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Fair Use and Market Failure: Sony Revisited

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FAIR USE AND MARKET FAILURE: SONY REVISITED

GLYNN S. LUNNEY, JR.

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INTRODUCTION

In 1984, by the margin of a single vote, the Supreme Court of the United States ruled that the home-taping of a copyrighted television broadcast for purposes of time-shifting constituted a fair use under the Copyright Act of 1976.1 Since that time, economic and legal commentators have generally justified the decision in terms of market failure. If time-shifting were not a fair use, the conventional understanding argues, then a license would be legally required. Yet, the transaction costs incurred in negotiating and agreeing to license terms with each home-taper would almost invariably exceed the potential gains from trade. Because of these prohibitively high transaction costs, a private market for time-shifting licenses would likely fail. Time-shifting should therefore constitute a fair use.2

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1 Sony Corp. v. Universal City Studios, Inc., 464 U.S. 417, 454-55 (1984) (finding that “the record amply supports the... conclusion that home time-shifting is fair use”).

2 See, e.g., Wendy J. Gordon, Fair Use as Market Failure: A Structural and Economic Analysis of the Betamax Case and Its Predecessors, 82 COLUM. L. REV. 1600, 1601 (1982) (asserting that “the courts and Congress have employed fair use to permit uncompensated
Despite gaining widespread acceptance, the market failure account of *Sony* does not accurately reflect either Justice Stevens’s reasoning for the majority in the case or a sound application of the relevant economic principles. Moreover, the market failure account has sharply restricted *Sony*’s potential reach. Interpreted as an exceptional instance of market failure, *Sony* has become its own limitation. If the inability to develop an effective licensing scheme justified the *Sony* outcome, then so long as a licensing scheme is or could be made practicable, the doctrine of fair use should presumably not apply. Under the market failure account, *Sony*’s finding of fair use thus becomes a rule denying fair use absent market failure—a result the Court seemed to adopt directly in distinguishing the fair use treatment of parody and satire in *Campbell v. Acuff-Rose Music, Inc.*

3 While I understand that circumstances other than high transaction costs can lead to market failure, this Article focuses on the issue of private copying, where high transaction costs would seem to be the principal barrier to negotiated licenses.

4 In Germany, the 1955 *Grundig* decision, BGHZ 17, 266, finding manufacturers of home-taping equipment liable for the copying of their customers, led ten years later to the first levy system in the German Copyright Act of 1965. See Juergen Weimann, *Private Home Taping Under Sec. 53(5) of the German Copyright Act of 1965*, 30 J. COPYRIGHT SOC’Y 153, 154-56 (1982) (discussing the *Grundig* holding and its implications for amendments to the 1965 Act). In the United States, Chief Judge Cowen suggested a similar approach in his dissent in *Williams & Wilkins Co. v. United States*. As Cowen stated:

I agree with the court that we have no jurisdiction to order a copyright owner to institute a licensing system if he does not wish to do so, but I think we are equally powerless to assume the congressional role by granting what amounts to a blanket exemption to defendant’s libraries. Without too much difficulty, however, we can determine the amount of just compensation that is due plaintiff for the infringement of its copyrights. If that should be done, it may very well lead to a satisfactory agreement between the parties for a continuation of the photocopying by defendant upon the payment of a reasonable royalty to plaintiff.

487 F.2d 1345, 1372 (Ct. Cl. 1973) (Cowen, C.J., dissenting), aff’d by an equally divided Court, 420 U.S. 376 (1975). The Ninth Circuit may also have had such a levy system in mind, though perhaps judicially imposed, when it held *Sony* liable for its customers’ unauthorized home-taping. See Universal City Studios, Inc. v. Sony Corp., 659 F.2d 963, 976 (9th Cir. 1981) (suggesting that the district court consider “damages or a continuing royalty,” rather than an injunction, as the appropriate remedy for *Sony*’s contributory infringement), rev’d, 464 U.S. 417 (1984).

5 510 U.S. 569, 580-81 (1995) (“Parody needs to mimic an original to make its point, and so has some claim to use the creation of its victim’s (or collective victims’) imagination, whereas satire can stand on its own two feet and so requires justification for the very act of borrowing.”).
With the development and dissemination of digital technology, the importance of private copying and its legal status, whether fair or unfair under copyright law, has only increased. Yet, despite its status as the Court's first and only pronouncement on the issue, Sony has played surprisingly little role in this ongoing debate. Even in cases bearing seemingly close similarity to the home-taping at issue in Sony itself, such as the private, home copying of musical works, courts have refused to follow Sony's fair use outcome. Having been narrowly construed as an exceptional instance of market failure, Sony seldom appears to have direct application to fair use cases generally, and courts have repeatedly rejected application of the Sony analysis outside of its specific factual context. Ironically, until “clarified” by the Court in Campbell, courts relied on certain dicta in Sony limiting the availability of the fair use doctrine for commercial uses far more than they relied on Sony's actual fair use holding.

In this Article, I would like to revisit Sony with the aim of achieving, if not a radical rewriting, at least a rational revitalization of Sony and copyright's fair use doctrine more generally. Properly understood, Sony stands not for the proposition that fair use is justified only in those exceptional cases where a licensing scheme or some other market mechanism is impractical. Rather, Sony stands for the recognition of fair use as a central and vital arbiter between two competing public interests. On the one side, a use that is considered fair and is allowed to continue may indirectly lead to fewer works of authorship by reducing the incentives to create such works. On the other, allowing such use to continue may directly improve the public's ability to use, transform, or otherwise obtain access to existing works.

In defining the balance between these competing public interests, Sony begins with a presumption in favor of fair use and a broad conception of the public interest that fair use protects. Merely increasing access to a work, even unauthorized access, represents a sufficient public interest to invoke the fair use doctrine. A transformative or “productive” use is not required. Once the fair use doctrine is invoked, Sony places the burden squarely on the copyright owner to justify recognition of her private ownership rights. Only where the copyright owner has demonstrated by the preponderance of the evidence that the net benefit to society will be greater if a use is prohibited, should a court

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6 See, e.g., A&M Records, Inc. v. Napster, Inc., 239 F.3d 1004, 1019 (9th Cir. 2001) (distinguishing Sony’s fair use outcome in a case involving private sharing of musical files); UMG Recordings, Inc. v. MP3.com, Inc., 92 F. Supp. 2d 349, 351 (S.D.N.Y. 2000) (distinguishing Sony’s fair use outcome in a case involving a service that allowed a subscriber who already owned a copy of a musical work to download that work from the Internet to make the work accessible at different locations).

7 See Campbell, 510 U.S. at 583-84 (rejecting the notion, “ostensibly culled from Sony, that ‘every commercial use of copyrighted material is presumptively . . . unfair . . . ’” (citation omitted)).

8 I refer to net social benefit in order to recognize expressly that copyright's incentive effect does not create more works out of thin air, as it were, but in fact draws resources
conclude that a use is unfair.

Moreover, in evaluating copyright owners' attempts to justify their private ownership rights, Sony, quite properly, requires courts to exercise a healthy skepticism. We do not know nearly as much as we sometimes pretend regarding the economic working of the markets for copyrighted works, nor do we fully understand the relationship between increased copyright revenues and the ultimate public purpose of copyright—creation of additional works. Given the inherently speculative nature of the relationship between more expansive rights and additional creative works, Sony counsels caution before enjoining unauthorized copying that offers some clear public benefit, even if that public benefit is "only" increased convenience and access.

When we reexamine Sony as it was written, we find that the market failure away from other productive activities. In evaluating the social benefit associated with producing additional works, we must therefore consider what is lost because creative resources are used in producing additional copyrighted works, rather than in some other productive activity. This trade-off has not played as important a role as it should in copyright law, and only a few commentators have acknowledged the issue. See Benjamin Kaplan, An Unhurried View of Copyright 75 (1967) ("Magnify the headstart and you may conceivably run the risk of attracting too much of the nation's energy into the copyright-protected sectors of the economy."); Robert M. Hurt & Robert M. Schuchman, The Economic Rationale of Copyright, 56 Am. Econ. Rev. 421, 425, 430 (1966) (papers and proceedings) (considering whether goods induced by copyright protection are more valuable than those that would have been produced absent such protection); Arnold Plant, The Economic Aspects of Copyright in Books, 1 Economica 167, 170 (1934) (discussing "the alternative products which free competition would allow to emerge" in the absence of copyright protection). Fritz Machlup expressed a similar concern in the patent area. Machlup argued:

It is easy to conceive of the possibility that such allocation [of productive resources to research and development] is too meager. But can there ever be too much? Is not more research and development always better than less? Is it possible that too much is devoted to the inventive effort of the Nation? This depends on what it is that is curtailed when inventive activity is expanded. More of one thing must mean less of another, and the question is, what it is of which there will be less . . . . Whenever permanent economic policies—not just war or depression measures—are discussed, sound economics must start from the principle that no activity can be promoted without encroaching on some other activity. More of one service or product must mean less of another.

account is, at best, a one-dimensional caricature of Justice Stevens’s sensitive and careful attempt to understand the economic consequences of time-shifting in light of the evidence presented. As Justice Stevens’s examination of these economic consequences reflects, unauthorized copying of a public good is not the economic, legal, or moral equivalent of theft. When a private good is stolen, the theft necessarily deprives the original owner of possession. Making an unauthorized copy does not. Because a public good such as a broadcast television program is characterized by nonrivalrous consumption, any number of individuals can copy an existing broadcast without thereby depriving some other individual of access. Because of this lack of rivalry, only when copying, given its nature and extent, becomes so widespread that it threatens the incentives necessary for a program’s production does government intervention, in the form of copyright, become potentially desirable. We should not therefore presume, as the market failure approach necessarily does, that a private market regime is necessarily desirable. Rather, as Justice Stevens’s opinion suggests, we must balance the competing public interests at stake.

I. SONY, MARKET FAILURE, AND THE ECONOMICS OF PUBLIC GOODS

On October 19, 1981, the Ninth Circuit issued its panel opinion in *Universal City Studios, Inc. v. Sony Corp.* The court held that the use of a Sony-manufactured Betamax machine to record copyrighted television programs was not a fair use and that Sony was liable for its customers’ unauthorized copying. In concluding that home-taping was not a fair use, the Ninth Circuit drew a line between “productive use” of a copyrighted work, where a defendant has taken copyrighted material and used it to fashion some new copyrighted work, and unproductive use, where “copyrighted material is reproduced for its intrinsic use.” Only productive uses, the Ninth Circuit wrote, had historically and could now legitimately claim fair use status. The Ninth Circuit also questioned in passing whether large-scale home-taping could appropriately be considered non-commercial. Finally, in evaluating the fourth and “most important” fair use factor—the effect of the use upon the value of the copyrighted work—Disney and Universal admitted that home-
taping had not caused any present financial harm, but offered a variety of theories to explain how home-taping might reduce the value of their respective portfolios of copyrighted works in the future. After considering the evidence, the district court rejected these theories, finding that the theories of possible future harm relied on assumptions that were "based on neither fact nor experience" and were "to some extent inconsistent and illogical." On appeal, the Ninth Circuit held that the district court's standard "was much too strict." In the Ninth Circuit's view, the use at issue necessarily interfered with the market for the original because it involved wholesale copying of the works. Although the Ninth Circuit expressly acknowledged that "[t]he harm to a copyright plaintiff [from private copying] is inherently speculative," the court stated that the money spent on videotape recorders and associated equipment demonstrated that home-tapers "assign economic value to their ability to have control over access to copyrighted works." From the fact of value, the Ninth Circuit inferred that a corresponding legal right to "exploit" that value must exist.

By any measure, the Ninth Circuit's decision represented a radical expansion in the legal rights of copyright owners. As Sony counsel Dean Dunlavey would subsequently argue in his petition for certiorari, the Ninth Circuit's decision was "the first judicial decision in American legal history to find as copyright infringement either (a) conduct taking place entirely in the privacy of the home or (b) making a copy of anything solely for private personal use." It was also the first "to hold a manufacturer . . . strictly liable for [its customers'] use as a contributory infringer." If that were not enough to attract the Supreme Court's attention, the Ninth Circuit heavily criticized the Court of Claims' decision in *Williams & Wilkins Co. v. United States* that photocopying medical and scientific journals for medical research constituted

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15 The district court rejected the copyright owners' arguments on the fourth fair use factor on the grounds that their predictions of future harm relied on assumptions that were "based on neither fact nor experience" and, as even plaintiffs admitted, "to some extent inconsistent and illogical." Universal City Studios, Inc. v. Sony Corp., 480 F. Supp. 429, 451 (C.D. Cal. 1979), rev'd, 659 F.2d 963 (9th Cir. 1981), rev'd, 464 U.S. 417 (1984).
16 *Universal City Studios, Inc.*, 659 F.2d at 973 & n.11 (asserting that the district court confused the applicable legal standard for "harm" for purposes of fair use with that for injunctive relief).
17 Id. at 974 n.13 ("Put another way, because the copies serve the same function as the original, the 'functional test' suggests that fair use is not available.").
18 Id. at 971.
19 Id. at 974.
20 Id. ("It is clear that home users assign economic value to their ability to have control over access to copyrighted works. The copyright laws would seem to require that the copyright owner be given the opportunity to exploit this market.").
21 Petition for Writ of Certiorari at n.1, *Sony Corp.* (No. 81-1687).
22 Id. at n.2.
fair use. Quoting Judge Nichols’s dissent in *Williams & Wilkins Co.*, the Ninth Circuit ridiculed the Court of Claims’ decision as the “‘Dred Scott . . . of copyright law.’” Given that the Supreme Court had voted to affirm *Williams & Wilkins Co.*, albeit by an equally divided vote, it is perhaps unsurprising that on June 14, 1982, the Court granted certiorari and agreed to review the Ninth Circuit’s decision.

A. *Sony as Written: Fair Use as Balancing*

In overturning the Ninth Circuit’s decision and concluding that home-taping was a fair use, the Court defined fair use as an “equitable rule of reason balance.” Through the fair use doctrine, the Court explained, Congress expressly directed courts to balance, not the private interest of copyright owners in broader protection against the public interest in narrower protection, but the competing public interests at stake. On one side of this

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23 487 F.2d 1345, 1347 (Ct. Cl. 1973) (finding that widespread photocopying of medical and scientific articles at institutions involved in scientific research was fair use), aff’d by an equally divided Court, 420 U.S. 376 (1975).

24 Universal City Studios, Inc. v. Sony Corp., 659 F.2d 963, 970 (9th Cir. 1981) (quoting *Williams & Wilkins Co.*, 487 F.2d at 1387 (Nichols, J., dissenting)). In the *Dred Scott* decision, the Court had held that a slave remained property even in a free state. *Dred Scott v. Sandford*, 60 U.S. (19 How.) 393, 453 (1856). As between allowing individuals to tape television programs in the privacy of their own homes without the copyright owner’s express authorization, and extending the copyright owner’s property rights into American consumers’ bedrooms, the latter approach, adopted by the Ninth Circuit, would seem to parallel more closely the logic and rationale of *Dred Scott*.

25 Justice Blackmun, who would later author the dissent in *Sony Corp.*, recused himself in *Williams & Wilkins Co.*, leaving the Court with eight evenly divided justices. See *Williams & Wilkins Co.* v. United States, 420 U.S. 376, 376 (1975).


28 In her article, Professor Gordon rejects as a fair use standard a balancing of the “social value” of the use against “any detriment to the artist.” See Gordon, *supra* note 2, at 1615. Such an approach “would be to propose depriving copyright owners of their right in the property precisely when they encounter those users who could afford to pay for it.” Id. I agree that balancing social value against detriment to the artist is improper, but not because of any inherent right of the artist. Rather, such a balance is improper because it mistakenly weighs the public interest in access against a private interest in revenue. A proper balance sets the public interest in access against the public interest in additional works.

29 *Sony Corp.*, 464 U.S. at 431-32. The Court held that:

The limited scope of the copyright holder’s statutory monopoly, like the limited copyright duration required by the Constitution, reflects a balance of competing claims upon the public interest: Creative work is to be encouraged and rewarded, but private motivation must ultimately serve the cause of promoting broad availability of literature, music, and the other arts. The immediate effect of our copyright law is to secure a fair return for an “author’s” creative labor. But the ultimate aim is, by this incentive, to
balance, unauthorized time-shifting "yields societal benefits" by "expand[ing] public access to freely broadcast television programs." On the other, unauthorized time-shifting might reduce the supply and variety of original works available by impairing the incentives for their creation. Yet, after carefully reviewing the factual evidence of record, the Court agreed with the district court that the copyright owners had "failed to demonstrate that time-shifting would cause any likelihood of non-minimal harm to the potential market for, or the value of, their copyrighted works." Given this finding, the Court held that a prohibition on time-shifting "would merely inhibit access to ideas without any countervailing benefit." Because the balance of competing public interests at stake weighed in favor of allowing unauthorized time-shifting to continue, the Court affirmed the district court's finding that home-taping constituted a fair use.

In establishing and applying this balancing approach to the fair use issue, the Court also expressly addressed and resolved a number of arguments that remain relevant to the ongoing debate over the legal status of private copying today. First, the Court directly rejected the Ninth Circuit's attempt to limit the application of fair use to "productive" uses. Although "[t]he distinction between 'productive' and 'unproductive' uses may be helpful in calibrating the balance,... it cannot be wholly determinative." As the Court noted, Congress "expressly identified ... [m]aking a copy of a copyrighted work for the convenience of a blind person... as an example of fair use." Because it is in the public interest, increased access is alone sufficient to invoke the fair use doctrine; some "productive" use is not required.

Second, the Court expressly rejected the attempts of respondents Universal and Disney to characterize private copying as "commercial." On this issue, Universal and Disney initially argued that private copying should be considered "commercial" because it can substitute for a commercial transaction: the purchase of authorized copies. Alternatively, Universal and

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30 Id.
31 Id. at 456.
32 Id. at 450-51.
33 Id. at 454-56.
34 Id. at 455 n.40 (stating that the Ninth Circuit's "understanding of 'fair use' [as requiring a productive use] was erroneous").
35 Id.
36 Id.
37 Id. (observing that "[v]irtually any time-shifting that increases viewer access to television programming may result in a... benefit" that might justify application of fair use).
Disney argued that the private character of the copying should not convert what would otherwise constitute infringement into a fair use, invoking an analogy that Professor Laurence Tribe had offered on behalf of copyright owners at the legislative hearings following the Ninth Circuit's decision: "Jewel theft surely is not converted into a non-commercial veniality if stolen jewels are simply worn rather than sold." 39 The Court rejected both arguments and expressly recognized the fallacy of applying Professor Tribe's private good analogy to the public goods at issue in copyright:

The use to which stolen jewelry is put is quite irrelevant in determining whether depriving its true owner of his present possessory interest in it is venial; because of the nature of the item and the true owner's interests in physical possession of it, the law finds the taking objectionable even if the thief does not use the item at all . . . . Time-shifting does not even remotely entail comparable consequences for the copyright owner. 40

Because of television's public good character, any number of consumers can time-shift without depriving any other consumer of their ability to view a program. Unauthorized time-shifting of a copyrighted television program, unlike theft of a private good, does not deprive the copyright owner of a present possessory interest in a tangible good. 41 Because of that critical difference, unauthorized copying, again unlike theft, becomes socially undesirable only when it goes so far as to threaten the public's interest in an adequate supply of creative works.

Third, in evaluating whether any given use poses a threat to the public's interest in additional works, both the Copyright Act and the Court approach the

39 Id.

40 Sony Corp., 464 U.S. at 450 n.33; see also United States v. Smith, 686 F.2d 234, 243 (5th Cir. 1982) (recognizing that taping a copyrighted broadcast "does not implicate a tangible item . . . [,] nothing was removed from someone's possession").

41 Of course, if someone shoplifted a CD of the latest music group, that would constitute theft of a tangible, private good and would be punishable under applicable state laws. Such conduct would not constitute copyright infringement, however. Moreover, under applicable state laws, the theft of a CD would presumably be valued at the market price for the CD, not at the value of the intangible rights to reproduction that copyright protects. For a discussion of this issue, see BRUCE STERLING, THE HACKER CRACKDOWN: LAW AND DISORDER ON THE ELECTRONIC FRONTIER 250-81 (1992). Sterling discusses the trial of Craig Neidorf, a hacker accused of stealing and publishing roadmap documents to Bell-South's Enhanced 911 System. In its prosecution of Neidorf, the government originally valued the documents at $79,449, reflecting the costs of overhead and research and development. Id. at 257-59. The defense argued that similar information could be purchased for $13. Id. at 276-77. The government eventually dropped the case against Neidorf. Id. at 281.
issue indirectly, focusing on the effect the unauthorized copying has on "the potential market for or value of the copyrighted work." Yet, in its opinion, the Court made clear that the private interest of the copyright owner in maximizing her own revenue is relevant under the fair use doctrine only as a proxy for the public's interest in additional works. As the Court explained at the outset of its opinion:

The monopoly privileges that Congress may authorize are neither unlimited nor primarily designed to provide a special private benefit. Rather, the limited grant is a means by which an important public purpose may be achieved. It is intended to motivate the creative activity of authors and inventors by the provision of a special reward....

To help ensure that copyright continues to serve this public purpose, the Court placed the burden of proof on the fair use issue squarely on the copyright owners. As the Court explained, Congress expressly "prefaced... the definition of exclusive rights in § 106 of the present Act... by the words 'subject to sections 107 through 118,'" thus limiting the exclusive rights of the copyright owner. Through this phrasing, Congress specified that certain uses are outside the scope of the copyright owner's exclusive rights, thereby ensuring that such uses could continue even without the copyright owner's consent. Rather than an exception to a presumptively private property regime, allowances for fair use are therefore inherent limitations on the rights afforded copyright owners. Moreover, the Sony Court reasoned that because a copyright owner bears the burden of proving that infringement has occurred, and because fair uses are non-infringing, the statute's language imposed on the copyright owner the burden of proving not only that unauthorized copying has occurred, but also that it constituted an unfair use. As a result, when, for

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example, the effect of the use on the potential market for or value of a copyrighted work is unclear, as even the Ninth Circuit admitted was the case for home-taping, the copyright owner has failed to establish infringement.\textsuperscript{47}

B. Sony Rewritten: Fair Use as Market Failure

Although both coherent and sensible, Justice Stevens's explanation of the Sony fair use outcome has been largely displaced in copyright law by an alternative explanation based upon the economic concept of market failure. Commonly traced to a Columbia Law Review article by Professor Wendy J. Gordon published in December 1982,\textsuperscript{48} the market failure account seeks to justify Sony's fair use outcome by arguing that the transaction costs involved in negotiating individual time-shifting licenses would inevitably exceed the potential gains in trade available. As a result, the market for time-shifting licenses would fail, justifying a finding of fair use.\textsuperscript{49}

Professor Gordon began her article with a version of the first fundamental theorem of welfare economics.\textsuperscript{50} This theorem formally states that if consumers are rational\textsuperscript{51} and markets are complete and perfectly competitive,
then the allocation of resources achieved in a competitive equilibrium through private markets is Pareto optimal.\textsuperscript{52} Within economics, this theorem can be and is proven mathematically.\textsuperscript{53} More importantly, in the real world, the general success of economies based upon private markets, and the general failure of centrally-planned economies, tends to confirm the relative efficiency of private markets. Nevertheless, both the economics literature and real world experience recognize that there are circumstances under which markets will fail to achieve an efficient outcome.\textsuperscript{54}

In her article, Professor Gordon takes this concept of market failure and uses it to formulate a three-part test for applying copyright's fair use doctrine. Under Professor Gordon's test, a use that would otherwise constitute infringement is fair if: "(1) market failure is present; (2) transfer of the use to defendant is socially desirable; and (3) an award of fair use would not cause substantial injury to the incentives of the plaintiff copyright owner."\textsuperscript{55}

Professor Gordon identifies prohibitively high transaction costs, informational asymmetry, and negative externalities as three potential causes of market failure.\textsuperscript{56} High transaction costs may lead to market failure, Professor Gordon explains, because they may prevent otherwise desirable transfers.\textsuperscript{57} In applying her test to the time-shifting at issue in \textit{Sony}, Professor Gordon suggests that, given the small potential gains in trade available from time-shifting licenses, "[h]ome users might well find transaction costs prohibitively high if they were required to bargain individually with copyright owners over

\textsuperscript{52} See ANDREU MAS-COLELL, MICHAEL D. WHINSTON & JERRY R. GREEN, MICROECONOMIC THEORY 307-08 (1995). A given allocation of resources is "Pareto optimal" if there is no way to reallocate the resources available that would make at least one person better off without making anyone else worse off. \textit{Id.}\textsuperscript{53}

\textsuperscript{53} \textit{Id.} at 326-27 (including formulae for the First and Second Fundamental Theorems of Welfare Economics), 549-50 (adding to the general equilibrium proof a "very weak assumption" that preferences are locally nonsatiated).

\textsuperscript{54} \textit{Id.} at 350-510 (exploring externalities, market power, informational asymmetries, and moral hazards as instances of potential market failure).

\textsuperscript{55} Gordon, \textit{supra} note 2, at 1614. In her introduction, Professor Gordon offered a slightly different version of her three-part test: "Where (1) defendant could not appropriately purchase the desired use through the market; (2) transferring control over the use to defendant would serve the public interest; and (3) the copyright owner's incentives would not be substantially impaired by allowing the user to proceed," courts should find a fair use. \textit{Id.} at 1601 (citations omitted).

\textsuperscript{56} See \textit{id.} at 1607-1608 (discussing the elements of "perfect competition" necessary to achieve an efficient market).

\textsuperscript{57} \textit{Id.} at 1608 ("When the transaction costs outweigh the net benefits that the parties would otherwise anticipate from a transfer, then the presence of the transaction costs may block an otherwise desirable shift in resource use." (citation omitted)).
the right to tape each desired program." Because of this potential failure of the market for time-shifting licenses, Professor Gordon concludes that a fair use finding might be justified in the Sony case.

Although Professor Gordon's analysis can reasonably be interpreted to support the Sony Court's subsequent finding of fair use, the actual effect of Professor Gordon's analysis, and the market failure account more generally, has been to limit Sony's potential reach. In the realm of private goods, where the concept of market failure first developed, private property and the resulting markets are presumptively efficient. In that context, "market failure" is a catch-all phrase for the circumstances where private markets will fail to achieve a Pareto optimal outcome, potentially justifying government intervention. However, because private markets are presumptively efficient, government intervention is justified only in cases of market failure. When we equate copyright's fair use doctrine with the economic concept of market failure, we necessarily impose on copyright law a corresponding economic framework. Thus, markets for copies of copyrighted works become the presumptively efficient markets associated with private property more generally. Fair use becomes a form of government intervention that, like government intervention into other markets, requires affirmative justification. And market failure becomes for copyright, just as it is for private property more generally, the exclusive justification for such government intervention.

Although it is not clear that Professor Gordon intended to embrace this economic framework in its entirety, she formally invokes the presumptive efficiency of markets for private goods in her analysis and recognizes that government intervention is appropriate only where the market would otherwise fail. Professor Gordon then argues that this presumptive efficiency should extend to markets for copyrighted works. As in the private goods context,
fair use therefore becomes an affirmative defense with the burden squarely on the defendant to prove that an exception to the private property baseline is justified. Professor Gordon thus seems to apply directly the private good conception of market failure to the market for copyrighted works.

By invoking the presumptive efficiency of private markets, a market failure approach to fair use necessarily replaces the Sony Court's balancing test with a threshold standard. Under the market failure approach, only if a likelihood of market failure is shown as a threshold matter should a court proceed to balance the competing public interests at stake. Furthermore, even if a defendant can show a strong likelihood of market failure and surmount this initial threshold, the presumptive efficiency of private markets implicit in the market failure framework remains. Given that private markets are presumptively efficient, additional revenues to copyright owners will necessarily lead to increased production of copyrighted works. As a result, when evaluating the effect of the use upon the potential market for or value of a copyrighted work, a loss in revenue (or potential revenue) to the copyright owner becomes important for its own sake, rather than as a proxy for the public interest in additional works. Under the market failure standard, any significant likelihood that the use will (or, in some as yet undeveloped market, may) reduce revenues to the copyright owner will bar a finding of fair use.

As the market failure interpretation of Sony has gained adherents, the
Court’s own explanation of its decision has become marginalized.\footnote{\textit{Ironically, the most prominent case to embrace \textit{Sony}'s essential reasoning, Recording Indus. Ass'n of Am. v. Diamond Multimedia Sys., Inc., 180 F.3d 1072, (9th Cir. 1999), was not a fair use case at all. Rather, the Ninth Circuit suggested that there was an analogy between \textit{Sony}'s analysis of time-shifting and the space-shifting that a portable MP3 player, the Rio, made possible. See id. at 1079 ("The Rio merely makes copies in order to render portable, or "space-shift," those files that already reside on a user's hard drive."). Because of the parallel private, non-commercial nature of time-shifting and space-shifting, the Ninth Circuit cited \textit{Sony} as support for its conclusion that the Rio did not qualify as a digital audio recording device within the meaning of the Audio Home Recording Act of 1992, 17 U.S.C. § 1002(a)(1), (2) (2000). \textit{Recording Indus. Ass'n of Am.}, 180 F.3d at 1079-1081 (concluding that since the Rio "cannot directly reproduce a digital music recording" or "reproduce a digital music recording from a transmission," the product was not subject to the regulations and prohibitions in the Audio Home Recording Act).}} For example, in \textit{Campbell}, the Court declared that "[s]ince fair use is an affirmative defense," the burden of proving fair use rests on the defendant seeking its protection.\footnote{\textit{Campbell}, 510 U.S. at 590 (holding that the burden of proof with respect to the fourth fair use factor rests on the defendants seeking to assert the fair use "defense").} In allocating the burden in this manner, Justice Souter failed even to mention \textit{Sony}'s contrary resolution of the issue.\footnote{\textit{See id. at 590 & n.20 (citing Harper & Row, Pubs., Inc. v. Nation Enters., 471 U.S. 539, 561 (1985), and H.R. REP. NO. 102-836 at 3 (1992), for the proposition that fair use is an affirmative defense). Despite the \textit{Harper & Row} Court's reference to fair use as an affirmative defense, in discussing the fourth factor, the \textit{Harper & Row} Court stated that "once a copyright holder establishes with reasonable probability the existence of a causal connection between the infringement and a loss of revenue, the burden properly shifts to the infringer to show that this damage would have occurred had there been no taking of copyrighted expression." 471 U.S. at 567 (finding that defendant's verbatim copying of approximately 300 words from an unpublished manuscript written by President Gerald Ford was not a fair use). Although not perfectly clear, because the Court curiously adds language dealing with an award of damages, switching the burden on the fourth factor to the defendant would seem to suggest that the burden of proof was initially on the plaintiff. The \textit{Harper & Row} Court also stated: "[T]o negate fair use, one need only show that if the challenged use 'should become widespread, it would adversely affect the potential market for the copyrighted work.'" Id. at 568 (quoting \textit{Sony Corp.}, 464 U.S. at 451) (emphasis only on "potential" in original). This language again suggests that the burden of proof is on the plaintiff "[t]o negate fair use."} While the Court is, of course, free to reverse itself on this issue (or to limit \textit{Sony}'s allocation of the burden of proof to cases involving non-commercial uses), one would hope that the Court, at the very least, would recognize and acknowledge that it is reversing itself.\footnote{\textit{At oral argument, Bruce S. Rogow, counsel for \textit{Campbell} and petitioner 2 Live Crew, simply conceded that his clients had the burden of proof on the fair use issue. \textit{See Campbell v. Acuff-Rose Music, Inc.}, 1993 U.S. TRANS LEXIS 113, at *17 (Nov. 9, 1993) ("[W]hen the plaintiff files a lawsuit, all the plaintiff need show is ownership of the copyright and copying, and then the burden shifts to the defendant to raise the fair use affirmative defense."). Whatever the reason for Mr. Rogow's concession, there seems little reason why} Courts of Appeals have treated \textit{Sony} with a similar
lack of respect. For example, although *Sony* found home-taping for personal consumption to be non-commercial despite its widespread nature and potential for displacing sales of authorized tapes,\(^7\) the Ninth Circuit, in *A&M Records, Inc. v. Napster, Inc.*, characterized similar copying of music files as commercial activity.\(^8\) Like Justice Souter in *Campbell*, Judge Beezer simply ignored the contrary (and here, presumably binding) result reached in *Sony*. Similarly, in *American Geophysical Union v. Texaco, Inc.*, Judge Newman labeled duplication of scientific articles for research purposes simple or "untransformed" copying.\(^9\) Mimicking the language of the Ninth Circuit's *Sony* decision, Judge Newman emphasized that "an untransformed copy is likely to be used simply for the same intrinsic purpose as the original, thereby providing limited justification for a finding of fair use."\(^10\) Although Judge Newman's consideration of the transformative—non-transformative nature of the use was not improper—*Sony* clearly acknowledged that the dichotomy was relevant\(^11\) and *Campbell* had specifically emphasized that transformative uses receive more favorable treatment under fair use\(^12\)—Judge Newman's analysis

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\(^7\) See *Sony Corp. v. Universal City Studios, Inc.*, 464 U.S. 417, 450 n.33 (1984) (rejecting the notion that consumptive use of time-shifting technology is commercial).

\(^8\) 239 F.3d 1004, 1015 (9th Cir. 2001). The district court ruled that Napster users were engaged in commercial activities because "(1) 'a host user sending a file cannot be said to engage in a personal use when distributing that file to an anonymous requester' and (2) 'Napster users get for free something they would ordinarily have to buy.'" *Id.* (citing *A&M Records, Inc. v. Napster, Inc.*, 114 F. Supp. 2d 896 (N.D. Cal. 2000)). The Ninth Circuit affirmed on a clearly erroneous standard. *Id.*


\(^10\) *Id.* at 923; see also *id.* at 923 n.9 (providing support for the notion that when copied material is put to the "same intrinsic" use as the original it should not be a fair use); accord *Universal City Studios v. Sony Corp.*, 659 F.2d 963, 970, 974 (9th Cir. 1981) ("If an alleged infringer has reproduced a copyrighted work to use it for its intrinsic purpose, fair use has not generally been applied . . . . Since the copies made by home videorecording are used for the same purpose as the original, a finding of fair use is not justified.")

\(^11\) See *Sony Corp.*, 464 U.S. at 455 n.40 (pointing out that the distinction between "productive" and "unproductive uses" is an important consideration, "but it cannot be wholly determinative").

\(^12\) See *Campbell*, 510 U.S. at 578-79 ("[T]he more transformative the new work, the less will be the significance of other factors . . . that may weigh against a finding of fair use.").
came perilously close to insinuating that only productive or transformative uses can be fair uses, an approach that the Court had expressly rejected eleven years earlier in *Sony*.

Moreover and somewhat curiously, Judge Newman labeled Texaco's copying of scientific articles for the purpose of scientific research "unproductive." Yet, the *Sony* Court identified as a "clearly productive" use an analogous case of "[a] teacher who copies to prepare lecture notes."

More generally, as copyrighted works have moved increasingly toward interactive digital distribution, the market failure approach argues for an increasingly reduced role for fair use. With interactive digital and its associated digital rights management technologies, transaction costs associated with licensing particular uses, at least in theory, can be sharply reduced. A copyright owner can build fees for particular uses into copying technologies and thereby eliminate the potential for a transaction-costs-based market failure. If the private markets that copyright creates are presumptively efficient, as invocation of a market failure argument necessarily suggests, then as market mechanisms develop (or will be led to develop by a finding of infringement), these market mechanisms should displace fair use.

C. *Choosing the Proper Fair Use Approach: The Economics of Public Goods*

In comparing these two interpretations of *Sony*, the differences are readily apparent. Writing for the Court, Justice Stevens embraced an approach that focused on balancing the competing public interests at stake in a particular factual scenario. Aside from the Court's dicta regarding commercial uses of a

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77 *See supra* notes 34, 75 (noting the *Sony* Court's rejection of "productive use" as being wholly determinative). Moreover, even the Ninth Circuit had acknowledged that copying for purposes of scientific and medical research was productive. *See Universal City Studios*, 659 F.2d at 970-71 (noting that the fair use photocopying of scientific and medical articles in *Williams & Wilkins Co. v United States*, 487 F.2d 1345 (Ct. Cl. 1973), *aff'd*, 420 U.S. 376 (1975), is "clearly distinguishable" because of the "serious damage to medical science that would result [according to the Court of Customs and Patent Appeals] if it held for the plaintiff").

78 *Am. Geophysical Union*, 60 F.3d at 922-24 (noting that the duplicate "is likely to be used simply for the same intrinsic purpose as the original").

79 *Sony Corp.*, 464 U.S. at 455 n.40 (adding that a teacher who copies material in an effort to further his or her specialized knowledge is also productive). Thus, according to the Court, a claim of fair use is advanced equally by productive activity that benefits the public and by productive activities that benefit the individual. *See id.*

80 *See, e.g.*, Tom W. Bell, *Fair Use v. Fared Use: The Impact of Automated Rights Management on Copyright's Fair Use Doctrine*, 76 N.C. L. REV. 557, 581 (1998) (describing how the fared use of commercial on-line services and other databases can provide "more and better verified, organized, and interlinked information, at less cost, than fair use does now").
the Court rejected bright-line rules, per se categories, or other presumptions as the means for resolving the fair use issue. Instead, the Court placed the burden on the copyright owner to demonstrate, in a realistic and concrete way, that the use at issue threatens the public’s interest in additional works sufficiently to outweigh the public benefits derived from the use directly. In contrast, the market failure approach relies on a presumption of market efficiency drawn from economic analysis of private goods. By starting with an assumption that private markets are efficient, the market failure approach shifts the burden to the defendant to establish the existence of market failure as a threshold matter. Only where market failure is likely to occur should a court consider intervening into the otherwise (presumptively) efficient operation of the market for copyrighted works. Moreover, even where a defendant successfully establishes a market failure, the strong preference for market outcomes and the distrust of government intervention (that fair use, but not copyright itself, somehow represents) remain, limiting the availability of the fair use “defense.” Given the strong preference for market outcomes inherent in the market failure approach, proof of neither actual harm nor probable harm should be required to defeat a claim of fair use. So long as a copyright plaintiff can show “a potential for harm,” then given the presumptive efficiency of private markets inherent in a market failure approach, fair use should be denied.

Given these differences, the Sony Court’s rationale is fundamentally incompatible with the market failure approach, and a choice must be made as to which interpretation to follow. For courts, one might have thought that following the Court’s own interpretation of its decision was required by the very nature of judicial authority. Yet, even if we were free to choose between these interpretations, the Court’s balancing approach better reflects our present economic understanding of the efficiency of markets associated with the private production of copyrighted works.

81 See Sony Corp., 464 U.S. at 449, 451 (“If the Betamax were used to make copies for a commercial or profit-making purpose, such use would be presumptively unfair . . . . Thus, although every commercial use of copyrighted material is presumptively an unfair exploitation of the monopoly privilege that belongs to the owner of the copyright, non-commercial uses are a different matter.”).

82 As the Court explained in Harper & Row:
Economists who have addressed the issue believe the fair use exception should come into play only in those situations in which the market fails or the price the copyright holder would ask is near zero . . . . As the facts here demonstrate, there is a fully functioning market that encourages the creation and dissemination of memoirs of public figures. In the economists’ view, permitting “fair use” to displace normal copyright channels disrupts the copyright market without a commensurate public benefit.

83 Sony Corp., 464 U.S. at 482 (Blackmun, J., dissenting) (acknowledging the impact infringements, seemingly minor in isolation, can have when compounded over time).
The central difficulty with the market failure account, from an economic perspective, is that it fails to account adequately for the fact that copyrighted works are public, not private, goods. Although Professor Gordon recognizes this, she argues that of the two characteristics commonly associated with public goods, nonrivalrous consumption and an inability to exclude non-payers, copyright addresses the "more important" characteristic by "providing a means for excluding nonpurchasers." Because it enables copyright owners to exclude non-payers, copyright, Professor Gordon insists, "allows a market for intellectual property to function" despite the public good nature of copyrighted works. Having rendered the property rights that copyright creates in works of authorship essentially equivalent to those associated with private goods more generally, Professor Gordon then looks to limitations on property rights generally, such as the doctrines of excuse and justification, to suggest fair use's proper scope—an approach that she repeats in a more recent article revisiting the fair use issue.

Yet, such an approach misses the point almost entirely. For private goods, there are any number of transactions that, in theory, could prove welfare enhancing. In the absence of transaction costs, welfare effects, offer-asking asymmetries, and the other market imperfections that Professor Gordon cites, one could well imagine farmers making their unused land available for temporary residents or commuters renting their automobiles to others outside of commute times. Yet, there is nothing like copyright's fair use doctrine in real or personal property law. Excuse and justification offer limited exceptions to private property's "sole and despotic dominion," but only in cases of strict necessity. Neither doctrine would, for example, allow someone to squat on a farmer's land or to borrow another's car simply because transaction costs (or some other cause of market failure) might otherwise preclude theoretically desirable transactions. Excuse and justification are far more limited with

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84 Although legal commentators are prone to defining "public" goods as goods that are characterized by: (1) nonrivalrous consumption, and (2) an inability to exclude non-payers, in truth, only the first is required. See, e.g., William H. Oakland, Theory of Public Goods, in 2 HANDBOOK OF PUBLIC ECONOMICS 486 (A.J. Auerbach & M. Feldstein eds., 1987).
85 Gordon, supra note 2, at 1612 (noting that an author retains legal control over reproduction and certain other uses of her work).
86 See id. at 1612. Professor Gordon has complained that courts and commentators have erroneously equated her position with a view that so long as transaction costs were not so high as to prevent the parties from striking a bargain in the form of a license, fair use should be denied. See Gordon II, supra note 48, at 2 n.2; see also Lydia Pallas Loren, Redefining the Market Failure Approach to Fair Use in an Era of Copyright Permission Systems, 5 J. INTEL. PROP. L. 1, 26-27 (1997). However, her argument that the ability to exclude non-payers alone is sufficient to invoke the presumptive efficiency of private markets seems to invite precisely such an interpretation.
87 See Gordon II, supra note 48.
88 2 William Blackstone, Commentaries *2.
89 Many of the causes of market failure on which Professor Gordon relies in developing
respect to private goods precisely because consumption of private goods is inherently rivalrous and therefore fundamentally incompatible with anything like copyright’s fair use doctrine. If a commuter happened to need her car unexpectedly during the day, someone else’s borrowing would not only reduce the value of the car to its owner; it would render the car owner physically unable to make her intended use. With private goods, allowing one use necessarily precludes any other.

In contrast, with copyrighted works, no such rivalry arises. One party can use her copy of a work without any affect on the physical ability of another to use his copy of the same work. This lack of physical rivalry is both the defining difference between copyrighted works and more traditional private goods, and the essential justification for the fair use doctrine. Attempting to define fair use’s proper scope without placing the nonrivalrous nature of copyrighted works at the center of the analysis is virtually certain to suggest an inherently flawed and unjustifiably restrictive approach to the fair use issue.

In terms of economic analysis, Professor Gordon’s suggestion that addressing the issue of excludability is alone sufficient to ensure an efficient market for copyrighted works is simply wrong. Even if copyright law enabled a copyright owner to exclude non-payers perfectly, the ability to exclude would not establish the efficiency of the resulting markets. So long as consumption of works of authorship remains nonrivalrous—that is, so long as “one man’s consumption does not reduce some other man’s consumption”90—the first fundamental theorem of welfare economics does not apply. As a result, even if the assumptions necessary for the theorem’s application are otherwise satisfied, a competitive equilibrium through private markets will not generally achieve a Pareto optimal allocation of copyrighted works or the resources necessary to create them.91

As economists have recognized, using a system of exclusive rights, such as copyright, to ensure an appropriate supply of a public good through private markets creates a Catch-22 situation.92 In the absence of copyright, if markets were perfectly competitive, there would be no economic incentive to produce

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91 See, e.g., Oakland, supra note 84, at 515-22.

92 Private markets will sometimes work efficiently for the creation of private clubs, despite the public good nature of the club facilities vis-à-vis club members, where the presence of congestion externalities from additional members can be used as the price for admission and the resulting fees can be used to finance construction of the facility. See, e.g., id. at 503-07.
works of authorship. When a new work was introduced, competitors would instantly copy it, price would be driven to the marginal cost of additional copies, and the work's author would receive no economic profit or rent to cover her initial authorship costs. Given the absence of an economic incentive to produce such works, too few works would be created. In the absence of copyright, perfectly competitive private markets would not therefore ensure an optimal allocation of resources. On the other hand, if we grant the author a legal right to prohibit unauthorized copying, thereby enabling her to set a price for her copies somewhat above their marginal cost, then the author will earn some economic rent and have a corresponding incentive to create the work. However, absent an ability to price discriminate perfectly, pricing above marginal cost will deny some consumers access to the work, creating a deadweight welfare loss. Because of this deadweight loss, private markets for copyrighted works will also fail to achieve a Pareto optimal allocation of resources.

Attempting to encourage private market production of works of authorship through legal restrictions on copying thus leads inevitably to market failure. Whether we narrow fair use and prohibit unauthorized copying somewhat more generally, or broaden fair use and allow somewhat more unauthorized copying, the resulting private market outcomes will not be Pareto optimal. We will either have too little new authorship or too little access to existing works (or perhaps some mixture of both). As Professor Kenneth Arrow has explained in the analogous patent context: "In a free enterprise economy, inventive activity is supported by using the invention to create property rights;
Because of the public good character of copyrighted works, the private rights that copyrights create will lead inevitably to market failure. Because market failure is inevitable, the concept of market failure cannot serve as a useful guide in determining which uses of a copyrighted work should be fair and which uses unfair, or as Justice Souter has expressed the issue, in separating "the fair use sheep from the infringing goats." Moreover, existing economic analysis suggests no reason to presume, as a market failure approach necessarily does, that private markets will necessarily, or even usually, prove efficient at ensuring adequate supply and dissemination of copyrighted works. Rather, what economic analysis seems to require is precisely the sort of balancing that Justice Stevens embraced in *Sony*. In applying the fair use doctrine, courts must balance what the public has to gain and what it has to lose from prohibiting the use at issue.

II. A BALANCING OF PUBLIC INTERESTS: THE REAL ECONOMICS OF FAIR USE

In the United States, copyright is public-minded. The primary purpose of copyright is neither to protect the natural or moral rights of authors nor to reward copyright owners. Rather, copyright's primary purpose is to ensure the public an adequate supply of copyrighted works. In Justice Douglas's words:

The copyright law, like the patent statutes, makes reward to the owner a secondary consideration. In *Fox Film Corp. v. Doyal*, 286 U.S. 123, 127, Chief Justice Hughes spoke as follows respecting the copyright monopoly granted by Congress, "The sole interest of the United States and the primary object in conferring the monopoly lie in the general benefits derived by the public from the labors of authors." It is said that reward to the author or artist serves to induce release to the public of the products of his creative genius.

So long as copyright is public-minded, then fair use must, given the public good character of copyrighted works, entail a balancing of the public benefits and losses associated with granting the copyright owner the right to prohibit particular uses.

Congress expressly embraced a balancing approach in its codification of the fair use doctrine. Although it adopted the four factors set forth in section

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100 See *Campbell*, 510 U.S. at 584-85 (drawing on a House Report and reasoning from *Sony* to determine that the character of a work is one factor to be weighed against others); *Sony Corp.*, 464 U.S. at 455 n.40 ("Congress has plainly instructed us that fair use analysis calls for a sensitive balancing of interests.")
107 as considerations that may prove relevant in particular cases, Congress did not intend the four factors to serve as a checklist or magic formula for the correct resolution of a fair use question. Moreover, as Justice Souter recognized in Campbell, courts developed the four statutory factors in the first half of the nineteenth century against a particular statutory and technological background. At that time, the printing press was essentially the only technology available for reproducing a copyrighted work, and given that technology, the question of infringement arose almost exclusively when a second, competing printer published a later work that incorporated, to a greater or lesser extent, material from an earlier copyrighted work. Such transformative, but potentially competing, reuse was the only type of infringement the technology of that time made possible; the technology that today enables private or routine copying for later use was not yet available. Given the limits of nineteenth century technology, the question of fair use arose, and courts developed the four fair use factors to address the competing public interests at stake, in one particular type of case: a second author's potentially transformative reuse of materials from an earlier work. In this particular context, the value added by the second author's work and the extent to which similarities will necessarily arise or borrowings necessarily occur given the shared subject matter, must be balanced against the need to ensure the original author a reasonable opportunity to earn a fair return on her creative investment. Out of the attempt to do so, courts developed the four fair use factors that Justice Story summarized in Folsom v. Marsh: "In short, we must, in deciding questions of this sort, look to the nature and objects of the

101 See, e.g., Campbell, 510 U.S. at 584-85.

102 Id. at 576 (citing Justice Story's 1841 opinion in Folsom v. Marsh, 9 F. Cas. 342 (C.C.D. Mass. 1841) (No. 4,901), as "distill[ing] the essence of [fair use] law and methodology" and noting that the 1976 Copyright Act codifies "Justice Story's summary" of the doctrine).

103 See Simms v. Stanton, 75 F. 6, 10-11 (C.C.N.D. Cal. 1896) (applying fair use doctrine in a case involving alleged infringement of plaintiff's physiognomy text by defendant's subsequent text on the same subject); Lawrence v. Dana, 15 F. Cas. 26, 60-61 (C.C. Mass. 1869) (No. 8,136) (applying fair use doctrine in a case involving alleged infringement of an earlier work when defendants later published an updated edition); Drury v. Ewing, 7 F. Cas. 1113, 1116 (C.C.S.D. Ohio 1862) (No. 4,095) (applying fair use in a case involving alleged infringement of plaintiff's dress-cutting chart by defendant's later dress-cutting guide); Greene v. Bishop, 10 F. Cas. 1128, 1134 (C.C. Mass. 1858) (No. 5,763) (applying fair use doctrine in a case involving alleged infringement of plaintiff's book on grammar by defendant's subsequent book on same subject); Emerson v. Davies, 8 F. Cas. 615, 625 (C.C. Mass. 1845) (No. 4,436) (applying fair use doctrine in a case involving alleged infringement of plaintiff's book on introductory arithmetic by defendant's book on same subject); Folsom v. Marsh, 9 F. Cas. 342, 348 (C.C. Mass. 1841) (No. 4,901) (applying fair use doctrine in a case involving alleged infringement of plaintiff's twelve-volume work, entitled the Writings of President Washington, by defendant's subsequent two-volume work, entitled The Life of Washington).
selections made, the quantity and value of the materials used, and the degree in
which the use may prejudice the sale, or diminish the profits, or supersede the
objects, of the original work.” 104

However, even in the transformative use context where the factors were
developed, the four factors were at best rough proxies for the balance of
competing public interests that must ultimately guide application of the fair use
doctrine. When we move to cases outside of the particular historical and
technological context of the nineteenth century, restricting the analysis to these
four factors may prove affirmatively misleading, as it did for the Ninth Circuit
in Sony. Moreover, we must take care not to substitute historical coincidence
for a reasoned and careful analysis of the competing public interests at stake in
any given case. Limiting fair use to cases involving productive or
transformative uses on the grounds that fair use in the past “has always had to
do with the use by a second author of a first author’s work,” 105 mistakes the
historical limits of technology for sound public policy. 106

As we move increasingly beyond the technological limits of the nineteenth
century and encounter uses other than the one at issue at that time, the specific
factors developed in the nineteenth century become increasingly outdated, and
a more general approach to the fair use issue becomes appropriate. 107 In an
ideal world with perfect information, courts could resolve the fair use issue by
determining precisely the social value of additional authorship resulting from

104 9 F. Cas. at 348; see also Simms, 75 F. at 9-10; Lawrence, 15 F. Cas. at 60-61; Drury,
7 F. Cas. at 1116; Greene, 10 F. Cas. at 1134; Emerson, 8 F. Cas. at 625.

105 Universal City Studios, Inc. v. Sony Corp., 659 F.2d 963, 970 (9th Cir. 1981)
(quoting LEON SELTZER, EXEMPTIONS AND FAIR USE IN COPYRIGHT 24 (1978)) (emphasis in

106 In Harper & Row, the plaintiffs advanced a similarly fallacious argument when they
insisted that statutory fair use had historically been limited to published works. 471 U.S.
539, 550-52 (1985). Of course, it had. Prior to the 1976 Act, publication was a prerequisite
for statutory copyright. See Copyright Act of 1909, 17 U.S.C. § 10 (current version at 17
U.S.C. § 410 (2000)) (“Any person entitled thereto by this title may secure copyright for his
work by publication . . . .”). As a result, prior to January 1, 1978, neither statutory
protection, nor presumably statutory fair use, applied to unpublished works. It was therefore
indefatigable that the initial application of statutory fair use to unpublished works would arise
only after the 1976 Act changed the prerequisite for the attachment of statutory copyright
protection from publication to fixation. Rather than recognize this simple fact, the Harper
& Row Court hypothesized an alternative, substantive justification for the historical limits of
fair use. See Harper & Row, Pubs., Inc., 471 U.S. at 550-51 (“Perhaps because the fair use
drivative was predicated on the author’s implied consent to ‘reasonable and customary’ use
when he released his work for public consumption, fair use traditionally was not recognized
as a defense to charges of copying from an author’s as yet unpublished works.”).

107 As Congress noted in the legislative history accompanying the 1976 Copyright Act,
the statutory codification of the four factors was not intended to freeze the doctrine in the
statute, especially during a period of rapid technological change. H.R. REP. NO. 94-1476, at
65 (1976). Instead, Congress left the courts to adapt the doctrine to particular situations on a
case-by-case basis. Id. at 66.
prohibiting a use and then comparing that value to the social value of allowing the use to continue. Although striking such an ideal balance in every case remains beyond the reach of our current legal and economic understanding, we can come considerably closer to the ideal balance by examining the competing public interests directly, rather than by continuing to rely on the four nineteenth century factors. On one side of the balance, attention should be directed toward the extent to which prohibiting a particular use will lead to more and better works of authorship by asking: (1) whether the unauthorized use would otherwise reduce the revenue associated with the copyrighted work; and (2) if so, how, if at all, that reduction would likely affect the production of copyrighted works. On the other side of the balance, we must consider what the public stands to lose if the use is prohibited. Once the competing interests have been identified, balancing those interests directly should provide a clearer picture of whether a particular use improves social welfare and hence should be considered fair, or reduces social welfare and hence should be considered infringing.

Justice Stevens's opinion in *Sony* opened the door to such a direct balancing approach. Refusing to accord controlling or otherwise undue weight to the four nineteenth century factors codified in section 107, Justice Stevens

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108 As part of this balance, we should also consider the value of the uses to which the available resources would otherwise be devoted if not devoted to the creation of additional works. As William Baxter argued:

Innovative activity should be subsidized as much and no more than is necessary to attract to that activity those inputs which, if invested in any other activity, would yield a product of lesser social value . . . [T]he question of how much subsidy is desirable could only be answered by a controlled experiment that would permit measurement of the social value of innovative output and of unsubsidized alternative outputs at each of a series of subsidy levels. Any such experiment is well beyond the reach of present techniques.


109 In *Sony*, the district court properly recognized that harm to the potential value of a copyrighted work should not be decided in the abstract, but in terms of the threat to the work's creation:

Before proceeding to a discussion of these factors, the court notes that the extent of the harm which plaintiffs ask the court to assume is probable is unclear. Harm which "imperils the existence of a publication" is more destructive of a fair use defense than is harm which would "limit profits." Plaintiffs' experts have testified that if Betamax is not enjoined, their profits will decrease, and that for some programs, they may not recoup their production costs. If this happens, plaintiffs warn, they will have to reduce the quality, or at least the production costs, of their audiovisual works. Plaintiffs have not said that they will no longer be able to produce this material.


110 Justice Stevens allocated only four sentences in his entire majority opinion to the first three statutory fair use factors:

Although not conclusive, the first factor requires that "the commercial or nonprofit character of an activity" be weighed in any fair use decision. If the Betamax were used
examined directly the competing public interests at stake. Unfortunately, further development of Justice Stevens's approach was cut short by the reinterpretation of Sony as an exceptional case of market failure. It is only fitting then that we return to the issue of time-shifting as the first step in illustrating the proper application of Justice Stevens's balancing approach and restoring the true reach of Sony's understanding of fair use.

A. The Relationship Between Unauthorized Use and Incentives: The Example of Time-Shifting

As a first step in the balancing approach, a court must determine whether the copyright owner has shown "by a preponderance of the evidence that some meaningful likelihood of [actual or] future harm [to the work's market value] exists." On this issue alone, the fairness of some uses can be readily resolved. When a use is not one the copyright owner would otherwise license or engage in, and where the use does not interfere with a market that the copyright owner would otherwise exploit, there is no public interest in allowing the copyright owner to exclude others from the use. As a result, the use should be fair per se. Cases become more difficult when the use is one whose economic value the copyright owner would like to capture. Even in these more difficult cases, we must, as the Sony Court admonished, not substitute presumptions, conclusory labels, or the invocation of private good analogies for a careful examination of the evidence presented. Too often in fair use analyses, courts and commentators leap from the fact that some consumers are obtaining unauthorized access to the conclusion that such free riding will necessarily impair the incentives for creating the work. Yet, free

to make copies for a commercial or profit-making purpose, such use would presumptively be unfair. The contrary presumption is appropriate here, however, because the District Court's findings plainly establish that time-shifting for private home use must be characterized as a non-commercial, nonprofit activity. Moreover, when one considers the nature of a televised copyrighted audiovisual work, see 17 U.S.C. § 107(2) (1982 ed.), and that time-shifting merely enables a viewer to see such a work which he had been invited to witness in its entirety free of charge, the fact that the entire work is reproduced, see § 107(3), does not have its ordinary effect of militating against a finding of fair use.


112 Id. at 451.

113 The Court came close to adopting such a position in its analysis of the fourth statutory fair use factor in Campbell v. Acuff-Rose Music, Inc., 510 U.S. 569, 591-94 (1994) (discussing how a parody will not supercede the original because it has a different market function).

114 See Sony Corp., 464 U.S. at 450 n.33 (rejecting proffered analogy to theft of private goods).

115 See, e.g., Gordon, supra note 2, at 1611 ("Because it is difficult or expensive to prevent 'free riders' from using such goods, public goods usually will be under-produced if
riding on a public good is not analogous to theft of a private good and can indeed prove Pareto optimal. Nevertheless, copyright owners continue to rely on the free rider argument hoping that courts will not adequately explore the underlying economics at issue.

For example, in the recently filed Paramount Pictures Corp. v. ReplayTV, Inc., the plaintiffs sued ReplayTV alleging contributory and vicarious copyright infringement based upon ReplayTV’s marketing of the ReplayTV 4000. Like the Betamax before it, the ReplayTV allows home taping of television programs. Although Sony would seem to control, the plaintiffs attempt to distinguish Sony on the grounds that the ReplayTV’s “AutoSkip” feature “automatically eliminates commercials during playback.” In Sony, the district court specifically found that only 25% of Betamax consumers fast-forwarded through commercials. Because of the ReplayTV’s AutoSkip feature, the plaintiffs allege that no ReplayTV consumer will watch commercials during playback. Advertisers, the complaint continues, will not pay for advertisements that consumers do not watch. The ReplayTV 4000 therefore poses a far more serious threat to a copyrighted television program’s advertising revenues than did the Betamax, or so the plaintiffs contend.

Because of the factual finding that most Betamax time-shifters were left to the private market.”)

As I have shown elsewhere, if we follow the usual assumptions that a copyright owner faces a downward sloping, linear demand curve and constant marginal costs, then to optimize her profits, the copyright owner will set a price such that,

for every consumer who willingly pays the copyright owner’s price, there is another who would have paid the work’s competitive price, but who is unwilling to pay the supra-competitive price the copyright owner is charging. Because these consumers are unwilling to pay the copyright owner’s [supra-competitive] price in any event, the copyright owner would see no reduction in her revenue, ceteris paribus, even if every one of them obtained an unauthorized copy of the work through private copying.


See id. ¶ 10-13. The plaintiffs also distinguish Sony on the grounds that the ReplayTV 4000 allows sharing of recorded programs over the Internet with other ReplayTV 4000 consumers. Id. ¶ 14.

Sony Corp., 464 U.S. at 452 n.36.

Paramount Complaint, supra note 117, ¶¶ 7, 11, 12.

Id. ¶ 7 (“Advertisers will not pay to have their advertisements placed within television programming delivered to viewers when the advertisements will be invisible to those viewers.”).

Id. (“[T]he AutoSkip feature would fundamentally and inevitably erode the means by which copyright owners are paid for their works and hence the value of the programming they create.”).
watching the embedded commercials, *Sony* is technically distinguishable. Moreover, as the *Sony* Court itself recognized in its analysis of the fourth fair use factor, television programs are, in truth, not offered to viewers "without charge." Rather, television broadcasters "charge" viewers for watching copyrighted television programs by embedding commercials in their broadcasts. Time-shifting without watching the commercials thus represents a paradigm case of free riding. Time-shifters value the television programs they tape at more than their pro rata share of the programs' costs, and so are willing to pay, but are able to avoid doing so because of the difficulties of collecting the payment. Yet if we refuse to allow the free rider label to control the analysis and examine the underlying economics instead, as *Sony* instructs, we find that such time-shifting is likely to remain Pareto optimal for the types of time-shifting common today. Through a more careful analysis, we can also better define the circumstances where this type of free riding will begin to reduce copyrighted television programs' associated advertising revenues.

In order to understand the economic consequences of time-shifting, we must first understand the economics of advertising. At the simplest level, advertisers pay to have their commercials included in television programs because they believe that their commercials will influence consumer-purchasing decisions and increase either the sales of, or the price that can be charged for, the advertised product or service. Although the precise manner in which advertising influences consumer spending is not yet fully understood, economists have identified three general mechanisms through which advertising can influence consumer spending. First, advertising can provide relevant information on product qualities, characteristics or prices—information that was previously unknown to the consumer. Consumers can use this information to make more rational decisions regarding which goods and services to purchase.

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123 *Sony Corp.*, 464 U.S. at 449-50, 454. Like the television industry, the *Sony* Court was using "free" or "without charge" to distinguish broadcast television from pay-per-view or subscription services. But cf. Paramount Complaint, *supra* note 117, ¶ 7 ("Defendants' unlawful scheme attacks the fundamental economic underpinnings of free television and basic nonbroadcast services and, hence, the means by which plaintiffs' copyrighted works are paid for.") (emphasis added)).


Second, advertising can serve as a signal of product or service quality. As a signal, the very fact that a given company advertises is itself suggestive of the likely quality of the company's associated product or service.\textsuperscript{126} At least for repeat purchase goods, advertising will usually prove more profitable for a firm with a high quality product than for a firm with a low quality product. Consider a market with two firms, one with a high quality product and one with a low quality product. If consumers are initially unaware of the differences in product quality between the goods, and both firms advertise at similar levels, the advertisements are likely to attract similar numbers of initial purchases. However, after purchasing the goods, consumers will learn directly the quality of the good purchased. If a consumer purchased a good that turned out to be low quality or otherwise unsatisfactory, the consumer is unlikely to purchase the same good again. By contrast, the consumer who purchased a good that turned out to be high quality or otherwise a good value for the price will likely purchase the same good again. Therefore, there is a somewhat greater likelihood of repeat purchasers for high quality goods, and advertising should prove more profitable for the firm with the high quality good, ceteris paribus. To the extent advertising is more profitable for the high quality firm, we should expect the high quality firm to advertise more. Consumers can therefore rely on the extent of a company's advertising as a signal of the advertised product's quality, at least under certain assumptions.\textsuperscript{127}

Third, advertising can seek to influence consumer purchasing by shaping

\textsuperscript{126} See Phillip Nelson, Advertising as Information, 82 J. Pol. Econ. 729, 732 (1974). Nelson argued that:

The miniscule amount of direct information from advertising for experience qualities gives the consumer an incentive to extract any conceivable indirect information that would help. Such indirect information is available from advertising. The consumer can learn that the brand advertises . . . . Their total informational role . . . is simply contained in their existence. The consumer believes that the more a brand advertises, the more likely it is to be a better buy.

\textit{Id.} Compare Thomas, Shane & Weigelt, supra note 124, at 425-26 (finding empirical support for signaling function) with Caves & Greene, supra note 124, at 50 (finding no empirical support for signaling function).

\textsuperscript{127} To the extent a firm earns a higher rent on each unit sold, advertising would prove more profitable for the firm even if it generates fewer repeat purchasers. Thus, advertising for a drug still under patent protection may prove more profitable than advertising for a drug no longer under patent protection, even if the still-patented drug is less effective. In such a case, the fact of advertising may be a misleading signal of product quality. See Daniel Q. Haney, Doctors Ignoring Older, Better Heart Drugs, Studies Say, DENVER POST, Mar. 21, 1998, at A6 (noting that extensive advertising and promotional expenditures on newer heart drugs still protected by patent led to increased usage of such drugs even though studies had shown that they were less effective than older, no-longer patented drugs); Linda Villarosa, Ads and Doctors' Drug Choices: A Link?, N.Y. TIMES, Apr. 20, 1999, at F8 (noting that researchers believe that marketing efforts may have led doctors to switch to newer, costlier drugs from older, established medications).
consumer's preferences towards a particular brand or product. This type of advertising may play on a consumer's insecurities, seeking to assure the consumer that he will be more attractive or popular, or simply happier should he begin consuming a particular good or service. To be effective, this type of advertisement may first need to heighten a consumer's insecurity about some aspect of himself by holding up a standard of success or happiness or beauty that is nearly impossible to achieve in ordinary life. After heightening the consumer's insecurities and disturbing his satisfaction, the advertisement can offer the consumer a product or service that, if purchased, will restore the consumer's satisfaction. Alternatively, an advertiser might consciously seek to create a certain image for a brand or product and attempt to tie that marketing image to some aspect of a consumer's preexisting self-image. Although one might be skeptical of the efficacy of these advertising approaches, image-oriented advertising represents the dominant form of television advertising today.

When we consider the economics of advertising as it relates to time-shifting, one of the key issues is the relationship between increased exposure to advertisements and increased consumer spending on advertised products. With live television viewing, the relationship between increased television viewing and increased exposure to advertisements is reasonably linear. Today, there is an essentially constant ratio of ten minutes of advertisements and 50 minutes of program content in each hour of television programming. Aside from premium subscription or pay-per-view services, and the occasional trip to the refrigerator, each hour spent watching television exposes an individual to ten minutes of advertisements. Nevertheless, although the relationship between time spent watching television and advertising exposure is reasonably linear, the relationship between advertising exposure and consumer spending on advertised products is probably not, for three reasons.

128 Professor Ralph S. Brown argued that such preference-shaping is wasteful and anticompetitive because it creates artificial distinctions between otherwise identical products. Ralph S. Brown, Advertising and the Public Interest: Legal Protection of Trade Symbols, 57 YALE L.J. 1165, 1167-83 (1948); see also William M. Landes & Richard A. Posner, Trademark Law: An Economic Perspective, 30 J.L. & ECON. 265, 274-75 (1987) (insisting that the correct economic model of trademarks is one where "trademarks lower search costs and foster quality control rather than create social waste and consumer deception"). More recent economic scholarship has suggested that there is nothing inherently illegitimate about preference-shaping. See Phillip Nelson, The Economic Consequences of Advertising, 48 J. BUS. 213, 213 (1975) ("We economists have no theory of taste changes, so this approach leads to no behavioral predictions.").

129 See Glynn S. Lunney, Jr., Trademark Monopolies, 48 EMORY L.J. 367, 420 n.212 (1999) (likening advertising that first heightens insecurity to blackmail).

First, although repeated exposure is probably important to an advertisement's effectiveness, at some point, the effectiveness of an advertisement at influencing consumer spending probably begins to diminish. To some extent, the ability of an advertisement to maintain its effectiveness over repeat exposures may depend upon the type of advertising at issue. If the advertisement aims to provide the consumer with information that the consumer did not otherwise have, a consumer's first exposure to the advertisement is likely to be the most effective at influencing the consumer's purchasing decisions. A second, third or fourth exposure to the same informational advertisement may also prove influential, reminding or reinforcing the information previously conveyed. At some point, however, additional exposures will merely repeat information the consumer already has, and, at that point, the marginal effectiveness of additional exposures is likely to diminish sharply. For the signaling and preference shaping types of advertisement, effectiveness probably also diminishes over repeated exposures, although the logical argument for diminishing returns for these types of advertisements is less clear-cut. Nevertheless, although some repetition is again likely to strengthen or reinforce an advertisement's signaling or preference shaping function, the fact remains that, in the end, the total quantity of a particular good that a consumer will purchase has reasonably clear limits. In any given day, there is only so much deodorant a consumer will use, only so much soda a consumer will drink, and probably only one truck that the consumer will drive to work. It may take a certain level of exposure to a particular brand's message before a consumer will adopt that brand as her own. However, once she has, further exposure may reinforce her commitment to the brand, but it is unlikely to increase her purchases of the associated product commensurately.\footnote{Otherwise, if the relationship between the number of exposures to an advertisement and the consumer's spending on the advertised product remained linear, rather than decreasing, then if a company found it profitable to advertise at all, the company would find it profitable to advertise continuously. Yet companies do not, suggesting, as one would expect, diminishing marginal returns from advertising investments.}

Second, in addition to a decreasing marginal influence on consumer spending, additional exposure to advertisements entails an opportunity cost. Time spent in front of the television watching commercials cannot be put to other uses, including such productive activities as work or raising a family. To take an extreme example, if a person spends all day watching television, the person may be exposed to any number of advertisements and may wish to purchase any number of the products so advertised. However, having spent all day watching television, the person will have forgone the income she could otherwise have used that time to earn and will therefore have less to spend on the advertised products. This opportunity cost may vary depending on whether a consumer is salaried or earns (or could earn) an hourly wage. For those consumers who could have worked at an hourly wage during the time spent
watching television, watching television reduces the consumer's income available for purchasing advertised goods at a constant rate equal to the available wage for each hour spent watching television. For those consumers who hold a salaried position in return for a 40-hour week, there may be little or no reduction in the income available for purchasing advertised goods so long as the consumer keeps her television watching within reasonable bounds. Only if the consumer allows television watching to interfere with his job (for example, by repeatedly calling in sick to stay home and watch soap operas), will television watching reduce the salaried consumer's disposable income. Rather than face a linear opportunity cost, a salaried consumer may face little or no opportunity cost for her initial television watching, but may then face a very substantial opportunity cost should she expand her television watching too much.

Third, an individual's expenditures on advertised goods and services ultimately face a cap as they approach the limit of the individual's available resources. Even with the capacity to finance additional purchases through borrowing, consumers will, sooner or later, face a limit on how much they can spend on advertised goods, no matter how persuasive the advertising. As they approach that limit, watching additional commercials will not increase their total spending on advertised products because they cannot afford additional purchases.

When we combine advertising's diminishing marginal influence, its increasing opportunity cost, and some ultimate limit on consumer spending, we can obtain some sense for the ability of advertising to influence an average consumer's spending as a function of a consumer's daily television viewing, as shown in Figure 1.

Figure 1
Total Expenditure on Advertised Products as a Function of Television Viewing
As Figure 1 suggests, television advertising is likely to be most effective in persuading the consumer to purchase the advertised products or services at low levels of daily television viewing. As the consumer spends more time each day watching television, some of the advertisements will conflict and cancel out. Others will be repeated and marginal returns will diminish. Increased time spent watching television and its attendant commercials also means an increase in the consumer’s opportunity cost, as time spent watching television cannot be spent on gainful employment. Moreover, as spending on advertised products increases, it will eventually approach the consumer’s ultimate budget constraint, limiting the potential for additional purchases. As a result, as a consumer’s daily television viewing increases, the marginal expenditures on advertised goods will decrease. Eventually, the increasing opportunity costs of watching additional television will exceed the marginal influence of the additional commercials, and, at that point, additional time spent watching television will actually begin to reduce a consumer’s spending on the advertised products.

Given this relationship between time spent watching television and expenditures on advertised products, a consumer’s total spending on advertised products may remain constant even if she manages to avoid some commercials through time-shifting. So long as the consumer continues to watch enough live television to maintain her advertising exposure at a sufficient level, the consumer will continue to spend the same amount on advertised goods. For example, a consumer who was initially watching sufficient television to be at point A in Figure 1, might substitute considerable time-shifting for live viewing without affecting her spending on advertised products, as the shift from A to A’ in Figure 1 depicts. Even a consumer who was initially watching relatively little television might substitute some time-shifting for live viewing without reducing her spending on advertised products, as the shift from B to B’ reflects. Given that the average U.S. working man between the ages of 25 and 64 spent 12.7 hours per week watching television in 1981, some limited substitution of time-shifting for live viewing is unlikely to reduce significantly a consumer’s total spending on advertised products.

One might argue, however, as the Paramount Pictures Corp. plaintiffs have alleged, that even if the consumer’s total spending on advertising remains constant, no part of a ReplayTV consumer’s spending will go towards products advertised on those programs that she time-shifts because she will use the AutoSkip feature to avoid the embedded commercials on those programs.


133 Cf. Paramount Complaint, supra note 117, ¶¶ 7, 10-12 (arguing that advertisers will not pay to have their ads delivered to viewers who are not watching).
Whatever the consumer may spend on advertised products would go elsewhere, presumably towards the products advertised on those programs that the ReplayTV consumer continues to watch live. As a result, whether she is counted in the broadcast audience of the program that she time-shifts or not, the program's advertisers will not earn any sales revenue from the time-shifting consumer and should, if the advertising market is reasonably efficient, refuse to pay the broadcaster for the time-shifting consumer.

Time-shifting thus appears to represent a paradigm case of free riding. If free riding were *per se* inefficient and economically equivalent to theft, such free riding would threaten directly the incentives necessary to ensure the program's creation, and under the market failure approach, the government should intervene to restore the appropriate level of incentives. Such intervention might take the form of establishing a regime of exclusive rights that would effectively require individually-negotiated licenses for time-shifting. More realistically, if the transaction costs associated with individual licenses are likely to prove prohibitively expensive, then the government should impose a system of levies on copying equipment and tapes to compensate copyright owners for whatever revenue they may lose as the result of time-shifting.

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135 As the Court noted in Sony, evidence before the district court suggested that the ability to measure audiences for particular television shows was not precise. See id. at 452 ("'Most of plaintiffs' predictions of harm hinge on speculation about patterns and ratings, a measurement system which Sydney Sheinberg, MCA's president, calls a "black art" because of the significant level of imprecision involved in the calculations.'" (quoting Universal City Studios v. Sony Corp., 480 F. Supp. 429, 469 (C.D. Cal. 1979))).

136 See Paramount Complaint, supra note 117, ¶ 7, 13

Yet, this private good analogy, that using the ReplayTV to obtain access to programs without paying the customary price is just like theft of a private good, and its associated solution are simply wrong, as a more careful analysis will demonstrate. Consider two cases: (1) proportionate time-shifting; and (2) disproportionate time-shifting. With proportionate time-shifting, each television program experiences a level of time-shifting roughly proportional to its live audience. With disproportionate time-shifting, consumers time-shift a particular program somewhat more than other programs of comparable popularity, either because of the program's inconvenient scheduling, the particular importance of not missing an episode, or for some other reason.

To explore how these two types of time-shifting may affect a program's advertising revenue, we will begin with a base scenario and then examine how the two types of time-shifting may influence the allocation of advertising revenues between available programming. Throughout the analysis, we will assume that: (i) there are four programs available for viewing, (ii) the programs are equally popular, and (iii) time-shifters do not watch, and hence are not influenced, by the advertisements on the programs they time-shift. We will also assume, consistent with Figure 1, that time-shifting represents a sufficiently small fraction of each consumer's television viewership so that total consumer spending on advertised products remains constant.

In the base scenario, time-shifting technology is not yet available. Given our assumption of equal popularity, each program enjoys 25% of total

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138 I have not considered in this analysis the possible increase in viewership that may arise for later episodes of a program or television series because time-shifting enables consumers to avoid missing episodes.

139 Changes in the levels of overall viewership will not alter this method of analysis so long as the ratio of time shifters to live viewers remains constant for each program.
television viewership. If the advertising on each program is equally effective, each program influences 25% of total consumer spending on the advertised products. Each program should therefore receive 25% of the advertising revenues, as summarized in Table 1.

<table>
<thead>
<tr>
<th>Program</th>
<th>% of Audience</th>
<th>% of Ad Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>25</td>
<td>25</td>
</tr>
<tr>
<td>B</td>
<td>25</td>
<td>25</td>
</tr>
<tr>
<td>C</td>
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<td>D</td>
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</table>

We can then introduce time-shifting technology and consider, for our first case, how proportionate time-shifting would influence the allocation of advertising revenue between the four programs. With proportionate time-shifting, each program experiences time-shifting proportionate to its popularity. Given our assumption of equal popularity, each program captures 25% of the live audience, 25% of the time-shifters, and 25% of the total television viewership, as reflected in Table 2.

<table>
<thead>
<tr>
<th>Program</th>
<th>% of Live Audience</th>
<th>% of Time-Shifters</th>
<th>% of Total Audience</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>25</td>
<td>25</td>
<td>25</td>
</tr>
<tr>
<td>B</td>
<td>25</td>
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<td>C</td>
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<td>D</td>
<td>25</td>
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</tbody>
</table>

Because each program's share of live viewership is the same as the program's share of total viewership, proportionate time-shifting does not alter example, assume that Program A has four live viewers and four time-shifters, Program B has three live viewers and three time-shifters, Program C has two live viewers and two time-shifters, and Program D has one live viewer and one time-shifter. Based upon live viewership shares, advertisements on Program A will influence 40% of consumer spending on advertised products, while advertisements on Programs B, C, and D will influence 30%, 20%, and 10%, respectively. If we could somehow force time-shifters to watch the commercials as well, and as a result, a program's advertisements influenced both live audiences and time-shifters, then based upon total viewership shares, advertisements on Programs A, B, C, and D would influence the same 40%, 30%, 20%, and 10% of consumer spending on advertised products as before.
or skew the incentives available for the production of any of the programs. Moreover, given our assumption that time-shifting remains a sufficiently small part of television viewership so that total expenditures on advertised products remain roughly constant, each program receives the same advertising revenue that it would have received in the absence of time-shifting.\footnote{Given that each program receives the same advertising revenue it would receive if each consumer watched the program live, it is difficult to see why copyright should enable the program to receive an additional royalty for the time-shifting convenience that the Betamax made possible. But see \textit{Sony Corp.}, 464 U.S. at 485 (Blackmun, J., dissenting) (arguing that copyright owners should receive “some kind of royalty” from consumers who “are willing to pay for the privilege of watching copyrighted work at their convenience”). From an economic perspective, a videocassette recorder is a complement to television programming, just as television itself is, and there is no more reason to impose a levy system on a videocassette recorder than there is on televisions, or portable radios, or the host of other products that ensure convenient access to copyrighted works. If television networks believe that time-shifting threatens advertising-based revenues, each can decide to switch to some mixture of advertising and subscription fees to raise the requisite revenue. Of course, if the networks cannot persuade Congress or a court to enact a uniform levy, then each network must decide whether to charge a subscription fee independently, subject to the fully appropriate rigors of competition from the other networks.}

Although the time-shifting is certainly a form of free riding, and despite the almost knee-jerk response that free riding seems to elicit, proportionate time-shifting affects neither the total incentives available for the creation of television programs, nor the allocation of those incentives among the programs. In our example, each consumer contributes to the cost of producing three of the four programs and then free rides on the cost of producing the fourth program. The cost of this fourth program is covered by other consumers, who free ride in turn on the cost of producing the first, second, or third programs, to which the first consumer contributed. The free riding is thus reciprocal; each consumer contributes to the cost of some works and then free rides on the costs carried by others.\footnote{Landes and Posner have identified a production-side form of free riding as similarly reciprocal. They argue that because each author relies to some extent on the work of authors who have gone before her, it is fair and efficient for that author to allow the same leeway to subsequent authors. \textit{See} William M. Landes \& Richard A. Posner, \textit{An Economic Analysis of Copyright}, 18 J. Legal Stud. 325, 332 (1989).} Where the assumptions set forth in the example apply, reciprocal free riding is Pareto optimal. Without reducing the level or changing the direction of incentives available to create works of authorship, reciprocal free riding increases access to and distribution of existing works.

In the real world, however, we cannot be sure that time-shifting will be proportionate to a program’s popularity. We must therefore consider how disproportionate time-shifting may affect the allocation of advertising revenues between the four programs. Table 3 presents one such case, where consumers prefer to time-shift Program A disproportionately.
Table 3
Allocation of Viewership: Disproportionate Time-Shifting

<table>
<thead>
<tr>
<th>Program</th>
<th>% of Live Audience</th>
<th>% of Time-Shifters</th>
<th>% of Total Audience</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>10</td>
<td>40</td>
<td>25</td>
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<td>B</td>
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<td>25</td>
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<tr>
<td>D</td>
<td>40</td>
<td>10</td>
<td>25</td>
</tr>
</tbody>
</table>

In this case, time-shifting may alter the distribution of the available advertising revenues between the four programs. If consumer spending is influenced only by advertisements that the consumer actually watches, and consumers do not watch advertisements on programs they time-shift, then we should expect Program A to receive only 10% of the available advertising revenues, far less than it would have received had consumers watched each program live.

With disproportionate time-shifting, there is again free riding, but this time, it appears that, even if total spending on advertised goods remains constant, disproportionate time-shifting will reduce substantially the incentives for those programs that consumers are particularly likely to time-shift. Although, in terms of total viewership, the first program was just as popular as the fourth, it received only one-fourth of the fourth program’s advertising revenue because it was the program that consumers were particularly likely to time-shift. Yet, a levy on recording machines and blank storage media is not the answer. Instead, we can remove the distortion that disproportionate time-shifting introduced and ensure that each program receives the appropriate advertising revenue by taxing the fourth program the excess advertising revenue it received (defined as the difference between the 40% of advertising revenue that the fourth program actually received less the 25% that it would have received but for the disproportionate time-shifting), and redistributing this excess advertising revenue to the first program. Such a redistribution would make up the shortfall in advertising revenue that the first program would otherwise face as a result of the disproportionate time-shifting and would ensure that each program received the same advertising revenue that it would have received had each consumer watched every program live. Although such a tax and redistribution scheme may initially seem politically and legally unlikely, the mechanism to implement such a scheme is already in place and operating. No government program, statutory enactment, or judicial action is therefore necessary. So long as the first and fourth show are commonly owned (or the advertising revenues from these two shows belong to a single entity), that entity—the network—has already received the full advertising revenue to which it is entitled for the two programs and needs only apportion that revenue between the two programs appropriately. While disproportionate time-shifting
may therefore alter the incentives available to particular works, existing market structures should correct any resulting imbalance in program revenues, suggesting that government intervention is neither necessary nor desirable.

Although the factual evidence presented in Sony rendered a detailed understanding of the economic consequences of time-shifting for advertising revenue unnecessary, a more careful reexamination of the economic consequences of time-shifting demonstrates that Sony’s conclusion that time-shifting is unlikely to reduce either the actual or potential market for television programs is both correct and robust. Although time-shifting may constitute free riding, in that it enables consumers to avoid the price—exposure to commercials—that broadcasters seek to charge for access to their programs, time-shifting represents a desirable, indeed Pareto optimal, form of free riding. So long as time-shifting remains a sufficiently small part of a consumer’s total television viewing that the consumer’s total spending on advertised products remains roughly constant,142 time-shifting increases access to television programs without reducing the associated incentives for the production of copyrighted television programs.143

As this example suggests, unauthorized copying does not have the same effect as theft. The mere fact that some consumers are obtaining access without paying the copyright owner’s customary price is not sufficient to establish that the use at issue will necessarily impair the market for or the

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142 Moreover, in evaluating whether time-shifting will become so predominant that total consumer spending on advertised products declines, we should not simply presume that time-shifting will, if permitted, become “widespread.” The Court has directed courts evaluating the fourth fair use factor to consider “not only the extent of the market harm caused by the particular actions of the alleged infringer, but also ‘whether unrestricted and widespread conduct of the sort engaged in by the defendant... would result in a substantially adverse impact on the market’ for the original.” Campbell v. Acuff-Rose Music, Inc., 510 U.S. 569, 590 (1994) (quoting Melville B. Nimmer & David Nimmer, Nimmer On Copyright § 13.05[A][4], at 13-102.61 (rev. ed. 1994)). Such an analysis implicitly assumes that if the use is permitted then it will necessarily become widespread. While such a presumption may prove appropriate for the commercial infringement at issue in Campbell, it is far less appropriate for private copying. In addition to other reasons, see infra notes 179-183 and accompanying text, consumers may decide to watch a program live because of the satisfaction derived from sharing the viewing experience the next day over the water cooler. So long as most people do not time-shift, the interpersonal experience of viewing a program live, see Lunney, supra note 116, at 882-86, provides a strong incentive not to time-shift, even if time-shifting would reduce, in some sense, the “cost” of watching television.

143 Only if time-shifting becomes so large a fraction of the time consumers spend watching television that it begins to reduce total advertising revenues does time-shifting pose some threat to the incentives for producing copyrighted television programs, potentially justifying the adoption of a levy system. Even then, this analysis suggests that revenues from such a levy should not be distributed based on either total audience or live audience alone. Rather, a distribution mechanism must also consider the relative levels of time-shifting that different programs experience.
potential value of a copyrighted work. If a copyright owner cannot present more concrete evidence of "a demonstrable effect upon the potential market for, or the value of, the copyrighted work,"\textsuperscript{144} then the use should be declared fair and noninfringing. As the \textit{Sony} Court recognized, "[t]he prohibition of such non-commercial uses would merely inhibit access to ideas without any countervailing benefit."\textsuperscript{145} On the other hand, if a copyright owner adequately demonstrates that the use will impair the market for or value of the copyrighted work, then she has established her own private interest in having the use declared unfair. To demonstrate that prohibiting the use will serve the public interest, the copyright owner must go further and establish, through relevant evidence, the relationship between her increased revenue and increased production of copyrighted works.

B. The Relationship Between Increased Revenue and More or Better Works: The Examples of Television Programming and Scientific Research

If a court finds a probable reduction in the potential market for or value of the copyrighted work, then the second step in the balancing approach requires a determination of the likely relationship, if any, between that probable reduction and the production of copyrighted works. In the nineteenth century, courts did not require a copyright owner to prove the relationship between her private interest in additional revenue and the public interest in additional works of authorship, implicitly assuming that revenue to the copyright owner was an accurate and reasonably direct proxy for output of copyrighted works. In the nineteenth century, this assumption may not have been unreasonable given the narrow scope of copyright at the time. Until Congress extended copyright to include the translation right in 1870,\textsuperscript{146} the various copyright statutes in force usually defined the copyright in terms of "the sole right and liberty of printing, reprinting, publishing, and vending such... book,"\textsuperscript{147} and courts usually interpreted the copyright statute as giving the author "the exclusive right of multiplying copies of what he has written or printed."\textsuperscript{148} As applied, nineteenth century copyright applied almost exclusively to the copying competitor who, by avoiding the marginal cost of authoring the work, could offer a lower priced copy of the original. By protecting a copyright owner against the copying competitor, nineteenth century copyright sought to ensure

\textsuperscript{144} \textit{Sony Corp.}, 464 U.S. at 450.

\textsuperscript{145} \textit{Id.} at 450-51.


\textsuperscript{147} Act of May 31, 1790, ch. 15, § 1, 1 Stat. 124 (repealed 1802).

\textsuperscript{148} \textit{Perris v. Hexamer}, 99 U.S. 674, 675-76 (1878) (holding that defendant had not infringed the author's copyright on maps of New York City when defendant "used to some extent their system of arbitrary signs and their key" in a map of Philadelphia); \textit{accord Greene v. Bishop}, 10 F. Cas. 1128, 1133-34 (D. Mass. 1858) (No. 5,762).
an author a fair opportunity to recover the costs of her work. \(^{149}\) Because of this cost-based focus, copyright tended to enable authors to recover in the market something close to their persuasion costs, defined as the sum necessary to persuade an author to undertake a given work’s creation. As a result, the assumption that any substantial change in a copyright owner’s expected revenues might affect her output was not completely unrealistic.

Over the course of the twentieth century, however, copyright has moved from a cost-based system of protection towards a value-based system of protection, particularly for entertaining works. Rather than limit protection to the case of the copying competitor, copyright has sought increasingly to protect the copyright owner against the loss of any opportunity to license the work and to ensure thereby that the copyright owner has an opportunity to capture fully the market value associated with her work. \(^{150}\) To illustrate the difference between cost- and value-based approaches, consider the idealized supply and demand curves for the production of copyrighted works\(^{151}\) presented in Figure 2:

\(^{149}\) As reflected in the four fair use factors, the key issues under a cost-based approach to copyright protection are whether the later author has borrowed so much, and contributed so little of her own authorship, that she can offer her work at a significantly lower price than the original author while still covering the costs of creating her work, and the later author has used what she has taken to create a substitute for the original. This is precisely the approach reflected in nineteenth century copyright cases. Compare Simms v. Stanton, 75 F. 6, 13-14 (C.C.N.D. Cal. 1896) (finding that defendant’s physiognomy text did not infringe the plaintiff’s text because, although the two works were competing, defendant had contributed enough of her own material and taken sufficiently little from the plaintiff that defendant did not have an undue cost advantage in creating her work and therefore could not significantly underprice plaintiff’s work in the market), Perris, 99 U.S. at 675-76 (finding that the defendant’s map of Philadelphia, although it duplicated the symbols and map-making approach of the plaintiff’s copyrighted map of New York, did not infringe because the map of Philadelphia would not substitute for the plaintiff’s map and hence was not a copy), and Stowe v. Thomas, 23 F. Cas. 201, 206 (C.C.E.D. Pa. 1853) (No. 13,513) (finding that the defendant’s German translation of the plaintiff’s copyrighted novel did not infringe because it would not substitute for the original and hence was not a copy), superseded by statute, Act of July 8, 1870, ch. 230, § 86, 16 Stat. 198 (granting author exclusive right to translate her work), with Folsom v. Marsh, 9 F. Cas. 342, 347-49 (C.C.D. Mass. 1841) (No. 4,901) (finding that the defendant’s subsequent two-volume work, entitled The Life of Washington, infringed the plaintiff’s earlier twelve-volume work, entitled The Writings of President Washington, because consumers would consider the defendant’s work a substitute for plaintiff’s and because defendant copied so much and added so little new material).

\(^{150}\) See, e.g., Benny v. Loew’s, Inc., 239 F.2d 532, 534 (9th Cir. 1956) (defining copyright as “the exclusive right to any lawful use of their property, whereby they may get a profit out of it”), aff’d without op. by an equally divided Court, 356 U.S. 43 (1958).

\(^{151}\) I have assumed for the sake of expositional convenience that we can treat the production of copyrighted works as a coherent industry, but that is not essential to the analysis.
Under a cost-based system of protection, the goal is to provide an author with the minimum rent required to ensure a work's creation. The rents available under a cost-based system of copyright protection therefore follow closely the supply curve, \( SS' \). In contrast, a value-based system seeks to ensure that an author receives the full "value" associated with her work, defined as the sum of consumers' reservation prices for access. The rents available under a value-based system copyright system therefore follow more closely the demand curve, \( DD' \). The triangle \( SQD \) represents the incentives that would be available under a value-based system of protection in excess of the work's persuasion cost. It therefore defines precisely the excess incentives available under a value-based system of protection.\(^{152}\)

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\(^{152}\) The rents available would exactly equal the demand curve if copyright and the associated technology available enabled each copyright owner to engage in perfect or first-degree price discrimination.

\(^{153}\) Although the excess incentives are simply a redistribution of income from consumers to copyright owners, and hence irrelevant to the efficiency of copyright, there are, at least, three reasons why excess incentives are problematic. First, to the extent that the preamble of the Patent and Copyright Clause, permitting Congress "to promote the Progress of Science and Useful Arts," U.S. Const. art. I, § 8, cl. 8, is a substantive limitation on congressional power, and not merely precatory, this limitation may trump the usual efficiency analysis of redistributions and require some affirmative showing of public benefit to justify a copyright regime that systematically provides excess incentives. But see Eldred v. Reno, 239 F.3d 372, 377-78 (D.C. Cir. 2001) (holding that preamble to Patent and Copyright Clause is merely precatory), cert. granted sub nom., Eldred v. Ashcroft, 122 S. Ct. 1170 (2002). Second, following the lead of Justice Breyer, one might also argue on fairness grounds that there is no clear reason why copyright owners' claims to a reward in excess of their persuasion cost should prove more compelling than others' claims for a
Because of copyright's shift towards a value-based system and associated expansion in protection, a copyright owner's private interest in maximizing her revenue is no longer a reasonable proxy for the public's interest in additional works. Copyright today ensures, for all but the exactly marginal work, revenue in excess, and sometimes radically in excess, of the work's persuasion cost. The availability of these excess incentives for almost all copyrighted works has sharply attenuated the relationship between a reduction in the copyright owner's revenue and the production of copyrighted works. By definition, when excess revenues are present, the copyright owner could experience some reduction in the market for or value of her work, yet still receive sufficient incentive to ensure her work's production.

In balancing the competing public interests at stake in a fair use determination, courts today should, because of copyright's shift to a value-based system of protection, evaluate more directly the relationship, if any, between additional revenues and more or better works. In doing so, courts should not seek to convert copyright into a form of rate regulation, where copyright owners present evidence of their fixed and marginal cost and courts tailor protection to ensure each owner a reasonable return on her investment, because such a system presents too great a risk of government censorship or favoritism. Rather, courts should evaluate the likely relationship between incentives and output at a more general level, for particular classes of works, based upon the evidence presented and the market structure of the relevant industry. Once a court has determined the likely relationship between marginal changes in revenue and marginal changes in output, that relationship should become a factor in calibrating the fair use balance. Specifically, as the likely relationship between incentives and output becomes more attenuated, similar entitlement. See Stephen Breyer, The Uneasy Case for Copyright Protection: A Study of Copyright in Books, Photocopies, and Computer Programs, 84 Harv. L. Rev. 281, 286 (1970) ("In fact, why is the author's moral claim to be paid more than his persuasion costs any stronger than the claim of others also responsible for producing his book: the publisher, the printer, the bookseller, and those responsible for the literature of the past that inspired him?").

Third, even limiting our analysis to more traditional efficiency considerations, the availability of excess incentives may also lead to competition among copyright owners for the excess incentives. As Judge Posner has noted, this competition may convert what would otherwise be social surplus into cost—a possibility clearly reflected in the ever-increasing cost and ever-decreasing success rate for many types of copyrighted works. See Richard A. Posner, Antitrust Law: An Economic Perspective 11 (1976) ("[A]n opportunity to obtain a lucrative transfer payment in the form of monopoly profits will attract real resources into efforts by sellers to monopolize, and by consumers to prevent being charged monopoly prices."); see also Richard A. Posner, The Social Cost of Monopoly and Regulation, 83 J. Pol. Econ. 807 (1975).

154 The Second Circuit appears to have suggested such a "rate-regulation" approach for reconciling the potential conflict between access and incentives in the area of privately-drafted materials that become public law. See County of Suffolk v. First Am. Real Estate Solutions, 261 F.3d 179, 194-95 (2d Cir. 2001) (holding that a county government may present its claim for copyright infringement of its official tax maps).
then for any given public interest in access, the copyright owner will have to establish more substantial market impairment in order to justify finding the use unfair. Consider two examples.

For the first, we will return to the issue of time-shifting and assume for the sake of argument that time-shifting would probably reduce the revenue associated with copyrighted television programs. In order to tie that probable loss in revenue to the public interest, we must consider how the revenue reduction will impact the production of copyrighted television programs at the margins given the structure of the television industry. When an enterprise such as a television network allocates its available revenues among its various factors of production, any revenue in excess of persuasion costs will necessarily be allocated to those scarce factors not easily replaced. Marginal television programs, in the sense of programs that are either relatively unpopular or of unproven and hence uncertain popularity, are both easily replaced and essentially indistinguishable from a host of alternative programming. Each year when the four television networks look to replace existing programs that have proven unsuccessful, they “evaluate thousands of concepts for new series and purchase approximately 600 pilot scripts.”

Although networks can judge the quality of the scripts and the subsequent pilots, they have “no reliable basis for predicting whether audiences, advertisers, and critics will accept the series.” If “all hits are flukes,” as television executives often insist, then the marginal programs are near-perfect substitutes for one another. As a result, these marginal programs should receive only their opportunity costs of production from the network.

In the absence of some “interference” with the television program market, additional revenues, whether received through a levy scheme or some other means, will flow not to the encouragement of these marginal works, but to the scarce factors of production—represented in the television business by those programs with a proven popularity that can serve to anchor the remainder of a network’s line-up. An analogous problem arises in professional sports where a team must allocate its available revenue among the owner, the coaches, the star players, and the rest of the team. If star players are relatively scarce and there is a relative abundance of substitutes available for the other positions or team members, then in allocating the revenue available for player salaries among the various team members, we should expect the star players to receive the lion’s

156 Id. at 1290.
157 Id. (quoting Jeff Sagansky, President, CBS Entertainment as quoted in BETSY FRANK, ON AIR: PRIMETIME PROGRAMMING DEVELOPMENT 1991-92, 1 (1991)); see also MURIEL G. CANTOR & JOEL M. CANTOR, PRIME-TIME TELEVISION: CONTENT AND CONTROL 70 (1992) (presenting examples to show how the television industry is unpredictable); TODD GITLIN, INSIDE PRIME TIME 31-45 (2000) (reviewing the unpredictabilities of the television industry).
share and the rest to receive only the minimum salary necessary to persuade them to play. This is precisely what happened in professional sports. The problem became so severe that one of the first goals of each of the players' unions in collective bargaining was to negotiate a minimum player salary to ensure that all players received, at the very least, a "livable" wage. In the television business, the Screen Actor's Guild and other guilds have attempted to ensure a similar "livable" wage for those involved with marginal works.

Because these guilds have some market power, an increase in total revenues may enable them to press for a slightly higher minimum wage in their negotiations with the networks and studios. To the extent the guilds are successful in their negotiations, an increase in total revenues may lead to some increase in the minimum wages for actors, screenwriters, and others involved in the production of marginal works. To that extent, an increase in total revenues may encourage the production of marginal works. Yet, established stars and popular programs also have market power. As a result, some part of any increase in revenues for television networks will simply increase the excess incentives copyright already ensures for the most popular works. An increase in these excess incentives may improve slightly the quality of the most popular programs, though it is hard to see how increased salaries for the cast of *Friends* will improve their abilities as actors. An increase in the excess incentives available for the most popular works may also somehow trickle down to the marginal programs, though, for reasons that I have explained elsewhere, that is unlikely. In the end, however, given that the incentives available for these programs already far exceed the persuasion cost necessary to ensure their creation, changes in the excess incentives available are likely to influence the marginal production of copyrighted television programs only indirectly, if at all. As Figure 2 illustrates, even with a value-based approach, total industry output will not (and should not) exceed the point, identified by $Q$, at which the demand for an additional work outstrips the

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158 For a discussion of the inequities that have developed with respect to professional wrestling in the absence of a union, see Stephen S. Zashin, *Bodyslam from the Top Rope: Unequal Bargaining Power and Professional Wrestling's Failure to Unionize*, 12 U. MIAMI ENT. & SPORTS L. REV. 1, 1 (1994) (addressing "the bargaining power disparity that exists in professional wrestling" and suggesting "that unionization within the industry could provide a more evenhanded contest").


160 See id. at 22 (noting the vast disparity that persists despite the acting guilds between the wages of average union members and stars).

161 One might argue that the higher salaries will ensure that the actors will remain with the program, but by increasing the actors' wealth, it may also encourage them to substitute leisure for labor and retire earlier. See Lunney, *supra* note 116, at 890-92.

162 See id. at 873-81.

163 See id. at 870-82.
persuasion cost associated with that work.

Given the structure of the television industry, we should therefore expect that slight changes in a television network's revenue are unlikely to affect the marginal production of copyrighted television programs. Even if there is some relationship between the level of excess incentives available and marginal output, we should certainly expect the relationship between changes in revenue and changes in output to prove far less direct than was the relationship between revenue and output under the nineteenth century's cost-based approach to copyright protection.\(^\text{164}\) Depending on the specific factual evidence presented regarding how an increase (or decrease) in the revenues available is typically allocated within the industry, even a substantial reduction in revenue may have little discernible effect on the marginal quality of television programming available.\(^\text{165}\) A court should therefore require a somewhat more substantial interference with the "potential market for, or value of" a copyrighted television program before finding any given use unfair.

In the time-shifting example, the relationship between additional revenue and marginal output was present, but indirect. In other cases, that relationship may prove almost entirely absent. To illustrate, consider our second example—the photocopying of copyrighted scientific articles for purposes of scientific research at issue in American Geophysical Union v. Texaco, Inc.\(^\text{166}\) Following the market failure approach to fair use, the Second Circuit ruled, by a 2-1 vote, that Texaco Research's practice of copying articles from scientific journals at the request of, and for use by, its researchers constituted copyright infringement.\(^\text{167}\) Scarcely acknowledging the possibility that such copying might itself serve to promote the progress of science,\(^\text{168}\) the majority condemned Texaco Research's practice because it denied the copyright owners

\(^{164}\) Even in the nineteenth century, courts required a plaintiff to demonstrate a substantial loss in revenue before they would declare a use unfair. See, e.g., Folsom v. Marsh, 9 F. Cas. 342, 348 (C.C.D. Mass. 1841) (No. 4901) ("If so much is taken, that the value of the original [was] sensibly diminished, or the labors of the original author [were] substantially to an injurious extent appropriated by another, that is sufficient, in a court of law, to constitute a piracy pro tanto.").

\(^{165}\) As I have noted elsewhere, see Lunney, supra note 116, at 919 n.329, the Motion Picture Association of America and others once insisted that a failure to impose levies on home-taping equipment would leave "the audiovisual marketplace . . . a barren wasteland of programming that does not edify, nor inspire, nor entertain." James Lardner, Fast Forward: Hollywood, the Japanese, and the Onslaught of the VCR 229 (1987) (citation omitted). Despite these pleas, Congress refused to enact the requested levies, and it is difficult to believe that television programming today is less entertaining, less edifying, or less inspiring because of that refusal.


\(^{167}\) Id. ("We agree with the District Court's conclusion that Texaco's photocopying of eight particular articles from the Journal of Catalysis was not fair use.").

\(^{168}\) Id. at 922-23 ("The District Court properly emphasized that Texaco's photocopying was not 'transformative.'").
a potential source of revenue. Reasoning in a circular path, the majority argued that if it found copyright infringement, then Texaco Research would have to pay a licensing fee for the copying, and if Texaco Research had to pay a licensing fee, then the loss of that fee as a potential revenue source would sustain a claim for copyright infringement. By finding the use unfair, the Second Circuit forced Texaco Research and other commercial research institutions to pay a fee for the copies their researchers need. To the extent that the ability to charge a separate fee per copy will enhance the ability of the copyright owners to price discriminate, the fee will increase the revenue of the copyright owners. The question remains, however, whether, and if so, how, this increase in revenue will affect the production of copyrighted scientific journal articles.

As the American Geophysical majority noted, the publishers of the scientific journals selected articles for publication from unsolicited submissions and, once an article was selected for publication, required the authors to assign their copyright to the publisher. In return, the publisher agreed to publish the article, but “no form of money payment [was] ever provided to [the] authors.” Although the majority admitted this fact, they did not further consider it in their analysis. Instead, the majority appeared to assume that increased revenue to the copyright owner would necessarily increase the production of copyrighted works.

Yet, in this case, added revenue for the publishers must come from those who use these scientific journals for their work, including institutions like Texaco Research. To pay these additional licensing fees, research institutions must either pass along the additional fees to consumers through higher prices or compensate for this new expense by cutting expenses elsewhere. If research institutions sold their discoveries in perfectly competitive markets, perhaps they could pass the increased licensing fees along to their consumers. However, if the markets for their discoveries were perfectly competitive, the research institutions would not exist. To cover the fixed costs of innovations, patents, secrecy, or other means of obtaining a lead-time advantage must offer research institutions some market power in the exploitation of their discoveries in order for their research to prove profitable. As a result, while research

169 Id.

170 Historically, the copyright owners engaged in limited price discrimination by charging libraries and commercial entities higher subscription fees than individuals. The ability to charge an additional fee for each journal article copied will improve the ability of the copyright owners to price discriminate among the commercial entities if the commercial entities’ reservation values for access to the information contained in the journal articles are reasonably proportional to the number of photocopies of the journal articles each entity makes.

171 Am. Geophysical Union, 60 F.3d at 915 (“Authors are informed that they must transfer the copyright in their writings to [the publisher] if one of their articles is accepted for publication . . . .”).

172 Id.
institutions may be able to pass some of these licensing fees along to consumers, part of the fees will come out of the rents the research institutions would otherwise earn on their discoveries. As these rents would otherwise go towards the costs of the research itself, using some part of these rents to pay licensing fees for copies of scientific journal articles means that research institutions will have to cut expenses elsewhere. As a practical matter, this means that institutions like Texaco Research will have to reduce their expenditures on research personnel, supplies, or facilities in order to come up with the licensing fees that the American Geophysical majority made possible. The American Geophysical decision thus increased payments to publishers, but such increased payments will come at the expense of the authors and their research.

Increasing the revenue of publishers at the expense of the authors and their underlying research scarcely seems likely “[t]o promote the Progress of Science,” as the Constitution requires. More money for publishers may lead to more journals. But unless there is an existing body of valuable scientific work presently denied publication because of limited journal space, it is almost impossible to see any connection between increased revenues for the copyright owners in this case and increased production of copyrighted works. Perhaps the top journals will begin to share their newfound wealth with the authors through royalties, but as yet, that remains only a speculative possibility. Given that Sony held that the mere possibility that a use may reduce “the potential market for, or value of,” a copyrighted work is insufficient to establish unfair use, it would seem that the mere possibility that additional

173 To the extent that scientific journals exhibit strong network characteristics, in that researchers tend to read only the most popular journals that every other researcher is reading as well, the fees may simply increase the excess incentives available to the most popular journals.

174 Following the rationale of the market failure approach, the American Geophysical court distinguished the Court of Claims’ earlier decision finding that photocopying for scientific research was a fair use on the grounds that the Copyright Clearance Center had established a market for photocopying licenses since the Williams & Wilkins case had been decided. See Am. Geophysical Union, 60 F.3d at 924 (“As the District Court observed, ‘To the extent the copying practice was “reasonable” in 1973 [when Williams & Wilkins was decided], it has ceased to be “reasonable” as the reasons that justified it before [photocopying license] have ceased to exist.’" (citation omitted)). It will be curious to see if courts remain equally willing to revisit the photocopying issue should the journals refuse to share part of their newfound wealth with authors.

175 Even if royalties become the norm, the significant capital costs involved in many areas of scientific research effectively preclude royalties from serving as the primary source of funding for such research.

176 Compare Sony Corp. v. Universal City Studios, Inc., 464 U.S. 417, 451 (1984) (requiring copyright owner to establish “by a preponderance of the evidence” that the use at issue creates “some meaningful likelihood” of harm to the potential market for, or value of, the work), with id. at 484 (Blackmun, J., dissenting) (requiring copyright owners to
revenues might lead to additional works should prove similarly insufficient.

Sony and American Geophysical Union both illustrate the dangers of presuming that a reduction in “the potential market for, or value of” the copyrighted work remains a reasonable proxy for the public interests copyright protection is intended to serve. Given copyright’s shift to a value-based system of protection, courts should require a copyright owner to demonstrate, by the preponderance of the evidence, that the use at issue will reduce both her revenues and the output of creative works at the margins. Only after the copyright owner has made such a showing should a court proceed to the third step of identifying the public’s direct interest in allowing the use to continue.

C. Identifying the Public Interest in the Unauthorized Use: The Example of Private Sharing of Music Files

Once a copyright owner has established that a use interferes with the public’s interest in additional works, the third step in the balancing approach is to identify the public’s interest in allowing the use to continue. If fair use is, in truth, a balancing, then even a substantial reduction in copyright revenues and associated reduction in copyrighted works is, on its own, insufficient to demonstrate that a use is unfair.\(^7\)\(^7\) Because of the public good character of copyrighted works, the key fair use question, from an economic perspective, is whether, on balance, society would be better or worse off by allowing the use to continue.

Because of the historical context in which they developed, the four statutory fair use factors expressly permit a court to consider the direct social benefit of allowing a transformative use to continue.\(^7\)\(^8\) None of the four, however, considers directly the value that a use may generate simply by expanding

\(^{177}\) Finding a fair use despite a substantial interference with a copyright owner’s potential market may run afoul of our obligations under Article 9(2) of the Berne Convention and Article 13 of the TRIPs agreement. See Berne Convention for The Protection of Literary and Artistic Works, July 24, 1971, art. 9(2), 1161 U.N.T.S. 31, 37 (“It shall be a matter for legislation in the countries of the Union to permit reproduction of work in certain special cases . . . .”); Agreement on Trade-Related Aspects of Intellectual Property Rights, Apr. 15, 1994, § 1, art. 13, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, LEGAL INSTRUMENTS-RESULTS OF THE URUGUAY ROUND vol. 31, 33 I.L.M. 81 (1994) (“Members shall confine limitations or 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 right holder.”). However, rather than interpret our fair use doctrine to avoid any possibility of conflict, the better approach is to allow the potential conflict to arise. Allowing the conflict to arise will both ensure that an actual conflict exists and will force the conflict into the open so that Congress will become aware that signing these types of treaties imposes a direct cost on U.S. consumers, in addition to whatever potential for export revenues they may generate.

access to existing works. The reason for this omission again lies in the
nineteenth century origins of the four fair use factors. At that time, the only
means available to expand access to an existing work was for a competing
printer to copy the work and sell it at a lower price. As this was, and is, the
paradigm case of copyright infringement, the unfair nature of such a use was in
a sense predetermined. Express consideration of increased access alone as a
potential social benefit was therefore unnecessary.

Yet, technology has changed radically since the nineteenth century. Today,
private sharing of copyrighted works may increase access to existing works
without undermining as extensively as the copying competitor of the
nineteenth century incentives for the creation of future works. As I have
explained elsewhere, there are at least three potentially material differences
between private copying and a commercial competitor’s copying in terms of
their effects on the incentives to create additional works. First, although we
often assume that consumers will free ride if they can, empirical research and
real world evidence have demonstrated that consumers will usually contribute
to the cost of a public good even where they could otherwise obtain the benefit
of the public good without charge.179 Among other reasons, a consumer may
contribute out of the conviction that paying her share is the right thing to do.180
A copying competitor is unlikely to be similarly motivated.

Second, because the purpose of private sharing is often to obtain a copy of a
work without charge, a consumer will not simply purchase the work and make
a copy, as that would defeat her purpose. Instead, she must find some other
consumer who is willing to share. Consumers are more likely to seek and
more likely to find popular works when they engage in private copying
because the enjoyment of copyrighted works exhibits network externalities.181
As a result, private copying is likely to occur disproportionately with respect to
the most popular works.182 It may therefore reduce the excess incentives

179 See Lunney, supra note 116, at 858-65 (arguing that “too much attention has been
paid to the assumption that if consumers can obtain copies for free, the vast majority of
them will do so”).

180 Id. (identifying altruism, the “warm-glow effect,” long-term self-interest, reputational
concerns, and informal cooperation as reasons why individuals may choose to contribute,
rather than free ride, even where free riding alternative was available).

181 A network externality arises when “the utility that a user derives from consumption of
the good increases with the number of other agents consuming the good.” Michael L. Katz
& Carl Shapiro, Network Externalities, Competition, and Compatibility, 75 Am. Econ. Rev.

182 In a recent study of Gnutella usage, for example, Eytan Adar and Bernardo A.
Huberman found that the vast majority of Gnutella queries (that is, file requests) are
concentrated on a relatively few topics. Based upon a recorded set of 202,509 Gnutella
queries, they report that:

The top 1 percent of those queries accounted for 37% of the total queries on the
Gnutella network. The top 25 percent account for over 75% of the total queries. In
reality these values are even higher due to the equivalence of queries (“britney spears”)
otherwise available for such works without affecting the incentives available for the production of marginal works. In contrast, a copying competitor expects to earn a profit on her copying. She can therefore simply purchase an authorized copy and need not worry about finding someone who will share another authorized copy with her. Moreover, a copying competitor would, absent copyright, copy any work so long as the copying offers a potential profit. Given that every author must price somewhat above marginal cost in order to recover her authorship investment, even marginal works offer a potentially profitable opportunity for a copying competitor. Allowing copying by competitors would therefore likely threaten more directly than private copying the incentives available for marginal works.

Third, because copyright enables an author to price her work somewhat above the marginal cost of additional copies, copyright generates a deadweight welfare loss. In order to force high reservation value consumers to reveal their true preference structure and purchase an authorized copy rather than free ride, copyright owners have used their exclusive rights to deny access to low reservation value consumers. In the nineteenth century, when a copying competitor was the only means to expand access to low reservation value, there was no effective way to separate and serve low reservation value consumers without also destroying the paying market made up of high reservation value consumers. If a copying competitor were allowed to enter the market, her work would be available through the same channels as the original, but at a lower price. Both high and low reservation value consumers would therefore find the copying competitor’s version attractive as a substitute for the original. Today, however, the technology that enables private sharing may allow low reservation value consumers to obtain an unauthorized copy without interfering unduly with the copyright owner’s ability to charge high reservation value

183 While, at first glance, one might suppose that a copier could earn the most profit from copying a popular work, popular works would (but for copyright) likely attract a crowd of copiers that would tend to eliminate any possibility of profitably copying such works. Because of this profit motivation, if one copying competitor’s use is found fair, other copying competitors will enter the field until the economic rents associated with copying are entirely dissipated. For that reason, in this for-profit setting, courts should consider not only the market effect of the particular use at issue, but the impact if the use becomes “unrestricted and widespread.” See Campbell, 510 U.S. at 590 (stating that the fourth fair use factor, the effect of the use on the potential market or value of the work, requires courts to consider whether unrestricted and widespread conduct would result in a substantially adverse impact on the potential market). When we move to a use outside of this copying competitor, for-profit setting, the assumption that a use, such as private copying, once permitted, will become widespread makes far less sense. See Lunney, supra note 116, at 858-68 (noting that private copying may prove self-limiting).
consumers the market price for an authorized copy. Unlike distribution by a
copying competitor, private sharing usually takes place through different
channels of distribution and entails a somewhat higher cost in terms of time
and inconvenience than would simply purchasing an authorized copy. To the
extent that low reservation value consumers typically have more time and less
money available for works of authorship, private copying may make copies of
existing works available to low reservation value consumers without becoming
an effective substitute from the perspective of high reservation value
consumers. Private sharing may therefore provide copies of the work to low
reservation value consumers who could not afford an authorized copy’s market
price in any event, and yet not interfere with the copyright owner’s sales to
high reservation value consumers.

To the extent that private copying expands access to existing works without
decreasing the copyright owner’s revenues and the resulting incentive to create
additional works, private copying is Pareto optimal and should constitute a fair
use. Moreover, even if private copying decreases revenues to some extent and
is thus not Pareto optimal, private copying may nevertheless expand access to
an existing work substantially more for any given reduction in revenue than
would a competitor’s copying. As a result, courts should not presume that
private copying has the same economic consequences as copying by a
competitor, but should expressly consider the increase in access that the private
copying achieves for any given reduction in revenue. Consider A&M Records,
Inc. v. Napster, Inc.\(^{184}\)

In granting and affirming the grant of a preliminary injunction against
Napster’s file-sharing service, both the district court and the Ninth Circuit
walked through the four nineteenth century fair use factors. The private
sharing of files through Napster was nontransformative and commercial;\(^{185}\) it
involved entertaining works “closer to the core of intended copyright
protection[;]”\(^{186}\) and the entire work was copied.\(^{187}\) As for the fourth factor—
"the effect of the use upon the potential market for, or value of,” the works—
even the plaintiffs’ expert admitted that “national [retail music] sales grew
'significantly and consistently’” over the four quarters studied.\(^{188}\) The courts

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\(^{184}\) 114 F. Supp. 2d 896 (N.D. Cal. 2000), aff’d in part, rev’d in part, 239 F.3d 1004 (9th
Cir. 2001).

\(^{185}\) See id. at 912-13 (finding that downloading does not transform the music and that
“although downloading and uploading MP3 files is not paradigmatic commercial activity, it
is also not personal use in the traditional sense”), aff’d, 239 F.3d at 1015 (affirming the
district court’s finding that the use was nontransformative and commercial).

\(^{186}\) See A&M Records, Inc., 239 F.3d at 1016 (quoting Campbell v. Acuff-Rose Music,
Inc., 510 U.S. 569, 586 (1994)) (affirming district court’s finding that the works were
creative in nature).

\(^{187}\) See A&M Records, Inc., 114 F. Supp. 2d at 913, aff’d, 239 F.3d at 1016 (affirming
district court’s finding that entire work was copied).

\(^{188}\) Id. at 910 n.14 (quoting Report of Michael Fine 1, A&M Records (No. 99-05183)),
nevertheless concluded that Napster “reduces CD sales among college students” because there was a decline in retail music sales at stores located: (i) near 67 schools where Napster had been recently banned; and (ii) near the “Top 40 Most Wired Colleges of 1999” as identified by Yahoo Internet Life. Although there are aspects of the courts’ fact finding that appear questionable, a more troubling aspect of the courts’ decisions is that neither considers the clear public benefit Napster generated.

Specifically, because of copyright, the market price for a full-length music CD hovered around $14.00 in 2000. Yet the marginal cost of downloading a CD through a file-sharing service like Napster was far less, particularly for technically sophisticated consumers with low opportunity costs for their time. If private file-sharing through Napster or similar services is banned, there will be a large deadweight welfare loss precisely because that ban would help the

189 Id. at 913 (finding that Napster use harms the market by reducing CD sales among college students and raising barriers to plaintiffs’ entry into the market for digital downloading of music).

190 The causal link between Napster usage and the decline in sales is particularly troublesome. As one study reports, most of the decline in sales for both colleges generally and the “Top 40 Most Wired Colleges” occurred primarily between the first quarter of 1998 and the first quarter of 1999. See Report of Michael Fine 8, A&M Records (No. 99-05183), available at www.riaa.org/PDF/fine.pdf (last visited May 30, 2002). Yet, Napster did not become popular until after the first quarter of 1999, suggesting that most of the decline in sales was unrelated to Napster’s subsequent rise. See Tanya Schevitz, Download Discord: Universities are Frustrated as Students Overwhelm Internet Lines to Access Digital Music Files, S.F. CHRON., Mar. 3, 2000 (noting that at U.C.-Berkeley, residence halls jumped from 10% of internet traffic to 90% of traffic from November 1999 to January 2000, and that at Indiana University, Internet usage jumped from 20% in January 2000 to 60% in February 2000). Moreover, after Napster was formally shutdown in the first half of 2001, CD sales in the second half of 2001 fell (both in units and dollar value) over the same period a year earlier when Napster was going strong. Compare RIAA, 2001 Yearend Statistics, at www.riaa.com/pdf/2001yearendmanufacturersshipmentandvaluereport.pdf (last visited May 30, 2002), with RIAA, 2001 Midyear Statistics, at www.riaa.com/pdf/midyear_2001.pdf (last visited May 30, 2002) (reflecting, in combination, that sales of CDs fell from 522.5 million units with a suggested retail price of $7,533.30 million in the second half of 2000 to 484 million units with a suggested retail price of $7,381.40 million in the second half of 2001).

191 The Federal Trade Commission has alleged that Sony’s Minimum Advertised Pricing (“MAP”) policy and the adoption of similar strategies by the other big four record companies may also have played a role in 2000’s high prices. Under the MAP policy, retailers who advertised (even through in-store displays) market prices below the established MAP for sales of compact discs faced a suspension of all cooperative advertising and promotional funds. Through strict and well-publicized enforcement of MAP, Sony and the other record companies managed to stabilize otherwise falling retail prices for music. See Complaint, In re Sony Music Entm’t, Inc., (No. C-3971) (filed Aug. 30, 2000), available at http://www.ftc.gov/os/2000/09/sonycomp.htm (last visited May 30, 2002) (alleging that Sony’s MAP policy unreasonably restrained trade and hindered competition in the prerecorded music market).
recording industry maintain a large gap between the market price and the marginal cost for the same music. Consumers who would willingly have paid the marginal cost of a file download, yet cannot afford the work’s market price, will be forced to do without. Yet at no point during their analyses did either the district court or the Ninth Circuit consider the elimination of this deadweight welfare loss as a potential public benefit that might justify allowing Napster to continue. Instead, they limited their analyses to the four fair use factors derived from the nineteenth century fair use cases and, in direct defiance of Congress’s explicit rejection of such an approach, applied the factors as if they were a checklist of all relevant considerations.

If we ignore the district court’s clearly erroneous (or materially misleading) finding that “[a]pproximately 10,000 music files are shared per second using Napster” as of August 2000, and rely on more objective and seemingly less biased published reports that Napster users downloaded 1.39 billion music files in the month of September 2000, we can generate a rough estimate of the increased access to musical works that Napster enabled. Given the extent of the sharing that occurred in September 2000 and assuming that ten files are equivalent to an album, Napster enabled users to create essentially 139 million albums in one month. If we extend that rate over a twelve-month period and focus exclusively on U.S. users, then allowing Napster to

192 A&M Records, Inc., 114 F. Supp. 2d at 902. Perhaps the district judge only meant that the files were in the process of being shared, as it takes far longer than a second to download a single musical work. See Robert Lemos, Internet Music Under the Gun?, ZDNET NEWS, May 26, 2000 (noting that it takes 33 seconds to download a single MP3 file on a T1 connection, DSL line, or cable modem, and 15 minutes on a 56.6K modem). If she really meant 10,000 files per second were “shared” (i.e. the downloading completed), that would amount to the creation of 43.2 million ten-file albums each day for U.S. consumers, or 157 billion albums per year (i.e. over 50 albums per year for each man, woman, and child in the United States).

193 Given that the average retail price in 2000 for a full-length CD was $14.02 and the average price for a CD single was $4.17, see RIAA, 2000 Yearend Statistics, at www.riaa.com/pdfs/year_end_2000.pdf (last visited May 30, 2002) (reflecting that 942.5 million CDs were sold for a total of $13,214.5 million and 34.2 million CD singles were sold for a total of $142.7 million in 2000), it might be more accurate to suggest that a full-length CD consists of four tracks that consumers want and another six to eight tracks of filler songs. If Napster users only downloaded those songs they desire from a CD (and not the filler), then five files might be effectively equivalent to a full-length CD for Napster users. In that case, the downloading of 1.39 billion files per month through Napster would amount to the equivalent of 1.67 billion albums created over the course of a year. File sharing through Napster would thus have increased access to digital-quality music by 178%, from 940 million full-length CDs to approximately 2.61 billion annually.

continue would have enabled U.S. users to create approximately 830 million albums a year. Given that only 940 million authorized, full-length CDs were sold in 1999 and in 2000, \textsuperscript{195} file-sharing through Napster would have essentially doubled the availability of digital-quality recorded music in this country, providing access to millions who, if left to face the market prices of copyright owners, would have been denied access altogether. Under any economic definition of social welfare, there is plainly some social value in eliminating this substantial deadweight loss, yet neither the district court nor the appeals court considered it.

Moreover, as the plaintiffs' own experts admitted, Napster nearly doubled the distribution of digital-quality music \textit{without any discernible effect on national sales of recorded CDs}.\textsuperscript{196} All that the plaintiffs could demonstrate was some slight, potentially unrelated, decline in sales for 92 retail music establishments that happened to be near 107 colleges where Napster use may have been particularly widespread. Perhaps Napster usage did, in fact, cause this decline in sales.\textsuperscript{197} Perhaps this slight decline in sales, despite the value-based nature of today’s copyright protection and consequential availability of excess incentives,\textsuperscript{198} would somehow filter back and reduce to an equally slight degree the production of new albums. Perhaps, however, a few albums at the margins are not too high a price for doubling access to the most popular, existing works. Certainly, in any utilitarian balancing of what society has to gain and what it has to lose from prohibiting private sharing through a service like Napster, the trade-off must be considered.

\textsuperscript{195} See RIAA, 2001 Yearend Statistics, \textit{supra} note 190 (listing sales of 942.5 million CD units shipped in 2000 and 938.9 million CD units shipped in 1999).


\textsuperscript{197} More realistically, the availability of free peer-to-peer file sharing may become a threat to the recording industry’s sales as sales of authorized copies move increasingly from the brick-and-mortar world to a digital distribution business model, though again under a proper fair use analysis, such harm must be proven and not merely assumed.

\textsuperscript{198} The district court cited a declaration from the plaintiffs for the proposition that “[t]o make a profit, the record company plaintiffs largely rely on the success of ‘hit’ or popular recordings, which may constitute as little as ten or fifteen percent of albums released.” \textit{Id.} at 908. I have discussed the flaws of this type of justification for excess incentives elsewhere. See Lunney, \textit{supra} note 116, at 870-82 (arguing that copyright provides much greater protection than the public interest in creative works requires). As a general matter, this type of reasoning mistakes cause for effect. Protection is not expansive because success rates are low. Rather, success rates are low precisely because copyright protection is so expansive. Specifically, because copyright protection is expansive, the potential pay-offs from a success are exceedingly high, and they in turn justify extremely risky investments. If protection is expanded because success rates are low, that will cause success rates to fall as broader protection will make even riskier investments attractive.
CONCLUSION: FAIR USE AS BALANCING

Properly understood, *Sony* is not concerned solely, or even principally, with the potential consequences of market failure. Rather, *Sony* is concerned as much with the consequences of market success. The efficiency of a private market regime, so readily assumed for private goods, does not extend to the public goods at issue in copyright. At best, the market regime that copyright establishes may come closer to ensuring an optimal supply of copyrighted works than a regime without any copyright and, for now, seems clearly preferable to the plausible alternatives, such as direct government financing. Nevertheless, because the market regime that copyright creates is inherently inconsistent with the public good character of copyrighted works, the mere fact that licensing can occur and that a market can develop does not ensure optimal dissemination and production of copyrighted works. For copyrighted works, such “market success” is not sufficient to ensure an efficient outcome. Even with market success, there remains a fundamental tension between copyright’s system of exclusive rights and the public good character of copyrighted works.

As Justice Stevens recognized in *Sony*, fair use exists in order to resolve this tension. As an inherent and express limit on each of the exclusive rights Congress accorded copyright owners under section 106, the fair use doctrine ensures that a copyright owner may enforce her rights to exclude others only where, on balance, exclusivity promotes social welfare. Once we acknowledge the public good character of copyrighted works, then, from an economic perspective, fair use must necessarily balance, on the one hand, the potential public benefit of additional or better works from prohibiting the use at issue, and on the other, the potential public benefit from the use itself. In applying this balance, we should not tie ourselves to a set of restrictive factors developed in the nineteenth century to address a particular type of use against the background of the technology available at that time. Rather, we should consider directly what the public has to gain and what it has to lose for the use at issue given today’s technology and associated market structures. Under this balancing approach, a use should be found unfair and hence infringing only where the copyright owner has proven by the preponderance of the evidence that society has more to gain than it has to lose by prohibiting the use at issue.