advantages and disadvantages of fair use versus fair dealing.

3. UK Fair Dealing

In the UK, copyright law grants exclusive rights to authors to create and distribute new expressive works normally understood to be the results of investing time in creative activity. The rights cannot apply to ideas or facts, but only to expressive works, and may coexist with each other as in the case of print publication and screen rights. These IP rights

[4] 7 USC §107 (2000 & Supp. IV 2004)

[5] [1972] 2 QB 84

have very much the fragmentary characteristics of private property rights more generally considered, which typically refer to the rights to carry out activities in relation to the property concerned and are never absolute in nature, but IP rights are quite deliberately time bound. Fragmentation allows assignment and trading of rights in a precise, efficiency enhancing manner. Copyright is counter-balanced by exceptions that allow defined uses of copyrighted material without requiring permission from the rights holder, and amounting to a permitted private *taking* of property that is sometimes associated with a liability to pay for the taking. The broad principles of copyright law obey the economic logic of creating temporary monopoly incentivizing creativity, but allowing exceptions in cases where the uses do not harm the market interests of the copyright holder and where transaction costs threaten to undermine a beneficial use.

The Copyright, Designs and Patents Act 1988 (CDPA), §§ 28-76, details several exceptions to copyright infringement,[6] which the *Gowers Review* (2006, p.12) and judges[7] have described as striking a balance between the rights of copyright owners and the benefits of a wider public use of the IP. The exceptions are typically of a non-commercial and not-for-profit nature, albeit possibly carried out by commercial entities since much news reporting and criticism is carried out on a for-profit basis. The fair dealing defence, or *exception* to copyright infringement, is based on three enumerated purposes listed in the CDPA §§29 and 30, and is a particularly clearly defined *part* of the longer list of exceptions (§§28 – 76) listed in the Act. Fair dealing allows takings for:

- Private research and study, excluding broadcasts and sound recordings (§29(1))
- Criticism and review and news reporting (§30(1))
- News reporting of current affairs (§30(2))

Since Parliament has indicated three very specific fair-dealing purposes, by statutory interpretation, no other purposes can currently be part of fair dealing. There are other copyright exceptions, discussed briefly below, that support purposes other than fair dealing, but the approach differs from that in the US, where an intentionally wide-ranging *fair-use* exception is a more general defence for the use of copyrighted material. However, even under the UK approach of enumerating purposes, the three defined purposes are necessary, but not sufficient conditions for a successful defence based on fair dealing: there is also a requirement that the dealing be „fair,' which has generated case opinion comparable to that in the US and showing that whether copying is fair is a matter of comparison between the facts and circumstances of the case.[8] Furthermore, it is irrelevant to claim that the

[6] Dworkin and Taylor (2002) p.70

[7] For example, Walker LJ in *Pro Sieben Media AG v. Carlton Television Ltd* [1999] 1 WLR 605 at 614, and Proudman J in *NLA & Ors. v. Meltwater BV & Ors.* [2010]EWHC 3099 (Ch), at paragraph 115.

[8] Lord Denning's dicta in *Hubbard v. Vospar* [1972] 2 QB 84; see also *Newspaper Licensing Agency v. Marks & Spencer plc* [1999] EMLR 369; *BBC v. BSB Ltd,* (1992) Ch 141; *Beloff v. Pressdram,* (1973) FSR 33.

dealing is fair in relation to some purpose not listed in the CDPA. The not-for-profit enumerated purpose, encompassing private research and study, is consistent with *complementary* uses of the work that are highly unlikely to harm the interests of the copyright owner. The free-speech elements embodied in critical and reporting purposes may harm the owner but are justified by wider considerations important in a pluralistic society. Other copyright exceptions independent of fair dealing, such as the time shifting of broadcasts via recorders, frequently are consistent with complementary uses of work that are unlikely to harm the interests of the copyright owner.

Digging into fair dealing

The factors that have been considered in deciding whether a taking represents fair dealing, i.e. in assessing whether a defence can succeed, include whether or not the taken work was published (taking unpublished work is considered less favourably), the amount copied, the nature of the use, the user's motives, the consequences for the copyrighted work, the presence or absence of acknowledgement and whether or not the user's purpose could be otherwise achieved. Lord Denning compared assessing fair dealing *to* the equitable approach to fair comment in libel law:

> „It is impossible to define what is fair dealing. It must be a question of degree. …consider …the extent of the quotations and extracts. … Then you must consider the use made of them. …comment, criticism or review … may be a fair dealing. If they are used … for a rival purpose, that may be unfair. … To take long extracts and attach short comments may be unfair. ...short extracts and long comments may be fair. …it must be a matter of impression. As with fair comment in the law of libel, so with fair dealing in the law of copyright. The tribunal of fact must decide.'[9]

These *dicta* impart some uncertainty to the fair-dealing exceptions in UK law, by introducing broad equity considerations into what is generally an inquiry in law, albeit moderated by additional sufficiency requirements for each of the three purposes. The defence based on research and private study, defined as not including „any study which is directly or indirectly for a commercial purpose,' implies a non-commercial setting[10] and full acknowledgement of source, and may be used in relation to literary, dramatic, musical, type-setting, or artistic work, but not for audio-visual works. A defence citing criticism or review requires copying in relation to a published work, and accepts the need to copy parts of the work in a review keeping back from the point where a substitute work might emerge.[11] The defence based on reporting current events can be used with virtually any

[9] *Hubbard v. Vospar* [1972] 2 QB 8, at p.94.

[10] Defined in §178 CDPA

[11] *Time Warner v. Channel 4 TV* [1995] EMLR 1(test is not severe: accepting 12-minute film extracts in a 30-minute show, and holding there is no required form for a review, which can consider ideas cited in the work as well as expressive forms).

non-photographic work with acknowledgement, [12] and even acknowledgement is dispensed with for broadcasting sources when this would be impractical, which is highly consistent with the transactions-cost rationale often cited (Gordon 1982; Miceli and Adelstein 2006) for exceptions.[13]

The initial curtailment of the scope of fair-dealing defences to just three specified purposes does provide a considerable reduction in the uncertainty attached to the delimitation of IP rights. It is tempting to suggest that the fair-dealing approach in the UK is more focused on *per se* exceptions, which would reflect a very bright line, whereas US fair use is based essentially on applying a rule of reason, to borrow terms common in antitrust law and economics. Judicial approaches based on rule of reason require courts to carry out an analysis to see whether an action should be permitted as in the public interest, whereas per se rights and wrongs are automatically defined by statutory or case-law terms of reference. In fact, UK courts apply a rule of reason to fair dealing, but have done so over a much more circumscribed area, compared with their US cousins, because of the statutory limitation of the fair-dealing *exception*. One consequence is that derivative works have remained part of the IP of the original copyright holder.

Care must be taken not to overestimate the simplicity of assessing fair dealing in the UK just because the scope of the defence is restricted to three enumerated purposes. The defence is intended to balance the rights of the copyright holder with the interests of the wider public, but this is not an easy matter in practice. In *Pro Sieben Media AG v. Carlton Television Limited* [14] Walker LJ pointed out that the terms underlying the enumerated purposes of CDPA §§29-30, such as „criticism,' „review' and „current events,' are capable of many considerably different interpretations. So, even without recourse to the equity considerations raised by Lord Denning, the UK courts have a significant interpretative role capable of generating uncertainty. In practice, the UK courts have not radically disagreed over fair dealing, and little use appears to have been made of the broad equity allowed by Lord Denning's dicta in *Hubbard v. Vospar*. If anything, after a period in which cases like *Carlton* focused on a liberal interpretation of fair dealing, there have been recent signs of

[12] But note *NLA & Ors. v. Meltwater BV & Ors.* [2010] EWHC 3099 (Ch) Case No. HC10C01718 (a commercial media monitoring and forwarding service, used by commercial firms, was infringing in all the circumstances).

[13] *Newspaper Licensing Agency Ltd v Marks & Spencer plc* [1999] EMLR 369 (reporting of current events is a very wide exception, although in the instant case the redistribution of photocopied newspaper clippings went beyond acceptable practice).

[14] Op cit at p.64

tightening in the interpretation of fair dealing, as shown by the approach in the controversial *Meltwater*[15] decision.

Further UK exceptions

Embedded in CDPA §§ 28-76 are other copyright exceptions that are defined separately from fair dealing.[16] These exceptions are of interest in any debate over the extension of fair dealing, or its possible replacement with a doctrine of fair use, not least because fair-use elements in the US often appear as stand alone exceptions in the UK (e.g., time shifting) . They have resulted from statutory intervention aimed at distinct justifications of non-infringing takings of copyrighted work. Examples are purposes matched to:

- De minimis inclusion in another work (§31)
- Library copying and lending (§42)
- Educational copies (§32, which also refers (§32(2A)(a)) to „fair dealing,' but not in the sense of an enumerated purpose).
- Proceedings of royal commissions, statutory inquiries, judicial proceedings and operations of parliamentary bodies (§45)
- Time shifting of recordings of broadcasts (§70)
- Archiving (§75)
- Collecting society licences (§66)

Such separately defined copyright exceptions are not connected to fair dealing but can also often be related to externality and transactions-cost explanation for allowing private takings. Some of the exceptions arise for completely distinct reasons, as in the preservation of public benefits arising from free access to information in the course of parliamentary inquiries. The de minimis exception could be found by common law. The categories are closer to the per se end of the spectrum of approaches to adjudication, and do not draw in the need to appraise fairness in the manner of a fair-dealing case. It may simply be that their fairness is automatically assumed. In terms of legal design, or reform, there is always an alternative to extending fair dealing (up to and including fair use) in specifying a further statutory exception, e.g. one based on compulsory licensing. As an example, an amendment to legislation could add transformative music sampling to the fair-dealing exception, or make it a statutory licence, possibly adding a compulsory levy (for example on blank recording discs) to compensate recording artists for the permitted takings of IP.

[15] Op cit at paragraph 116 (per Proudfoot J. citing the strict interpretation of significant copying required following *Case C-5/08 Infopaq International v.Danske dagblades Forenung* [2010] FSR 495). *Meltwater* is a first-instance case under appeal and could be overturned.

[16] There is also other secondary legislation covering copyright exceptions, such as the Copyright (Computer Programs) Regulations 1992 No.3233.

Any discussion of the fair-dealing exception needs to consider alternative methods of establishing exceptions in addition to alternatives such as moving to fair use: these are all feasible alternatives in terms of a comparative-institutions assessment (Demsetz 1969).

The *Gowers Review* (2006, p.44), among other criticisms, regards the UK fair-dealing exception as insufficiently flexible in the face of movement into the digital age. Resulting recommendations included the introduction of further exceptions covering transformative works and parody, which would be subjected to a Berne-Convention three-step test[17] to qualify fairness, and a new private-copying exception legitimizing current consumer format-shifting, but not file-sharing. The recommendations should be understood in the context of an additional suggestion that there be no retroactive alteration of the scope of copyright law, following the principle that retroactive change cannot affect incentives on existing works (Landes and Posner, 1989) but might destabilize expectations over the treatment of new work. The review also considers changes that would need to be made to Directive 2001/29/EC (harmonisation of aspects of copyright and related rights in the information society – the „Information Society Directive') so that it would accommodate new exceptions for transformative (and orphan) works. *Gowers* argues that careful wording of new UK legislation could keep copyright law in line with the Directive and allow the developments. The review stopped short of proposing the adoption of a broad fair-use doctrine.

European Copyright Code

The „Wittem Group' of copyright scholars has proposed a European Copyright Code[18], something like the model acts proposed from time to time by the American Law Commissioners, or a Law Commission Report in the UK. The full code is discussed in (Ginsburg 2011). The approach to copyright exceptions is along the lines of enumerated purposes, with some additions to the usual suspects, for example an exception to promote competition that recognizes the growing interaction between IP and antitrust issues.

Controversies

Four types of use of copyrighted material have emerged as controversial in a UK context. First, the reverse engineering of computer programs so as to extract underlying mathematical algorithms is thought to be difficult in some variants of the practice, notwithstanding the introduction of §50B (by regulations in 1992) into the CDPA allowing temporary copies for decompiling. The algorithms cannot be copyrighted because they

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[17] The test in the Berne Convention, Article 9 (2), allows limitations of copyright: (i) in certain special cases; (ii) not conflicting with normal exploitation of the work; and (iii) not unreasonably prejudicing the legitimate interests of the copyright holder. Note that some of (ii) is a subset of (iii). The three-step test also appears in the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS), Article 13, the WIPO Copyright Treaty, Article 10, the WIPO Performances and Phonograms Treaty, Article 16, and in several EU Directives. In a European context, the test has been regarded as compatible with a wide ranging exception for parody and transformation, as in *Germania* 3 (2001 GRUR 149) where the German Federal Constitutional Court held that freedom of expression drove a parodic and transformative use.

[18] http://www.copyrightcode.eu/

are pure ideas and not expression, but CDPA §50B really only permits the basing of a new product on the original, and not the production of a substitute product[19]such as one allowing the use of proprietary software on a different manufacturer's platform. It may be that manufacturers can foreclose markets using copyright law in the UK in a way that would not be permitted under a doctrine of fair use. Such reverse engineering could be supported where beneficial under fair use, although a separate exception avoiding anticompetitive foreclosure of markets would also do the job.

Secondly, in the UK, emergent database technologies have run into difficulties, the history of which is best considered in relation to the „Google question.' In the US in the 1990s, Google was allowed to develop an efficient search engine based on caching: the storage of website data for quick retrieval of information even covering instances where the website has subsequently disappeared, which requires temporary and long-term storage that is frequently used for commercial purposes.[20] The use was inherently transformative and resulted in a new and very much unforeseen product. There was no support for such a development in UK copyright law at the time, although this has been changed following an EU directive in 2002. There remain contemporary concerns that other new technologies, possibly encompassing data mining for commercial purposes, may be developed outside of the UK because of rigid copyright laws. Underlying the identification of transformative work is the need to distinguish it from derivative work making substantial use of the original work: derivatives being part of the original copyright.

In practice, the copyright owner will always claim that valuable transformations are merely derivatives, and the distinction will need to be made by exercising judgment in the courts and in legal design concerning the quantum of „newness' needed to define an independent transformative work. The transformation issue arises across many copyright areas, including patents where it relates to the scope of patent protection. Patents and copyrights can both benefit from a focus on allowing new elements to dominate and identify an independent work. As with debates over enforcing contract modifications (Dnes 1995), the issue is really whether the adaptation could have been foreseen at the time investment in the original work occurred: if not, then worries at the start about the law allowing it as an independent transformation could not have upset the investor's incentives, and allowing the transformation independent life later on will not destabilize the property-rights system and alarm other investors.

The third area of concern relates to music composition and recording, representing two separate copyrights, in relation to either the parody of a musical composition, or the direct „sampling' of musical recordings in a new and often stylistically very distinct recording. Parody, which can sometimes encourages demand for the original music, requires licensing in the UK where it is seen as akin to a musical arrangement, but has been accepted as transformative fair use in the US subject to case-law guidelines

[19] In an unpublished note Ben Hawes of the UK IPO compares UK practice with the US case of Sony *Computer Entertainment, Inc. v. Connectix Corp*. (2000) F 3d 596, where the court saw reverse engineering as a vital part of encouraging a competitive software industry.

[20] *Field v. Google Inc*., 412 F. Supp. 2d 1106 (D. Nev. 2006) discussed further below.

concerning transformation and limited extraction of old material. Sampling generally requires a licence in both the UK and US, but may have developed at an early stage in the US owing to lax enforcement by owners of recording copyrights. There is some concern in the UK that genre such as „hip hop' that depend upon *sampling* recordings developed in the US, notwithstanding the UK's substantial standing in the international recording industry (Rogers et al 2009, p.15). As with the „Google question,' the concern is that the UK may sometimes miss out on value-adding innovation, although, in the case of sampling, slower development could have been the result of narrow copyright exceptions only in the sense of expectations of lax US enforcement versus firm UK enforcement.

The fourth area of concern has been consumer downloading and copying of material via the internet and from media such as CDs and DVDs. Such file-sharing and format-shifting practices have been made easier by the development of digital copying technology, which has become widely available. At present, the time shifting of broadcasts by copying for personal use using devices such as MP3 players or DVD recorders is covered by copyright exceptions, but format shifting is not legal in the UK. Peer-to-peer file sharing via networks is not legal and is unlikely to become so, and remains illegal in the US. The *Gowers Review* (2006, p.62) recommends easing the position over format shifting for *personal* use. According to Rogers et al (2009, p.15), there is widespread disregard for the current law on format shifting *and* file sharing, neither of which can be cost-effectively policed by industry. In the US, format shifting appears to be a presumptive fair use, although cases have never gone before the Supreme Court.[21] The argument mainly concerns enhancing consumer convenience while protecting the value of copyrighted work: recording industry sales have fallen as copying friendly technology such as the MP3 has emerged. The technology is conflicted as noted by Klein, Lerner and Murphy (2002): it can increase convenience for the listener who wishes to copy previously purchased CDs onto portable media, but it also facilitates the capture of illegal downloads. The position has been eased in some respects by the advent of digital rights management (DRM) technology, but then this in turn raises questions about closing off legitimate fair use.

Directive 2001/29/EC (on the harmonization of certain aspects of copyright and related rights in the information society) [22]

The „Information Society Directive' resulted in the application of UK legislative amendments (regulations) to the CDPA 1988,[23] with which the European Commission was

[21] *Recording Indus. Assoc. of America v. Diamond Multimedia Sys., Inc.*, 180 F.3d 1072, 51 U.S.P.Q.2d (BNA) 1115 (9th Cir. 1999) (an MP3 device makes permissible portable copies from a user's hard drive) is usually taken to indicate that if the US Supreme Court did give an opinion it would support format shifting. Other cases in lower courts have not always followed *Diamond* but really because they have been more concerned with downloading from the internet as in cases concerning Napster-type file sharing.

[22] *Official Journal* L 167, 22/06/2001 P. 0010 - 0019

[23] *Copyright and Related Rights Regulations 2003*

not happy, resulting in its bringing a case against the UK.[24] Five other member states were also pursued over failure to bring national legislation in line with the Directive. The UK regulations modify broadcasting definitions to allow for internet developments, place restrictions on copyright exceptions and allow new copyright enforcement measures to be developed. The underlying Directive is regarded as establishing a broad range of rights that are subjected to an „exhaustive' list of narrowly defined permitted exceptions (Griffiths, 2010, p.87). The approach to exceptions flowing from the Directive represents a refinement of permitted purposes, including those supporting fair dealing. The exception of incidental copying arising from transmission within computer networks is mandatory. European law generally shows an approach based on formulating a narrow list of exceptions.

Copying for the purposes of research or private study (§29 of the 1988 Act) is now permitted if it is for a non-commercial purpose (regulation 9). Fair dealing for criticism, review or news reporting (§30) is only permitted for works that have been made available to the public (regulation 10). Examination of the functioning of a computer program is no longer fair dealing (by regulation 9), but there is a separate statutory exception for decompiling (reverse engineering) computer programs (regulation 15 and §50BA). Librarians are restricted to non-commercial copying for third parties (regulation 14 and §§38, 39, 43), as are archivists (folksongs - §61 from regulation 16), and educational users (§§ 32, 35, 36 and regulation 11-13). Third parties cannot be used for playing of music by a non-commercial club or society (§ 67 and regulation 18). Public playing of broadcasts of music, such as factories' use of radio, without a licence (§72) was removed as a permitted copyright exception, although the Directive allows the development of a licensing scheme covering public rebroadcasting (regulation 21).

Conflict between the UK approach to fair dealing and an even more narrowing approach in European jurisprudence raises the issue of whether revisions could be made to UK fair dealing under EU treaty and other trade-related treaties, such as TRIPS. Brenncke (2007, p.13) argues that the UK would have a serious problem in making changes because these obligations reflect the Berne three-step test[25] and, in particular, its requirement for restriction of copyright exceptions to „œrtain special cases,' although note that the US has succeeded in reconciling its signatory status with having fair use. For the purposes of this paper, the issue of legality can be noted but set aside, since the principal issue concerns the impact of making a fair-use defence available, rather than its legitimacy under current treaties. Also, there may be a separate route through which to develop fair use in the UK, since current actions for copyright infringements already require proof that the taking is substantial, which could be the basis for further case-law developments.

Summary of the UK stance on fair dealing

The UK position over a copyright exception for fair dealing, even after some modification by EU-orientated regulations, is best described as having evolved an approach to what is fair that is based on the application of a rule of reason. However, the

[24] *Commission of the European Communities v United Kingdom of Great Britain and Northern Ireland* (Case C-88/04), 2005 *OJ* C045 (action under Article 226 EC for failure to fulfil obligations).

[25] Supra.

scope for applying that rule of reason is very limited because of the careful specification of permitted purposes in CDPA 1988. The exceptions that are not linked to fair dealing, such as that permitting copying by libraries, are further restricted by an absence of scope to apply a rule of reason, and are best regarded as stricter, per se exceptions based on meeting certain factual requirements such as having a not-for-profit purpose. The fair dealing exception is the dominant part of the UK's copyright exceptions, and has not demonstrated significant equity-based variation in the approach taken in practice by the courts.

In practice, cases show a mechanistic application of tests for fair dealing related to statutory requirements. There appears to have been a retreat from widening of fairness considerations, as shown for example by the restrictive stance of *Meltwater*[26] The narrowness is consistent with risk aversion among users of IP: buying licences when they may not be strictly necessary could influence a court that is observant of industry practice into thinking the use is not fair use (Gibson 2007, p.898). However, such a process of „rights accretion' may be efficient if the purpose of fair dealing is to avoid transaction costs: it shows that feasible licensing exists (Cotter 2008, p.1289, n.44). Comparable narrowing has also occurred in US fair use cases.

4. US Fair Use

Copyright law in the US descends from origins in the common law as well as the Copyright Clause of the Constitution.[27] It grants exclusive rights to authors to create and distribute new expressive works, and, as in the UK, the rights cannot apply to ideas (or facts) but may coexist with each other. These fragmentary IP rights are counter-balanced by exceptions[28] that reserve the rights to defined uses of otherwise copyrighted material for general use that does not require permission from the rights holder. Within these exceptions we find one for fair use, codified by §107 of the US Copyright Act 1976 (USCA), that performs a function similar to fair dealing in the UK CPDA. Fair use is the dominant exception in terms of case load and the broadest in scope, and is widely regarded as reflecting the deliberate maintenance of flexibility in the courts (Beebe 2006, p.561). Over the years, differences have emerged between federal (appellate) circuits in their understanding of the fair use doctrine (Beebe, 2008, table 3., p.577) along with other aspects of copyright law, such as the acceptability of software licensing agreements, which are particularly notable comparing the Second Circuit and Ninth Circuits covering the major jurisdictions on the east and west coasts. Other US copyright

[26] Op cit. It is worth repeating the caution that *Meltwater* originates in a lower court and is under appeal.

[27] US Constitution, Article I, §8, clause 8: „The Congress shall have power … to promote … the useful arts, by securing for limited times to authors and inventors the exclusive rights to their respective writings and discoveries.'

[28] As just one example, §108 of the US Copyright Act permits libraries to make archival copies of works (extended to three copies by the Digital Millennium Copyright Act, §404). The exceptions are in §§107-122 of the Act.

laws are of relevance in considering more generally defined exceptions, notably the Audio Home Recording Act 1992[29] and the Digital Millennium Copyright Act 1998.[30] The US is almost alone in using a wide ranging doctrine of fair use.

The fair-use doctrine

The defence of fair use in relation to an action for copyright infringement is defined in §107 of the USCA:

> „Notwithstanding the [protective] provisions of section 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 in 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 in itself bar a finding of fair use if such finding is made upon consideration of all the above factors.'

The language of §107 draws on *Folsom v. Marsh*[31] and is said to be deliberately left vague by the US Supreme Court,[32] reflecting regard to First Amendment rights of free speech as well as to the Copyright Clause contained in the US Constitution. It is clear however that the four factors listed above are similar to the guidelines that have evolved in the UK courts in relation to deciding whether dealing is fair: i.e. there is an overlap with consideration of whether or not the taken work was published, the amount copied, the nature of the use, and the consequences for the copyrighted work. Lord Denning's *dicta* leave considerable further room for interpretation, just as the US Supreme Court has emphasized flexibility.[33] It is the wider scope of applications of the fair use doctrine

[29] Authorizing home digital copying and used to mount an unsuccessful defence in the Napster cases: *A&M Records v. Napster Inc*, 239 F. Supp. 3d 1004 (9th Cir. 2001).

[30] 112 Stat. 2860 (1998): inter alia, limiting the liability of internet services for content transmitted.

[31] 9 F. Cas. 342 (D. Mass. 1841)

[32] *Steward v. Arbend*, 495 US 207 (1990) (The fair use doctrine requires courts to avoid rigid applications of the copyright statute).

[33] In *Campbell v. Acuff-Rose Music*, 510 US 569 (1994) (citing *Stewart v. Arbend*, op cit.).

compared with narrowly defined enumerated purposes behind fair dealing that gives a *possible* doctrinal source for less certain holdings in the US case. The US also experiences jurisdictional (in this case Circuit) variation that does not affect the UK.

In considering whether there is a defence of fair use, „the factors to be considered shall include' the four factors in §107 of the USCA. This wording means that the assessment includes, rather than comprises, the four factors, and it is widely held that the US court can draw in additional, non-statutory elements in arriving at its holding in a particular case, which has been cited as a distinction between UK and US copyright law (Brenncke 2007, p.5). Fair use is an „equitable rule of reason'[34] in the US, but Lord Denning's dicta in *Hubbard v. Vospar* compare fair dealing *to* the equitable doctrine of fair comment in defamation cases and similarly point to the possibility of making wide interpretations of „fairness' within the narrower scope of fair dealing. It is worth emphasizing the difference between fair use and fair dealing as essentially concerning scope rather than equitable deliberations.

It is instructive to examine deliberations in US cases of fair use, where successful defences typically result from copying work for a limited purpose and, very broadly, involve a degree of transformation: for example, using a play to train students rather than as a commercially offered entertainment, or providing multiple copies for classroom use instead of private reading. Transformative use refers more to use than physical transformation, as made clear by the *Perfect 10* cases.[35] Principal examples tend to involve commentary and criticism, as in writing a review, forming a parody, or format shifting such as video recording. The deliberations concern the application of the four factors and the use of additional elements. It is worth initially highlighting the relative importance of factors one (purpose and character of the use) and four (effect of the use upon the potential market for the work), and a tendency, according to Beebe (2008) toward avoidance of using non-statutory factors as case law has developed. It may well be that the courts have eschewed the exercise of a wide equity doctrine because of efficiency considerations: in particular, equity is the sort of approach likely to raise appeals. There are not that many copyright cases: between 1978 and 2006, the US circuit courts[36] dealt with 215 cases in 306 opinions that cited §107 four-factor defences (Beebe 2008, p.565).

[34] House of Representatives Report No. 1476, 94th Congress, 2nd Session, p.65.

[35] *Perfect 10 v. Amazon.com Inc.* 508 F. 3d 1146 (9th Cir. 2007). (Consolidating earlier separate suits against Amazon and Google and finding Google's wide-ranging use of thumbnails derived from Perfect 10 to be „highly transformative since their creation and display is designed to … display visual search results quickly and efficiently to users of Google Image Search' and to have benefits outweighing commercial damage to Perfect 10.)

[36] The US has 13 federal circuit courts providing mostly geographically defined appellate courts for cases concerning federal law often emanating from state courts. They are important final courts in most practical cases since the US Supreme Court hears very few cases in the course of a year.

Digging into fair use

Factor 1. The purpose and character of use

(i)The 'transformative' element.

The Supreme Court has emphasized the purpose and character of use as a primary indicator of fair use. When portions of work are taken the question is whether the material has been used to help create something new, or merely copies old work into another work. In *Blanch v. Koons,* [37] an artist used portions of a copyrighted fashion photograph; the court viewed the painting as a transformative use because of its commentary upon fashion and consumerism. Taking song lyrics is not a fair use because singing them is not transformative and the purpose is for profit, as shown by „karaoke' cases.[38] In his empirical examination of fair use, Beebe (2008, p.107) argues that, following the publication of Judge Leval's (1990) influential paper, and *Campbell*,[39] circuit courts increasingly focused on the transformative factor in applying factor 1, following Leval's argument that transformative work represents the very creativity copyright law is meant to encourage. In more recent cases, a complementary transformative purpose can compensate for factor-4 damage to the plaintiff's market and indicate a successful fair-use defence as in the Ninth Circuit decision over *Perfect 10*. Beebe (2008, p.604) also shows that in practice the influence of transformative work is less strong than is often supposed, citing a relatively low number of case references to the transformative doctrine, either before or after *Campbell*. Nonetheless, a transformative finding, where cited in the circuit courts, is *sufficient* to yield a finding of fair use. Beebe also shows that a finding in favour of factor 1 correlates with the finding of fair use in 82% of 297 circuit court opinions (op cit, p.605). In *Lennon v. Premise,* the transformative nature of use of a recording of the song "Imagine" in a documentary was sufficient to give a defence against an infringement action notwithstanding the commercial nature of the film.[40] A transformative use has to be distinguishable from a *derivative* work in terms of showing substantial new input with significant benefits. Otherwise its development is not a fair use of the original work. Debates over the substantive taking element in derivatives also arise in UK copyright law in assessing whether infringement has occurred. As Landes and Posner (1989, p. 336)

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[37] 2005 U.S. Dist. LEXIS 26299 (S.D.N.Y. 2005).

[38] *ABKCO Music, Inc. v. Stellar Records, Inc*., 96 F.3d 60, (2d Cir. 1996); *Leadsinger, Inc. v. BMG Music Publishing*, CV-04-08099-VAP (9th Cir. 2008).

[39] *Campbell v. Acuff-Rose Music,* 510 U.S. 569 (1994) (Fair use: Court of Appeals erred in applying the presumption that the commercial nature of the parody rendered it unfair, and erred in holding that 2 Live Crew had necessarily copied excessively from Roy Orbison's Pretty Woman, considering the parodic purpose of the use).

[40] *Lennon v. Premise*, 556 F.Supp.2d 310 (S.D.N.Y. 2008) (No. 08 Civ. 3813(SHS). The case is lower court and concerns transformation from a recording into a documentary, but appears to have elements analogous to music transformation across recordings.

point out, it saves transactions costs to have the copyright on original and derivative works in one place, so other benefits are needed to support transformation as a „productive' fair use. In practice, not much transformation is needed in modern cases to support a finding of transformative use in the US.

An emphasis on transformation is consistent with the emergence of new expressive work complementary to the original work, although this observation is not the whole story. Derivative work can also contain complementary elements and it does not always follow that a transformative work does no harm to the original, as it may encompass elements that can substitute for the original (in musical arrangements for example). Courts have been exercising judgment over what is transformative versus what is derivative and actionable. A sensible economic basis for the distinction would be whether new works were foreseen possibilities at the time of investment in the original, since unforeseen new works are not likely to destabilize incentives as discussed in Dnes (1995) in relation to contract modifications. The courts' emphasis on distinct new elements of *use* in a transformation, as in the *Google* appeal cases and in lower-court holdings such as *Lennon v. Premise,* may reflect a growing intuitive understanding of the significance for incentives of a foreseeable versus an unforeseeable product development. Although unforeseen change cannot destabilize incentives, it will, as with many other economic influences, often have an effect on the market for the original work.[41]

The US courts can carry out a benefit-cost analysis over market harm by following *Campbell* and treating transformation (per factor 1) as something to be traded off against market harm (factor 4) in coming to a holding over fair use, as clarified in *Perfect 10 v. Amazon*.[42] The approach of the *Campbell* court recognized elements of economic logic. Again, it is important to emphasize that the trade off between (i) encouraging new creativity by allowing takings for transformations, and (ii) discouraging *new* creativity by destabilizing existing property rights connected to *old* work needs to avoid erosion of net incentives for incurring the costs of *new* creative work. Regulatory change imposing losses ex post on owners of *existing* work can have an ex ante disincentive effect on *new*

[41] An underlying economic issue of scholarly interest is the distinction between technological and pecuniary externality (Scitovsky 1954). Pecuniary externality occurs when loss of money by one party is associated with financial gain to another, as when one business increases its sales at the expense of another: it represents redistribution of income with no impact on output or overall economic welfare. Courts are right to ignore pecuniary externality as they indeed do when following the doctrine of not compensating pure economic loss in tort law. Technological externality associates gains and losses with changes in underlying outputs in the economy and are of concern as they reflect social costs. In placing an emphasis on transformative *uses* courts may have intuitively reached for a distinction between supporting emerging new products associated with harming the financial interests of copyright holders but delivering additional products („transformations' - a positive technological externality associated with a negative pecuniary one) and not supporting simpler products (labeled derivative) that merely redistribute revenues from the copyright holder. There is a slight complication in applying this distinction in that the pecuniary effects can feed back onto ex ante incentives to invest.

[42] Op cit.

creativity notwithstanding the sunk nature of the costs of creation, because creative artists notice how predecessors have been treated. The economics is not just a matter of comparing gains to transformative users against incentive losses to copyright holders, who, following the generally correct arguments in Akerlof et al (2002) and CIPIL (2006), have made sunk investments based on ex ante incentives in the past. It is important to recognize the incentive effects on creative artists other than the transformative user and existing copyright holder: including those not currently holding copyrights but worrying about lower than anticipated returns, and those innovators likely to be encouraged by low-cost access to existing work. Disincentives for creativity cannot arise if the transformative use creates no losses for the owner of the original copyright.

Downloading songs is emphatically not fair use. In *BMG Music v. Gonzalez,*[44] a defence of fair use in downloading for sampling purposes was rejected since numerous sites permit listeners to sample portions of songs prior to purchasing without downloading. The use could be achieved by other means, such as listening in a library or store, a factor that would also be important in weighing fairness in the UK. In the *Grokster*[45]case, a Napster-type file sharing service could not claim format-shifting fair use, and an analogy with the *Betamax*[46] case was not accepted by the US Supreme Court. The courts have distinguished carefully between time or format shifting of owned recordings and illegal down loading.

(ii) The 'commercial use' element

Following the *Betamax* case,[47] factor 1 assessments became heavily focused for a period on the „Sony presumption' (Boyle 1996, p.99) that non-commercial uses of copyrighted work are not infringing in the absence of additional proof by the copyright holder that some *future* market harm is likely to result. The presumption carries an unfortunate element of „harm in the air,' which is not a cause of action in other areas of law such as tort, since future harm might anyway not have been experienced and might be inconsequential. The Sony presumption in *Betamax* led to a period in which *commercial* use of copyrighted material was held to be presumptively infringing, despite a retreat in *Harper & Row*,[48] and an explicit rejection of the presumption in *Campbell.*[49] The lower level courts continue to apply the Sony presumption according to Beebe (2008, p.549). It seems that the courts have been searching for routines and guiding sub-factors to narrow down factor 1 inquiries,

[44] 430 F.3d 888 (7th Cir. 2005).

[45] *Metro-Glodwym-Meyer et al v. Grokster, Ltd., et al,* 545 U.S. 913 (2005).

[46] *Sony Corp. of America v. Universal City Studios*, 464 U.S. 417 (1984)

[47] Op cit.

[48] *Harper and Row, Publishers, Inc. v. Nation Enters*., 471 U.S. 539 (1985) (assessing effect on the market without an explicit discussion of commerciality).

[49] Op cit p.585

consistent with an hypothesis of „rights accretion' (Gibson 2007, p.898). Distinct non-commercial uses are complementary to commercial ones.

(iii)Bad faith

The US courts have not paid great attention to fairness and faith issues in assessing character of use in fair-use cases according to Beebe (2008, p.607). It can be argued that neither should they (Leval 1990, p. 1126) since what matters is efficient use of IP. The argument overlooks the economic analysis of intent in criminal law (Posner 1985; Dnes 2009, p.111) that suggests that intent may reflect the hiding of harm warranting an increase of ex post penalties to maintain deterrence of harmful acts.

Factor 2. Nature of the copyrighted work

There is much more scope for acceptable copying from factual works and from published compared with unpublished works. There has been very little examination of why this may make sense. Recent opinions such as *Campbell*[50] have noted the closer proximity of creative works of fiction to the intentions of copyright protection, compared with factual works. Empirically, a fair-use defence is approximately twice as likely to succeed if the taking is of an expressive work based on factual material (Beebe 2008, p.611). Factual work is more readily a basis for simple dissemination of information, which may account for the easier defence of fair-use takings in that case. Facts are not copyrightable making it easier to claim fair use of copyrighted expression.

Unpublished works were protected under common-law copyright in the US until the passage of the Copyright Act 1976[51] after which they received the same statutory protection as published works (Martin 2002, p.264). Statistical analysis based on logistic regression[52] suggests that published status does favour findings of fair use, but that the converse is not true and unpublished status does not disfavour a finding of fair use (Beebe 2008, p. 595). Supreme Court opinions have favoured substantial protection of unpublished work, and although it seems to be true that lower courts have not followed a supportive line, the US Congress was sufficiently motivated to amend in §107 of the USCA in 1992: „The fact that a work is unpublished shall not bar a finding of fair use.'[53] The amendment may run against economic logic. It is reasonable to suppose that unpublished work is at an earlier stage than published work and that the value of it to the originator is therefore higher than after it is published, which would give a reason for not finding fair use.

[50] Op cit, p.586.

[51] 90 Stat. 2541 (1976)

[52] Logistic regression categorizes dependent variables (e.g., fair use, not fair use) using statistically significant independent variables.

[53] 106 Stat. 3145 (1992) 17 U.S.C. §107 (2000 & Supp. IV 2004)

Another reason for denying fair use could be to stop authors from devoting substantial resources to prevent users gaining access to their unpublished work (Landes and Posner 1989, p.355, n.39). Nonetheless, unpublished work does not appear to have been favoured in practice.

Factor 3: The amount and substantiality of the taking

Smaller takings are generally excused as a fair use in the US, but, as in the UK, there is no hard and fast rule. This approach has been criticized as amounting to allowing theft as long as it is small theft: ‚As in the law of larceny, so in the law of copyright, there … should be no privilege for stealing small' (Posner 1992, p.72). In fact, it should be easier to obtain licensed use in the case of a small taking, particularly in areas such as parody. An economic commentary would suggest that the cost of pursuing small takings is too high relative to benefits, and that in the case of larceny we also see the authorities not pursuing relatively small crimes. It is important to relate the issue of small takings in copyright to comparable takings of other types of property because criminal sanctions are used to enforce copyright.

In practice, copying is not fair use if the portion is effectively such as to provide an alternative publishing of the original. In *Wright v. Warner Books, Inc.*, an author quoted from six unpublished letters and ten unpublished journal entries but less than 1 per cent of the unpublished letters were copied and the purpose was judged to be informational.[54] However, in *Salinger v. Random House*,[55] large portions of unpublished letters were published in a biography of the author J.D. Salinger and were considered to be an alternative publication of the author's as yet unpublished work. Parody has thrown up yet a further view that large portions are sometimes essential for the transformative work to exist, as in *Campbell v. Acuff-Rose Music.*[56]

Factor 4. The effect of the use upon the potential market

In the *Betamax* case,[57] the Supreme Court held that videotaping of television broadcasts was a fair use, regarding the underlying activity as ‚time-shifting.' The delayed viewing did not deprive the copyright owners of revenue. However, in *Harper & Row v. Nation Enters* a magazine published excerpts from Gerald Ford's unpublished memoirs, and the Supreme Court held that the copying seriously damaged the market for Ex-President Ford's

[54] 953 F.2d 731 (2d Cir. 1991).

[55] 811 F.2d 90 (2d Cir. 1987).

[56] 510 U.S. 569 (1994).

[57] Op cit; see also *Recording Industry Association of America v. Diamond Multimedia Systems*, Inc., 180 f.3d 1072 (9th Cir. 1999) (copying of already downloaded file for personal use was fair use).

publication rights.[58] In *Harper & Row*, the Supreme Court declared the effect on the market to be the single most important element in determining fair use, which is borne out by Beebe's (2008, p.617) statistical work that also notes that no sub-factors have developed in the doctrinal history of applying factor 4. In a sample of 297 opinions, Beebe found that the outcome of assessing factor 4 coincided with the disposition of the case in 84 per cent of the opinions, and dominated all other factors. In addition there was a very strong correlation between factor 4, the market-impact test, and factor 1 identifying commercial versus non-commercial use. The correlations were also supported by logistical regression analysis. The outcome of assessing the fourth factor in many ways drives the outcome of the analysis of fair use. That is, a finding of damage to the copyright holder's market correlates very strongly with finding a commercial purpose and with denying fair use, and dominates all other factors.

The empirical importance of factor 4 triangulates with theoretical economic analysis emphasizing the harm done to the incentives of creative workers by substitute products based on the copyrighted work, and the lack of harm done by complements (Miceli and Adelstein, 2006, p.363). The emphasis on transformative uses following Leval (1990, p.93) and in much contemporary economic writing on copyright (Rogers et al, 2009, p.26) is also consistent with a focus on economic damage. At one time, factor 1 threatened to disappear from the factor analysis of fair use because the courts appeared to sense the overlap with factor 4; the revival of factor 1 via a focus on transformative use shows that transformative work is a strong basis for complementary products that do not impose economic harm on the copyright holder. In general, it is important to look beyond the effects on the copyright holder.

Additional factors

In one of the Google cases, [59] an attorney sued for infringement when the company's cached search results provided end users with copies of copyrighted works. The technology of caching makes it possible to search web pages that have been permanently removed from the internet. The Supreme Court held Google to be passive in the search and to be the beneficiary of an implied licence since owners of websites could turn off caching by using code. Also, Google adds „something new' to the original work – a highly transformative use. This new-technology case illustrates the court's ability to reach outside of the four factors to deal with new developments. However, statistical analysis suggests that such outreach has not occurred, on average, to the extent one might expect. Beebe (2008, p.549) examines individual factor influences on case outcomes to show that it is the four-factor test, and not the drawing in of additional, non-statutory factors that drives the typical result in fair-use cases. This regularity does not imply that courts never reach outside the four factors and does not clarify why they define uses as, say, transformative in

[58] 471 U.S. 539 (1985).

[59] *Field v. Google Inc*., 412 F. Supp. 2d 1106 (D. Nev. 2006).

the first place. It does tell us that despite recognizing the inclusive but not limitative nature of the §107 USCA tests, the US courts do not make extensive reference to wider factors in practice. They can be described as approaching fair use in an increasingly mechanized fashion over time, with an observable shift in emphasis moving the assessment of fair use toward a routine application of statutory factors.

The US stance on fair use: certainty v. flexibility

The *Gowers Review* (2006) regards the US fair-use defence as more flexible than UK fair dealing because it offers an instrument that can be adapted by the courts as new events unfold. This paper shows that this potential flexibility is used *carefully* by US courts, which have been reluctant to operate in an unfettered, equity-based manner in practice. The four-factor test has been used in a restrained manner focusing on market impacts, particularly by identifying transformative uses that create complementary products. Nothing wild has ever happened and those courts have been able to accommodate innovations such as video-recording and MP3-based format shifting without recourse to fresh legislation, whereas the courts in the UK have been unable to fit technical change into existing enumerated fair-dealing uses, and have often waited on parliamentary action to accommodate technical change, with some areas, such as format shifting outstanding to this day.

The point was made earlier that the emphasis placed by US courts on transformative uses may reflect an intuitive understanding of the need to identify and support uses providing new benefits that do not undermine *ex ante* incentives for creativity. The route to that distinction travels through early examinations of factor 1 based on commercial versus non-commercial uses, with the modern position being that developing transformative commercial products can be acceptable fair use. The US courts have done an impressive job of recognizing some important economic considerations operating in the field, which has not really been the case for the statutory approach in Europe and the UK.

The emerged focus on routine in US doctrine has not impaired the flexibility of fair use, but has served to enhance its predictability. The scope for adapting existing law to new cases remains intact, albeit in a system that has settled down into reasonable predictability. Uncertainty over fair use arises more in relation to pair-wise comparisons of different circuits, with the Ninth and Second Circuits dominating opinions but notoriously differing from each other in approach. The Ninth is popularly considered more pro-defendant compared with the legal conservatism of the Second Circuit, although Beebe's (2008, p.595) statistical analysis taking many case factors into account, apart from location, suggests the contrary.[60] The Ninth's perceived innovative history is well illustrated by *Perfect 10*,[61] in which the court accepted that the transformative nature of Google's search

[60] But note that the small sample predates the Google case (*Authors Guild, Inc & Assoc. Amer. Publishers, Inc. v. Google*, Case No. 05Civ.8136 (S.D.N.Y.) 2005) discussed immediately below.

[61] *Perfect 10 v. Amazon.com, Inc.,* op cit.

engine was a transformative use outweighing the harm done to Perfect 10's photography sales notwithstanding there being no new artistically creative element in the service. Perfect 10 in fact went into receivership subsequent to the case. Such holdings in the Ninth reinforce a modern view that the transformative element can be quite small but still support a finding of fair use in many cases; this view is supportive of innovation. In the Second Circuit, the Authors Guild, the publishing industry and Google entered into a settlement agreement in 2008, in which Google agreed to pay a total of $125 million to right holders for books, to cover plaintiffs' court costs and to create a Books Rights Registry, after publishers had taken action over digitization and caching of books.[62] The settlement anticipated a conservative holding, and was in fact ultimately rejected by Chin J. of the Second Circuit in March 2011, in part because it required opting out which was expected to give Google scope to „exploit' books without the clear permission of copyright holders and leading to market dominance, and in part because of potential conflict with international treaty obligations covering explicit consents.[63]

Cases are in fact highly predictable within circuits, and plaintiffs and defendants do forum shop to some extent, with technological defendants apparently favouring the Ninth Circuit and old-media plaintiffs favouring the Second. These distinctions do not automatically reflect uncertainty, since it is possible for plaintiffs and defendants to *predict* the approach of the two main circuits, as has been emphasized by US attorneys in discussions with the author. Jurisdictional differences can result purely from the efficient evolution of precedents (Zwicki and Stringham 2011) as particular jurisdictions face specific issues such as a prevalence of high-tech cases. One measure of judicial uncertainty, the extent to which lower courts are reversed by higher ones, shows no difference between copyright law and other areas of law in the US (Beebe 2008, p574).

UK fair use?

It is worth emphasizing once more that this paper is more about providing an economic commentary than coming to a conclusion on fair use versus fair dealing. Setting aside the issue of whether treaty obligations would allow the change, in principle, the UK could adopt fair use as a flexible element in its law of copyright exceptions based on the US approach, or liberalize its case law to broaden the interpretation of fair dealing by

[62] *Authors Guild, Inc & Assoc. Amer. Publishers, Inc. v. Google*, Supra. In 2009, French courts awarded €300,000 in damages and interest and ordered Google to pay €1,000 per day until it removed books from its database. A German action against Google was withdrawn in 2006. A similar Chinese case was commenced in 2009. Vaidhyanathan (2007) criticizes Google's book copying as an abuse of fair-use claims.

[63] *Authors Guild, Inc et al v. Google,* Case 1:05-cv-08136-DC, Document 971, Filed 03/22/11 (2nd Circuit) particularly pp.32-33. Judge Chin emphasizes that not opting out is not necessarily opting in.

extending the existing approach of enumerating purposes. [64] The flexible element could be achieved, outside of EU governed exceptions doctrine, by extending current case law linked to the assessment of the substantiality of an alleged infringement of copyright, which currently relates to a de minimis doctrine drawn from the common law. The experience of the US courts in retaining firm statutory guidance over the hearing of a fair-use defence, suggests that fair-use need not then be associated with an increase in uncertainty. The US courts have acted as independent brakes on the legislature's intention of creating a less fettered equitable doctrine, most probably because of the coherence required by precedent in common-law jurisdictions: a „wide ranging equity' would be an invitation for increased appeals and reversals.

The observed advantage of the US approach is its ability to absorb high-tech developments as they unfold, apparently mitigating problems attached to innovation based on copyright-using industries. From a UK point of view, the shared origins of the US and the English courts make US fair use a natural comparator. No other approach to copyright exception is likely to generate the same ability for a system to „think' on its feet. Indeed the evidence is of fair-use courts homing in over time on complex economic distinctions affecting ex ante incentives and the social benefits of new works: they appear to have handled many central issues competently to the point that the doctrines have evolved to match the efficiency considerations that could have been designed in by well informed initial planning. The alternative of adapting the statutory provision by adding further exceptions, possibly also educating judges to exercise more flexibility (Brenncke 2007, p.16), is less straightforward and anyway unlikely to produce the required flexibility, which is not so much about being equitable as having the scope to deal with changing technology. Continuing review by Parliament of statutory exceptions could amount to little more than catching up after the event, such that the current lacunae simply remained. Parliaments are also subject to attention from pressure groups, which an independent judiciary can ignore.

Jurisdictional differences, which anyway need not imply uncertainty, should not affect UK courts to any great extent.

5. The Music Industry and Fair Use

Music parody and sampling of recordings

This section focuses on an important modern development in the music industry linked to parody and sampling. The *Gowers Review* (2006, p.68, Recommendations 11 and 12) proposed the introduction of an addition to the fair-dealing copyright exception for transformative works, including music sampling, and for „the purpose of caricature, parody

[64] Israel has moved in this direction via legislation. Canada is moving by case law following *CCH Canadian Limited v. Law Society of Upper Canada*, [2004] 1 S.C.R. 339. Australia introduced refinements to fair dealing, e.g. for format shifting, following a report (Attorney-General of Australia 2005).

or pastiche,' which currently do not exist since rewards attached to derivative works are simply part of copyright. Recommendation 11 relates to an implied need to push for a revision in the Information Society Directive,[69] which *Gowers* proposes should take the form of following the Berne three-step test, which reads: „Members shall confine limitations and exceptions to exclusive rights to certain special cases which do not conflict with a normal exploitation of the work and do not unreasonably prejudice the legitimate interests of the rights holder.'[70] The context of the recommendation indicates that the suggestion is to move the UK toward the US position following *Campbell,*[71] where courts exercise a rule of reason in assessing whether the use is one that makes a significant direct use of the original work, so that the use is derivative and an infringement, compared with uses that are predominantly transformative and either do not harm the market for the original work, or, if they do, provide net benefits. In *Campbell*, the Supreme Court accepted that 2 Live Crew's substantial sampling (for purposes of parody) of a recording of Roy Orbison's "Pretty Woman" was a fair use. The strong contemporary interest in such cases reflects the nature of modern pop music, which makes heavy use of sampling patterns in genre such as hip hop and rap, although, compared with parody, US law is much less supportive of sampling for commercial purposes that save recording costs. Parody and pastiche of literary works[72] have already developed a more accepting case law under the „criticism and review' statutory heading of CDPA 1988. Collage in visual art is another useful parallel for music sampling from recordings.

Those carrying out music sampling from recordings must generally seek a licence and pay fees in both the UK and the US, although US fair use does in principle hold out the possibility of free use if the sampling could be shown to fit the description of a transformative *use*.[73] It really does need to be emphasized that courts in the US will penalize significant but small samplings held to be outside of transformative use: following an unsuccessful appeal in the Sixth Circuit, rap artist Sean „Diddy' Combs paid $150,000 in statutory damages plus $366,939 in actual damages to copyright owners for a five-second sampling of musical themes from the Ohio Players' 1970s recording "Singing in the Morning."[74] The underlying US case law follows from an earlier *Bridgeport* case and from

[69] Directive 2001/29/EC. Note that the Berne Convention also binds the US, which interprets its fair use provisions as meeting the requirements of the Convention.

[70] Trips, Article 13.

[71] Op cit. Justice Souter quoted Lord Ellenborough: „While I shall think myself bound to secure every man in the enjoyment of his copyright, one must not put manacles upon science.' *Carey v. Kearsley*, 170 Eng. Rep. 679, at 681 (K.B. 1803). Although *Campbell* is a parody case, its principles could apply more widely to sampling.

[72] A good example of such work is John Grace's *Brideshead Abbreviated*, 2010.

[73] *Lennon v. Premise,* op cit, is a transformative use because the sampling, a quotation from the song "Imagine," is used in a documentary.

[74] *Bridgeport Music, Inc.& Other v. Justin Combs Publishing & Other,* 507 F.3d 470 (6th Cir. 2007)

Newton[75] in the Ninth Circuit, both concerning de minimis rather than fair use defences. The 2005 *Bridgeport* court subsequently made it clear that it had not ruled on and therefore had not ruled out fair use defences in sampling cases. The court in *Newton* faced a case that was complicated by an interaction between copyright in composition and that in the recording, with the use of the underlying recording having anyway been licensed, and decided somewhat in opposition to *Bridgeport*. Although not technically settled, the contemporary US law reflects the view that the most likely commercial use of recording sampling is to save the cost of going into a studio and recording the sampled piece from scratch, that licences are easily available and unlikely to create disincentives for valuable new derivative uses – encapsulated in the often quoted *Bridgeport* dicta „Get a license or do not sample.' The *Bridgeport* court made it very clear that it was deliberately trying to establish a bright line test for infringement over sampling in relation to the USCA §106, based on its perception of a distinctive treatment of recording copyright, to force the transactions into the market place. This is consistent with the establishment of a property rule as a basis for bargaining to efficient use of the entitlement (Coase 1960) but has been criticized as ignoring elements of USCA §106 and the associated House of Representatives Report[76] making it clear that recordings are *not* to be treated differently (Mueller 2006, p.443).

Why should courts resist unlicensed sampling from recordings, whereas sampling from compositions, say as short extracts in a jazz numbers is considered more acceptable?[77] The *Bridgeport* court cites the non-transformative purpose of simple cost saving. The sampler could go into a studio, hire musicians and perform the sampled material, which might not infringe compositional copyright if sufficiently varied. In choosing to copy recorded sound for rearrangement, the artist escapes those costs. The court did not think that requiring licensing to avoid the separate studio costs was a major impediment to creative offshoots. From an economic perspective, it is tempting to argue that the cost saving is probably desirable and it is easy to see how many commentators think there should be something like a fair use defence for digital sampling. Conversely, care needs to be taken not to overlook the foreseeable nature of the cost-saving use, implying that ex ante incentives for new composition and recordings could be affected by ex post removal of copyright revenues. Interestingly, the German Supreme Court has focused closely on the issue of investment incentives in the *Kraftwerk* decision.[78]

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[75] *Bridgeport Music, Inc. & Ors. v. Dimension Films & Ors.,* 410 F.3d 792 (6th Cir. 2005) (Affirmed on rehearing: digitally sampling a very short recorded musical sequence was not a de minimis use based on statutory interpretation of USCA §106) *Newton v. Diamond*, 388 F.3d 1189 (9th Cir. 2004) (Certiorari denied and concluding that sampling a three-note sequence was a de minimis exception.) The difference is partly linked to the copyright in composition element in *Newton* and to the *Bridgeport's* search for a bright line.

[76] H.R. Report No. 92-487, p.10 (the sound recording copyright is not intended to grant any broader rights than granted to other copyright holders).

[77] *Gaste v. Kaiserman*, 863 F. 2d 1061(noting the limited language of music and the scope for compositional overlaps).

[78] The *Metall auf Metall* case (*Kraftwerk, et al v. Moses Pelham, et al,* Decision of the Federal Supreme Court no. I ZR 112/06; November 20, 2008) citing *Bridgeport(2005).*

In the UK, the seeds of a bright-line test for non-transformative sampling are arguably in place based on the requirement that, for sampling to be an infringement, a substantial quantitative or qualitative taking is required.[79] A test for fair use could be whether the new use is transformative with net benefits, in which case it would satisfy the Kaldor-Hicks test for an economic improvement, or whether it simply harms existing and future interests. There is concern that the UK lost some developmental momentum over new trends in musical performance and recording owing to a more rigid fair-dealing doctrine working against sampling developments, although it seems much more likely that the momentum in earlier decades in the US was more to do with weak enforcement.

Lax enforcement of the law in the US was more sampler friendly prior to the *Bridgeport* cases, with artists relying on failure of record companies to pursue them, raising a question about other influences, such as growing US gang culture, dominating the legal position. Unless we believe the UK record companies were tougher, or that UK groups could not have sampled US recordings with the same de facto ease as US groups, it does seem that other influences account for the differential development. Further cautions may be in order. Easing the position in the UK over licensing might not open up a free market in sampling because of the possibility of action to enforce artists' moral rights (§80, CDPA 1988), since the copyright holder can seek to prohibit derivative uses making unwanted associations with the original, such as sampling in obscene gangsta rap „songs.' The issue of derogatory treatment arises in the US too: early on, rap artist Coolio had to alter lyrics to obtain permission to sample from Stevie Wonder, and Posner (1992, p.72) discusses unwanted adaptations at some length distinguishing between „target' and „weapon' parody. Undesired associations were the impetus behind the plaintiff's unsuccessful US action in *Lennon v. Premise,* where the transformative nature of use of the song "Imagine" in a documentary was sufficient to give a defence against an infringement action.[80]

In the UK, permissions are obtained either through direct negotiation or through the Performing Rights Society for Music collecting society, depending on whether it is sampling of the recording or composition that is being sought. Empirical work suggests UK licensing suffers from cost and complexity and does not accommodate transformative uses well (see the papers in Frith and Marshall 2004) although a claim of high cost raises questions concerning the basis of comparison. Also, in a sense, *compositional* sampling has always been an issue and was also carried out for cost savings: the late Benny Green frequently joked on his long-running BBC programme covering the mid-twentieth century art of popular song writing that first-night audiences went *into* theatres whistling the tunes when attending the musicals of one certain composer. A musical arrangement is another traditional example of a derivative work with transformative elements.

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[79] *Produce Records Ltd v. BMG Entertainment Ltd* (1999) (recording sampling case settled out of court on the assumption that a 7.5-second sample of "Higher And Higher" incorporated into Los Del Rio's "Macarena" was an infringement). In the composition case *Ludlow Music Inc v Williams & Ors (No.2)* [2002] EWHC 638 (Ch), singer Robbie Williams paid over royalties for a two-line and approximate lyric sampling.

[80] *Lennon v. Premise*, op cit.

The recording industry does not currently like the idea of a free and easy regime over sampling, which is a puzzle since it could improve earnings if new developments overtook the market for original songs. There is clearly a tension between the benefits of new developments and the profits currency of original work, which most likely reflects competition between different recording companies. In the UK, artists must pay for the use of the original work. When somebody uses a sufficiently recognizable chunk of musical composition, this effectively counts as a derivative use that is traditionally protected by copyright. Some publishers and recording firms will simply not allow any work to be used for free. Under the fair dealing regime, as the market for transformative works increases, the fees for sampling would be expected to increase, which apparently is the case. Tension then exists between new and old creative uses, and if it is intended to increase the level of innovative work, there could be a case for easing the restrictions, with courts carrying out the work of assessing derivative versus transformative uses in the manner (for parody) of *Campbell*. In this connection it is unfortunate that the *Gowers Review* used the term „derivative' alongside „transformative' use in Recommendation 11, since economic logic suggests using the distinction as a test in a copyright exception supporting transformative work. The practices of the recording industry represent the sort of tension identified by Klein, Lerner and Murphy (2006, p.208) in relation to format shifting, but equally applicable here: „Eliminating a "fair use" is not a benefit to the record companies; it is an unfortunate cost they have to bear.'

Some commentators will argue that attention to the details of the licensing regime could fix the problem of incentives for transformative uses in the music industry, at least for some works, without moving to fair use. At the present time, even very simple takings need to go through the licensing process, as, broadly, if the original work can be recognized it is possible to infringe copyright. However, it is possible for underlying musical ideas to be used without infringement, and this observation could be developed into an argument for making some underlying musical ideas exempt from copyright in the manner of the underlying mathematics in a computer program. Music publishers and recording companies presently employ teams of people to listen to recordings to detect infringements, revealing a preference for holding onto profits in the context of rivalry within the industry. It could be objected in relation to the current distinctions being drawn between digital sampling and sampling of compositions that it makes no real difference, apart from cost, whether a musician reads or remembers notes and adapts them, or makes the same use of a digital source.

Format shifting

Format shifting is also importantly music related and has received considerable attention from consumer advocates, as it is of benefit to consumers who may wish to transfer already purchased CDs or DVDs, or purchased downloads, onto a portable media such as an MP3 payer. Unfortunately, modern digital technology also facilitates the capture of illegally downloaded materials, e.g. the illegal copying for resale of song recordings or newly released films. This tension has led to much soul searching over the extension of fair dealing/fair use and it is wrong to think this has been substantially different on either side

of the Atlantic. The time shifting of broadcasts by copying for personal use using electronic devices is covered by copyright exceptions, but format shifting is not legal in the UK. Peer-to-peer file sharing via networks is not legal and is unlikely to become so, and remains illegal in the US. In fact, format shifting is really only presumptively legal in the US, based on a Ninth Circuit case, as no case has yet come before the US Supreme Court.[81]

The *Gowers Review* (2006, p.62) recommends easing the position over format shifting for personal use. There appears to be no interest in easing the position over file sharing for personal use. Rogers et al (2009, p.15) point out the widespread disregard for the current law on format shifting. In itself, the complete inability to enforce a law suggests that the legal rule may not be cost effective and that another route should be found to achieve some behavioural objective. In assessing the impact on markets of format shifting a wide view needs to be taken and one cannot look at the market for the recording taken on its own. As pointed out by Oberholtzer-Gee and Stumpf (2010) in connection with the more problematic area of file sharing, it is common to observe impacts on declining CD sales, but to ignore the likely impact on concert attendance and sales of MP3s, which (following the logic of *Perfect 10*[82]) may represent the fruits of transformative use. It is therefore often highly debatable whether there is damage to copyright holders if people digitize recordings for personal use, or even if private users take recordings that they would not anyway buy. The issues are quite different for commercial takers/shifters. European regulation contemplates the replacement of the prohibition of format shifting with a permissive regime that then imposes a levy on sales of recording media such as blank tapes. The levy is then distributed to copyright holders by a collecting society. *Gowers* suggests that a requirement for EU-Directive inspired levies, could be met in the UK without a new tax by noting that the add-on value of the extra copying can be incorporated into the price of the original CD.

The logic in the *Gowers* approach to format shifting may be questioned in that it uses an argument drawn from Liebovitz (1985) to suggest that the price of CDs and similar first sales could be adjusted upward to reflect the additional benefit from derived copies, leading to no adverse effect on revenues. That is only true if the manufacturer can exclude buyers who wish to buy the CD and to format shift, which may not be the case. Liebovitz's argument largely depends upon ability to practice price discrimination, as when publishers charge libraries a higher price for a journal, which also requires exclusion possibilities to prevent private purchasers depositing volumes in libraries. Klein, Lerner and Murphy (2002, p.206) suggest that a better explanation for library

[81] *Recording Indus. Assoc. of America v. Diamond Multimedia Sys., Inc.*, Op Cit (an MP3 device makes permissible personal copies from a user's hard drive notwithstanding the absence of copy-control technology required in *Betamax*). Other cases in lower courts have not always followed *Diamond* but really because they have been infiltrated by other issues such as Napster-type file sharing.

[82] Op cit. Perfect 10 went into receivership but Google developed highly valuable web business using its input.

pricing is that publishers recognize that allowing local copying lowers the local costs of delivering the desired number of copies. Similarly, with format shifting, it appears to be the case that home copying is the efficient way to use CDs and similar products across platforms for personal enjoyment. An increase in sales price would decrease sales revenue assuming that price elasticity[83] of demand exceeds unity, as it likely will for a recording/publishing firm facing limited competition, unless secondary uses really increase demand at all prices. In the end, an argument favouring format shifting may simply be that it is of value to consumers, but that its restriction is very costly to enforce, so that cost-effective deterrence cannot be achieved anyway. Format shifting is predominantly a consumer, rather than innovation issue.

6. Conclusions

This study does not attempt to address the EU framework constraining legal change, but, rather, takes an overview of the UK and US doctrines concerning fair dealing and fair use and provides an economic commentary linked to the encouragement of innovation. Scope for considerable discretion in viewing fairness already exists in UK fair-dealing jurisprudence. Private use and, particularly, transformative use of creative works do not pose any special issues of judicial uncertainty. A move to incorporate fair use into UK copyright law could bring in a doctrine of copyright exceptions that would be adjustable by courts as technological developments unfold. An advantage would almost certainly be better response times than those seen recently under a legislative approach in relation to changes such as caching, transformative use, form shifting and reverse engineering. It is nonetheless important to remember that some differences between US and UK developments arise for reasons not connected with fair use: notably the development of modern music based on sampling recordings, where lax enforcement has been a key factor in allowing early US growth.

In the US, the courts have developed their guidelines in a rigorous manner that avoids unstructured equity inquiries, and have done a good job. The legal conservatism in the US could reflect the operation of rights accretion, in which courts respond to industry practices and firms have an incentive to appeal over, or even just to „forum shop' around, inconvenient holdings. Differences in the treatment of copyright exceptions in US courts have more to do with relatively certain jurisdictional differences, particularly between the Ninth and Second Federal Circuits. The UK courts may also be becoming more mechanistic in their application of guidelines in assessing fair dealing, but in relation to tightly worded directives and treaty obligations, and they have seemingly made little use so far of the broad equity envisioned by Lord Denning, although scope for that remains in place.

Flexibility could help in dealing with new technological developments such as the data mining for marketing purposes that is beginning to emerge around the world. Relying on

[83] That is, responsiveness.

an independent legal system to adjudicate conflicts over IP rights may provide stronger safeguards, for example over privacy or restraint of trade, than relying on the legislative process, which can be seen as more open to political lobbying by special interests. Independence may prove to be extremely important in a world where IP, privacy and competition are increasingly intermingled.

As a matter of observation and from an assessment of US cases, a system of copyright law adhering to a doctrine of fair use does not appear to be characterized by unusual levels of uncertainty. As a matter of comparison, most of what fair use does could still be achieved by adjusting fair dealing, broadly in the manner proposed by the *Gowers Review*. The distinction between the two approaches, in the end, revolves around an assessment of the benefits of adhering to parliamentary governance versus moving to reliance on judge-made law in the area of copyright exceptions. It needs to be borne in mind that current treaty obligations impose limits on the room to maneuver in relation to fair-dealing exceptions.

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