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**COPYRIGHT AND NEW TECHNOLOGIES:
THEORETICAL AND EMPIRICAL ANALYSES OF COPYRIGHT
TRANSFERS AND CONTENT PRODUCTION INCENTIVES**

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COPYRIGHT AND NEW TECHNOLOGIES

THEORETICAL AND EMPIRICAL ANALYSES OF COPYRIGHT
TRANSFERS AND CONTENT PRODUCTION INCENTIVES

Kate Darling

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EXECUTIVE SUMMARY

ENGLISH

This research explores how copyright law can affect markets. The conventional policy justifications for intellectual property commonly involve an economic tradeoff. Using different methodologies, the four papers in this thesis examine the costs and benefits of specific laws, and attempt to provide some economic insight into innovation policies. Two theoretical papers evaluate copyright laws that are designed to compensate creators, while a literature review and empirical industry study look at the incentive theory behind intellectual property more generally.

Combining economic theory and comparative legal analysis, the first paper highlights laws that restrict the grant of rights to unknown uses of copyrighted works. Looking at the bargaining situation between creators and intermediaries, it finds that part of the political reasoning behind the laws is plausible. In particular, wealth distribution could be unfavorable to creators without legal intervention. It also demonstrates, however, that restricting new use right grants can come with transaction costs that effectively thwart the intended goals. In light of this, it concludes that preventing the grant of unknown-use rights may not be a suitable instrument for policy makers to protect creators' financial interests. The second paper looks at author termination rights in United States copyright law. It comes to a similar conclusion regarding the distributive justification, for slightly different reasons. Because of price changes, risk shifting, hold-up problems, and skewed incentive structures, this work also indicates that author termination rights may be at odds with a utilitarian view of copyright law.

Exploring market incentives more generally, the third paper in this thesis provides a systematic overview of a growing body of research on 'low-IP' industries, situating it within an existing literature on law and social norms. 'Low-IP' industry research examines how information

production is sustained in environments without (or with reduced) intellectual property protection. The fourth paper follows with a contribution to this literature in the form of an empirical industry study. Because of large-scale copyright infringement, enforcement difficulties, and the proliferation of free content substitutes, the online adult entertainment industry is largely unable to rely on copyrights in order to finance production. Through qualitative interviews with industry specialists and content producers, the study finds that the industry has shifted towards other strategies to recoup costs, with increased focus on services, experiences, and interactivity. Traditional content continues to be produced, partially as a basis for these new goods, and partially for use as a loss leader. Studying the relationship between copyright and innovation in the online adult entertainment industry is an attempt to contribute some perspective to ongoing policy discussions as copyright laws are reconsidered for the digital age.

This work recognizes that traditional justifications for intellectual property may sometimes be overly abstract. By combining law, economics, and an understanding of the realities of legal discourse, this thesis attempts to collect detailed information in specific settings to show where such abstractions are potentially harmful.

DEUTSCH

Diese Arbeit untersucht den Einfluss von Urheberrechtssystemen auf die Marktwirtschaft. Die konventionelle politische Begründung für geistiges Eigentum beinhaltet abstrakte, oft vereinfachte wirtschaftliche Abwägungen. Mit verschiedenen Methoden untersuchen die vier Papiere in dieser Arbeit die Kosten und Nutzen spezifischer Gesetze und versuchen, genaueren Einblick in den wirtschaftlichen Einfluss unserer Innovationspolitik zu gewinnen. Zunächst werden in zwei theoretischen Teilen Urheberrechtsgesetze beurteilt, die darauf abzielen, Urheber zu entlohnen. Danach wird mit einer Literaturrecherche und einer empirischen Industriestudie die allgemeine Anreiztheorie hinter geistigem Eigentum untersucht.

Durch die Anwendung ökonomischer Theorie und rechtsvergleichender Analyse untersucht das erste Papier Gesetze, die eine Abtretung von Rechten für unbekannte Nutzungsarten von

urheberrechtlich geschützten Werken beschränken. Unter Berücksichtigung der (oft ungleichen) Verhandlungssituation zwischen Urheber und Vertragspartei wird ein Teil der politischen Argumentation hinter den Gesetzen für plausibel gehalten, insbesondere dass die Reichtumsverteilungssituation ohne rechtliche Intervention für die Urheber ungünstig ausfallen könnte. Die Arbeit stellt jedoch ebenfalls fest, dass die Beschränkung der Abtretung unbekannter Nutzungsarten Transaktionskosten verursachen kann, die zu einer effektiven Vereitelung der gesetzgeberischen Ziele führen. Die Arbeit gelangt zum Schluss, dass die Beschränkung der Übertragung unbekannter Nutzungsrechte generell dazu ungeeignet ist, die finanziellen Interessen der Urheber zu schützen. Das zweite Papier untersucht Urheberkündigungsrechte im U.S. amerikanischen Urheberrecht. Diese Arbeit kommt zu einem ähnlichen Ergebnis in Bezug auf die gesetzgeberische Argumentation der Verteilungsgerechtigkeit, jedoch mit teilweise anderer Begründung. Ausserdem zeigt sie auf, dass das Urheberkündigungsrechtssystem aufgrund Preisänderungen, Risiko Verschiebung, „hold-up“ Problemen und schiefen Anreizstrukturen womöglich in direktem Widerspruch zu der utilitaristischen Theorie des Urheberrechts steht.

Der dritte Beitrag dieser Doktorarbeit gilt der Untersuchung von allgemeinen Marktanzügen. Die Arbeit erstellt einen systematischen Überblick über die wachsende Zahl von Studien in „low-IP“ Industrien und ordnet diese innerhalb einer bestehenden Literaturströmung zu Recht und soziale Normen ein. Die Forschung in „low-IP“ Industrien untersucht, wie in bestimmten Umgebungen Informationsproduktion entstehen kann, trotz fehlendem (oder unter reduziertem) Schutz von geistigem Eigentum. Das vierte Papier bietet darauf einen eigenen Literaturbeitrag in Form einer empirischen Industriestudie. Zunächst wird die These untersucht, dass die heutige U.S. Online-Erotik-Unterhaltungsbranche einen „low-IP“ Markt darstellt. Darauf folgt eine Analyse der Informationsproduktion in der Industrie. Die Arbeit kommt zum Schluss, dass aufgrund des Ausmass der Urheberrechtsverletzungen, der Rechtsvollzugsschwierigkeiten und der generellen Verbreitung von freiem Inhalt die Online-Erotik-Unterhaltungsbranche derzeit weitgehend nicht in der Lage ist, ihre Produktion durch das Urheberrechtssystem zu finanzieren. Durch qualitative Interviews mit Branchenexperten und Inhaltsproduzenten stellt die Studie fest, dass die Industrie derzeit auf neue Geschäftsmodelle umsteigt, um Kosten

einzubringen, zum Beispiel durch verstärkte Investition in Dienstleistungen, Erfahrungsgütern und Interaktivität. Gleichzeitig werden traditionelle Informationsgüter weiterhin produziert, teilweise als Grundlage für die neuen Modelle, teilweise um als Lockvogelangebot zu dienen. Im digitalen Zeitalter werden Urheberrechtsgesetze vermehrt politisch diskutiert. Die Untersuchung der Beziehung von Urheberrecht und Innovation in der Online-Erotik-Unterhaltungsbranche bringt hierfür möglicherweise zusätzliche Perspektiven auf den Tisch.

Diese Doktorarbeit untersucht die Abstraktionen in der konventionellen ökonomischen Begründung für geistiges Eigentum. Das Ziel dieser Arbeit besteht darin, mit praktischem Verständnis der Realität des juristischen Diskurses genauere Informationen in bestimmte Umfelder zu sammeln und durch die Anwendung einer Kombination von Rechtswissenschaft und Wirtschaftswissenschaft aufzuzeigen, wo solche Abstraktion möglicherweise fehlgeleitet ist.

INTRODUCTION

Over the past few decades, economic analysis of law has become a dominant field of legal research.¹ The law and economics approach applies interdisciplinary, scientific methods to lawmaking. It evaluates legal regulations in their function as tools for influencing behavior and implementing policy goals.² One such legislative goal is technological and creative innovation. Scientific and cultural progress is driven by society's investments in research & development and the arts. Law and economics can help explore how laws can be used to influence these investments by providing the right incentives for market players. The innovation policy tool that plays a pivotal role in this setting is intellectual property.

Although the philosophies at its basis are diverse, intellectual property law has significant economic impact.³ Granting ownership of information goods is a market intervention that comes with costs and benefits, essentially creating an economic tradeoff. Society exchanges limited exclusive rights to inventions and creative works in order to gain disclosure and to foster innovation incentives.

Technological progress warrants continuous reconsideration of this tradeoff. Recently, companies in the computer, Internet, and software industries have begun to lobby for reforms of intellectual property law.⁴ The political landscape surrounding copyright is changing, as our existing

¹ See for the United States, *e.g.*, RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW*, 8th ed., Aspen (2011); William M. Landes, *The Empirical Side of Law & Economics*, 70 U. CHI. L. REV. 167 (2003); for Europe and other, *see, e.g.*, Eli Salzberger, *The Economic Analysis of Law - The Dominant Methodology for Legal Research?! 4* HAIFA L. REV. 207 (2008), p. 2.

² See ROBERT B. COOTER, JR. & THOMAS ULEN, *LAW AND ECONOMICS*, international ed., Addison-Wesley (2008), p. 11.

³ See WILLIAM M. LANDES & RICHARD A. POSNER, *THE ECONOMIC STRUCTURE OF INTELLECTUAL PROPERTY LAW*, Harvard University Press (2009), p. 1-5.

⁴ See JAMES BESSEN & MICHAEL J. MEURER, *PATENT FAILURE: HOW JUDGES, BUREAUCRATS, AND LAWYERS PUT INNOVATORS AT RISK*, Princeton University Press (2009), p. 27-28.

legal structures grapple with the current impact of digitization. In the face of technical reality, policy may sometimes need to be restructured to minimize the costs of reaching certain objectives.

Intellectual property is not only an increasingly important area of the law, but also a field of great interest for interdisciplinary research. It lies at the intersection of law, economics, technology, innovation, and competition policy. Intellectual property laws influence market developments, national and international growth, technological and cultural progress, social welfare, and the interplay between individuals, intermediaries, and the innovative process. Law and economics research in the field of intellectual property is therefore not only interesting, but also important and timely.

The general body of this research finds its basis in theoretical economics, prominently inspired by scholars like Landes & Posner (2003)⁵ and Scotchmer (2004).⁶ More recently, the theoretical work on the law and economics of intellectual property is being supplemented by newer research that explores its predictions and implications in practice. Copyright law, for example, and the surrounding policy debate are often either based on an abstract theory of market failure, or abstractly focused on compensating creators, both of which carry the risk of oversimplification. This thesis contributes to a recent trend in intellectual property scholarship toward using different methodologies to more closely examine and evaluate these traditional policy justifications.

The research in this thesis comprises four attempts to gather more substantial insights into how copyright laws affect markets and individuals' behavior in practice. The two theoretical papers look at the incentives and economic costs of legal interventions that aim to compensate creators of copyrighted works. The 'low-IP' industry literature review and empirical industry study look at the extent of market failure and evaluate the abstract incentive theory underlying copyright laws and innovation policy.

The first theoretical paper explores the problem of new-use right grant restrictions in copyright law. Some legal systems prevent authors from licensing the rights to uses of their work that are unknown or have not yet

⁵ See LANDES & POSNER, *supra* note 3.

⁶ SUZANNE SCOTCHMER, *INNOVATION AND INCENTIVES*, MIT Press (2004).

been invented at the time of the contract.⁷ The legislative idea behind this restriction is to protect authors from signing away rights of value that they could later profit from due to bargaining disadvantages. This work first compares the differing legal approaches that exist in selected countries. A review of the legislative history uncovers the underlying reasons for the differences across borders, including history, culture, and differing legislative views on the purpose of copyright law. It then explores whether and to what extent the legislators took potential economic effects into account, finding the justification for new-use-right grant restrictions to be largely distributive. The paper analyzes this reasoning from a law and economics perspective. It finds that wealth distribution is likely to be unfavorable to authors without any legal intervention, but also that restricting new-use-right grants may not achieve the intended goal of wealth reallocation. Although the analysis does not aim to determine the optimal design of new-use-right laws, it offers potentially helpful insights and provides a sensible direction for further research and policy discussion.

The second theoretical paper looks at author termination rights in United States copyright law. With a justification along similar lines to that of Continental European new-use-right grant restrictions discussed in the first paper, the United States Copyright Act of 1976 has instated a termination right for authors thirty-five⁸ years after the license or transfer of their copyrights. Although the law officially came into effect on January 1, 1978, the windows in which authors can exercise their terminations will begin to occur only now, three decades later. The boundaries of these termination rights have yet to be clarified in court cases. This paper contributes to the currently ongoing debate over this law by providing some economic perspective. Because of price changes, risk allocation, hold-up problems, and other effects on author and publisher incentives, it predicts that the economic costs of introducing termination rights will outweigh the benefits. This paper concludes that the current structure of author termination rights in the United States is at odds with its political justification, as well as the utilitarian purpose of copyright law.

The third paper provides a comprehensive literature overview of empirical research on ‘low-IP’ industries. Innovation policy is frequently

⁷ In this context, the term ‘author’ describes any creator of a copyrighted work.

⁸ Respectively 56 years for grants prior to 1978, *see* paper for details.

based on the utilitarian theory of incentivizing creative works. A recent trend of empirical industry studies tries to better understand the relationship between intellectual property and innovation, testing the traditional economic assumptions behind the laws. Through the fine-grained approach of empirical industry studies, this literature is in the process of collecting a more detailed picture of what incentivizes the creation of information goods, for example in information markets that appear sustainable despite reduced - or even without - intellectual property protection.⁹ Some of these industries have developed alternative mechanisms that are able to partly, or fully, assume the prescribed role of intellectual property. Industry-specific characteristics and other factors make it possible for innovators to appropriate returns, or rely on other investment incentives, thereby sustaining a certain level of innovation even in absence of formal exclusivity protection. Because the law and policy surrounding intellectual property is based on such abstract economic theory, gathering reliable images of what effects these laws have in practice may ultimately lead to a more realistic general model and provide the necessary tools for industry-specific differentiations. These studies are therefore a first critical step in striving towards the optimization of intellectual property law in particular, and innovation/competition policy in general. So far, this research has discovered numerous industries where intellectual property rights do not play the role predicted by traditional theory. The literature review provides an overview of these studies and theoretically grounds the current research into the general literature on self-regulation and social norms. It establishes the basis for the fourth paper, which follows with an empirical study that extends the literature.

Contributing to the body of literature on 'low-IP' industries, the fourth paper is an empirical study of content production incentives in the online adult entertainment industry - a major content industry where copyright protection has been considerably weakened in recent years. Because copyright infringement is widespread and prohibitively difficult to prevent, adult entertainment producers have been effectively unable to rely on the economic benefits that copyright is intended to provide. Qualitative interviews with industry specialists and content producers support the hypothesis that copyright enforcement is not cost effective. As

⁹ These markets are often described as "IP without IP" – Information Production without Intellectual Property.

a result, the study finds that many producers have developed alternative strategies to recoup their investment costs. Similar to the findings of other scholarly work on ‘low-IP’ industries, this research finds a shift toward the production of experience goods. It also finds that some incentives to produce traditional content remain. The sustainability of providing convenience and experience goods while continuing content production relies partially on general, but also on industry-specific factors, such as consumer privacy preferences, consumption habits, low production costs, and high demand. While not all of these attributes translate to other industries, determining such factors and their limits brings us toward a better understanding of innovation mechanisms.

These four papers all represent attempts to analyze the costs and benefits of copyright laws in more detail. This work recognizes that intellectual property systems constitute an economic tradeoff. As mentioned above, current copyright theory and policy operate under assumptions that may sometimes be overly abstract. Collecting better information in individual settings helps to show where these assumptions are potentially misguided, and draws attention to more general considerations. This doctoral thesis applies economic theory and empirics to draw a better picture of the tradeoff inherent to individual copyright laws and general innovation policies.

It should be emphasized that an economic evaluation of copyright law does not necessarily lead to one-size-fits-all solutions. The real world comprises an intricate web of factors that may influence the outcome of legal rules beyond what economics can predict. It is not only variation in market structures or interplay with other legal rules that create differences across industries and borders, but also differences in the underlying beliefs regarding the purpose of copyright law altogether. Nevertheless, in order for legislatures to be able to make informed decisions, gathering information about the relationship between copyright laws and innovation incentives is important. This thesis aims to draw approximations of economic costs and benefits, while respecting their limitations.

COPYRIGHT AND NEW MEDIA

A LAW & ECONOMIC ANALYSIS OF RESTRICTING LICENSES TO UNKNOWN USES*

Some legal systems prevent authors from licensing the rights to unknown uses of their work. This paper analyzes the distributional reasoning behind this approach from a law and economics perspective. It finds that wealth distribution is likely to be unfavorable to authors without this intervention, but also that restricting new-use-right grants may not achieve the intended goal of reallocation. Although the analysis does not aim to determine the optimal design of new-use-right laws, its conclusions may grant helpful insights and provide a sensible direction for further research and policy discussion.

* A revised version of this paper has been published as: Kate Darling, *Contracting About the Future: Copyright and New Media*, 10 NW. J. TECH. & INTELL. PROP. 485 (2012).

A. Copyright and New Media: A Law & Economic Analysis of Restricting Licenses to Unknown Uses

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INTRODUCTION

Today is a world of technological change. The increasingly rapid development of new media continuously leads to new and unanticipated ways of distributing copyrighted works. Distribution methods are frequently modernized—sometimes replacing former methods, sometimes supplementing them—giving old content new value and creating additional sources of wealth. The performing arts and film industries have witnessed a progression over the last few decades from theater to motion pictures, television, videocassettes, DVDs, on-demand movies, streaming video, cell phone formats, and more. The music industry has experienced a similar succession of technological developments, including piano rolls, vinyl records, 8-tracks, reel-to-reel tapes, cassette tapes, CDs, mini discs, MP3 downloads, and streaming audio. Around the turn of the century, new distribution methods such as CDs, online databases, and e-books began to revolutionize the print media industry.¹ Now more than ever, the digital age is changing the ways that information can be accessed and

¹ In July 2010, Amazon reported that the number of sold e-books was for the first time consistently higher than that of printed books. See Dylan Tweney, *Amazon Sells More E-Books than Hardcover*, WIRE (July 19, 2010), online edition, available at <http://www.wired.com/epicenter/2010/07/amazon-more-e-books-than-hardcovers>.

distributed by expanding content beyond its initial medium.² These developments potentially affect any kind of creative authorship. We are yet unable to imagine what further possibilities the next decade, let alone the next century, will bring.

Copyright law grants authors³ certain exclusive rights over their creations. To monetize these rights and distribute the work, authors regularly enter into contracts with publishers⁴ and assign to the publisher the exclusive rights granted by copyright law, such as the rights to produce, publish, and distribute the work. Copyright terms can last for longer than a century.⁵ During this time, the value of the work and the circumstances surrounding its distribution may be subject to considerable change. Many lawmakers, courts, and scholars are concerned about the case of the writer whose screenplay rights are bought out upfront by the production company. The concern lies in protecting disadvantaged creators from losing out on the later financial success of their work.

Looking across borders, many countries have been dealing with this issue within their copyright systems. The individual approaches to the problem, however, differ. To prevent authors from signing away rights of unforeseen future value, some countries simply prohibit granting rights to uses unknown at the time of the contract. The legislative goal of this restrictive measure is primarily distributional: because authors are viewed as entitled to the financial returns of their creations, the law intervenes to

² See Marc Breslow et al., *An Analysis of Computer and Photocopying Issues from the Point of View of the General Public and the Ultimate Consumer*, in: NAT'L COMM'N ON NEW TECHNOLOGICAL USES OF COPYRIGHTED WORKS, FINAL REPORT OF THE NATIONAL COMMISSION ON NEW TECHNOLOGICAL USES OF COPYRIGHTED WORKS, Library of Congress (1979), p. 128.

³ For the purposes of this paper, "author" pertains to any original copyright owner.

⁴ For the purposes of this paper, "publisher" pertains to any entity that acquires rights from the author for the purpose of disseminating and benefitting from the copyrighted work.

⁵ See Berne Convention for the Protection of Literary and Artistic Works art. 7, July 24, 1971, 1161 U.N.T.S. 30 (as amended on Sept. 28, 1979) (stipulating that, for most works, the length of the copyright term must be at least fifty years after the author's death). Many countries set even longer terms: the United States stipulates a seventy-year period *post mortem*.

ensure that they are not “cheated” out of this wealth by incautiousness, inexperience, or a lack of bargaining power in dealing with publishers.⁶

This paper delves into the reasoning behind these restrictions on granting rights to unknown uses of copyrighted works and evaluates the legislative assumptions from a law and economics perspective. This paper finds it economically plausible that the distribution deemed undesirable by the restrictive legislatures will occur in absence of legal intervention. When individual authors engage in contract negotiations with publishers, they are often in a poor bargaining position due to economic factors that leave them with the shorter end of deals.

This paper also argues, however, that the chosen solution of preventing authors from transferring rights to uses that do not yet exist may have effects that counteract the legislative goals. Restricting the grant of rights to unknown uses essentially means that a new contract negotiation is necessary between author and publisher whenever a new distribution method emerges. This practice can give rise to transaction costs and other hindrances to market exchange. Importantly, not only does this situation harm the publisher, it also may harm authors by decreasing the total number of rights transfers or leaving them with unfavorable terms. In light of this result, restrictions on granting the rights to new uses should be considered with caution, even by author-protective legislatures, as they might not be suitable instruments for distributing wealth to creators.

The analysis of this paper is primarily descriptive. It focuses on what legislatures are trying to achieve with restrictions on transfers of new use rights and evaluates whether they are likely to reach their goal. While using elements of economic welfare theory, this paper distinguishes between general wealth lost due to economic market failure and the loss of distributable wealth to authors due to bargaining disadvantages. Whether or not the latter is a warranted ground for intervention from an economic welfare perspective, it is largely what the legislatures in question aim to correct. For this and other reasons,⁷ this paper refrains from a general welfare analysis and instead examines and evaluates the

⁶ Although the argument could also be made that the distribution of wealth to authors serves to incentivize investment in artistic creation, such economic reasoning is scarce in the legislative discussion on restricting new use right grants. Instead, the distribution rationale is regularly based on natural rights theories or fairness concerns. *See infra* Part II.

⁷ *See infra* CONCLUSION.

concrete legislative assumptions and goals. Although this paper's conclusions do not determine the optimal design of new use right laws, they provide helpful insights and indicate a sensible direction for further research and legislative discussion. Market reality and technological change call for continuous reconsideration of copyright laws. For example, in 2008, Germany fundamentally reformed its previously prohibitive approach to the grant of unknown use rights, and other countries, such as India, are currently engaged in legislative debate over the question of these restrictions.⁸ This paper helps to draw a better picture of the costs and benefits involved in the various methods of achieving legislatures' goals.

Part I establishes the legal approaches to new use right grants in the prominent jurisdictions of Germany, France, and the United States. Part II looks at the legislative reasoning for restricting new use right grants in France and pre-reform Germany. Part III evaluates this reasoning in light of applicable economic theory. The final Part concludes and discusses possible future implications.

I. LEGAL LANDSCAPE OF NEW USE RIGHTS

The United States generally allows the free transfer of rights to unknown uses of copyrighted works.⁹ Similar situations exist in other countries, such as the United Kingdom¹⁰ and Ireland.¹¹ Some countries,

⁸ A recent copyright reform bill in India introduced a new provision that would prohibit the grant of rights to unknown uses. *See* Copyright (Amendment) Bill, Rajya Sabha 24, § 6 (2010) (India) (as introduced), *available at* <http://copyright.gov.in/Documents/CopyrightAmendmentBill2010.pdf>. *See also* STANDING COMM. ON HUMAN RES.DEV., REP.NO. 227, REPORT ON THE COPYRIGHT (AMENDMENT) BILL, 2010 (2010) (India), *available at* <http://www.prsindia.org/uploads/media/Copyright%20Act/SCR%20Copyright%20Bill%202010.pdf> (committee report leading to the amendment).

⁹ *See infra* Part I.3.

¹⁰ Copyright, Designs and Patents Act, 1988, c.48, §§ 90, 91 (U.K.), *available at* <http://www.legislation.gov.uk/ukpga/1988/48/data.pdf>; *see also* MICHAEL CHOI, STELLUNG DES URHEBERS UND SEIN SCHUTZ IM URHEBERVERTRAGSRECHT SOWIE IM COPYRIGHT CONTRACT LAW: EINE RECHTSVERGLEICHENDE STUDIE [POSITION OF THE AUTHOR AND HIS

however, limit copyright grants to those distribution methods known at the time of the contract. This restrictive approach is taken in jurisdictions such as Germany (prior to the reform in 2008),¹² Spain,¹³ Belgium,¹⁴ Greece,¹⁵ Poland,¹⁶ Hungary,¹⁷ and the Czech Republic.¹⁸ France has a system that allows the grant of unknown use rights but is considerably restrictive in effect.¹⁹ There was recently a legislative proposal in India

PROTECTIONS IN THE COPYRIGHT CONTRACT ACT VERSUS COPYRIGHT CONTRACT LAW: A COMPARATIVE STUDY] Kovac (2007), p. 171.

¹¹ Copyright and Related Rights Act 2008 §§ 120, 121 (Act No. 28/2000) (Ir.), available at <http://www.irishstatutebook.ie/pdf/2000/en.act.2000.0028.pdf>.

¹² See *infra* Part I.1.

¹³ Intellectual Property Law art. 43(5) (B.O.E. 1996, 97) (Spain), translated in Spain: *Royal Legislative Decree 1/1996 of April 12 Approving the Revised Law on Intellectual Property, Regularizing, Clarifying and Harmonizing the Applicable Statutory Provisions*, WORLD INTELL. PROP. ORG., available at <http://www.wipo.int/wipolex/en/details.jsp?id=1358>.

¹⁴ Loi relative au droit d'auteur et aux droits voisins [Law on Copyright and Neighboring Rights] of June 30, 1994, art. 3(1), MONITEUR BELGE [M.B.] [Official Gazette of Belgium], July 27, 1994, 19297 (Belg.), translated in Belgium: *Law on Copyrights and Neighboring Rights*, WORLD INTELL. PROP. ORG., available at <http://wipo.int/clea/en/details.jsp?id=348>; see also Frank Gotzen, *Das belgische Urhebervertragsrecht [Belgian Copyright Contract Law]*, in: URHEBERRECHT IM INFORMATIONENZEITALTER: Festschrift für Wilhelm Nordeemann zum 70. Geburtstag am 8. Januar 2004 [COPYRIGHT LAW IN THE INFORMATION AGE: COMMEMORATING WILHELM NORDEEMANN'S 70TH BIRTHDAY ON JANUARY 8, 2004], Ulrich Loewenheim ed., Beck (2004) (Ger.) [hereinafter COPYRIGHT LAW IN THE INFORMATION AGE], 515, p. 520.

¹⁵ Nomos (1993:2121) Pnyematikh idiokthsia, syggenika dikaiwmata kai politistika themata [Law on Copyright, Related Rights and Cultural Matters], EPHEMERIS TES KYVERNESEOS TES HELLENIKES DEMOKRATIAS [E.K.E.D.] 1993, A:25, art. 13(5) (Greece), translated in Greece: *Law 2121/1993 on Copyright, Related Rights and Cultural Matters*, WORLD INTELL. PROP. ORG., available at <http://www.wipo.int/clea/en/details.jsp?id=1790>.

¹⁶ Ustawa o prawie autorskim i prawach pokrewnych [Act on Copyright and Neighboring Rights] of Feb. 4, 1994, DZIENNIK USTAWA [DZ.U.] 1994 Nr 24, poz. 83, art. 41(4) (Pol.), translated in Poland: *Law of February 4, 1994, on Copyright and Neighboring Rights*, WORLD INTELL. PROP. ORG., available at <http://www.wipo.int/wipolex/en/details.jsp?id=3500>.

¹⁷ 1999. évi LXXVI. törvény a szerzői jogról (Act LXXVI of 1999 on Copyright Law), art. 44(2) (Hung.), translated in Hungary: *Act No. LXXVI of 1999 on Copyright*, WORLD INTELL. PROP. ORG., available at <http://www.wipo.int/clea/en/details.jsp?id=2213>.

¹⁸ Zákon č. 121/2000 Sb., autorský zákon, art. 46(2) [Copyright Act] (Czech), translated in Czech Republic: *Law No. 121/2000 Coll. of 7 April 2000 on Copyright, Rights Related to Copyright and on the Amendment of Certain Laws (Copyright Act)*, WORLD INTELL. PROP. ORG., available at <http://www.wipo.int/clea/en/details.jsp?id=962>.

¹⁹ See *infra* Part II.2.

that aimed to introduce a prohibition on such grants.²⁰ This Part describes the legal landscapes of prominent jurisdictions—specifically, pre-reform Germany, France, and the United States. It finds that the two European copyright regimes are more restrictive in their legal treatment of new use rights than is U.S. copyright law.

1. *New Use Rights in Germany*

Prior to its reform in 2008, the German Copyright Act explicitly prohibited the licensing of rights to new uses. Section 31(4) established that “[t]he grant of an exploitation right for as yet unknown types of use and any obligations in that respect shall have no legal effect.”²¹ This strict protection of new use rights, although not statutorily introduced until the 1960s, was a codification of judicially developed rules that began restricting rights transfers as early as the beginning of the twentieth century.²² In a prominent case in 1927, the German Federal Court of Justice denied a publisher the film rights to the operetta *Das Musikantenmädel*,²³ even though film technology was known (albeit not

²⁰ See *supra* note 8.

²¹ Gesetz über Urheberrecht und verwandte Schutzrechte [Urheberrechtsgesetz] [UrhG] [Copyright Act], Sept. 9, 1965, BUNDESGESETZBLATT [BGBl.] I at 1273, § 31(4) (as adopted in 1965) (Ger.). “Exploitation right” is a continental European term covering use and distribution of a copyrighted work.

²² Artur-Axel Wandtke & Eike Wilhelm Grunert, § 31 *Einräumung von Nutzungsrechten*, in: PRAXISKOMMENTAR ZUM URHEBERRECHT [PRACTITIONER’S COMMENTARY ON COPYRIGHT LAW], Artur-Axel Wandtke & Winifried Bullinger eds., 2d ed., Beck (2006) (Ger.), p. 422; STEFAN DREWES, NEUE NUTZUNGSARTEN IM URHEBERRECHT [NEW USES IN COPYRIGHT LAW] Nomos (2002) (Ger.), p. 28–37; KERSTIN A. ZSCHERPE, ZWEITVERWERTUNGSRECHTE UND § 31 ABS. 4 URHG: EINE KRITISCHE ANALYSE [COPYRIGHT COLLECTIVES AND § 31 PARA. 4 OF THE COPYRIGHT CODE: A CRITICAL ANALYSIS], Nomos (2004) (Ger.), p. 29; Stefan Lütje, *Die unbekanntete Nutzungsart im Bereich der Filmwerke—alles Klimbim?* [*The Unknown Use in the Area of Cinematic Works—Always Klimbim (Fuss and Bother)?*], in: AKTUELLE RECHTSPROBLEME DER FILMPRODUKTION UND FILMLIZENZ: FESTSCHRIFT FÜR WOLF SCHWARZ ZU SEINEM 80. GEBURTSTAG [CURRENT LEGAL PROBLEMS OF FILM PRODUCTION AND FILM LICENSE: COMMEMORATING WOLF SCHWARZ ON HIS 80TH BIRTHDAY], Jürgen Becker & Mathias Schwarz eds., Nomos (1999) (Ger.) 115, p. 116; see also *infra* Part II.1.

²³ Reichsgericht [RG] [Federal Court of Justice] Oct. 29, 1927, 118 ENTSCHEIDUNGEN DES REICHSGERICHTS IN ZIVILSACHEN [RGZ] 282 (Ger.).

widespread) at the time, and the broadly worded contract clause covered the rights to the text and stage directions “for all times and with all current and future derived rights, including all translation and performance rights, as well as the rights of stage operation and performance for all countries.”²⁴

Two years later, the German Federal Court of Justice decided that a publisher did not have control over the broadcasting rights to the creations of Wilhelm Busch, despite a contract assigning the company the full copyright to all of his works.²⁵ In a following case concerning gramophone record rights in 1931,²⁶ the court validated the grant, reasoning that it pertained to a closely related advancement of previous distribution methods. This argument, in effect, confirmed that not all uses were covered by the blanket clause granting the “irrevocable exclusive authorization to exploit all held rights using currently known or yet to be invented mechanical music instruments of all kinds. . . as well as all cinematographical rights.”²⁷

²⁴ *Id.* at 285 (“[F]ür alle Zeiten und mit allen gegenwärtig und künftig fließenden Rechten, auch den sämtlichen Übersetzungs- und Aufführungsrechten, sowie dem Rechte des Bühnenbetriebs und der Aufführung für alle Länder.”). Translations by the author, unless otherwise noted.

²⁵ RG Feb. 16, 1929, 123 RGZ 312 (Ger.).

²⁶ RG Nov. 14, 1931, 134 RGZ 198 (Ger.).

²⁷ *Id.* at 199 (“[U]nwiderrufliche ausschliessliche Vollmacht zur Ausnutzung aller ihrer Rechte bei jetzt bekannten oder noch zu erfindenden mechanischen Musikinstrumenten aller Art . . . und aller ihrer kinematographischen Rechte.”). Two other prominent cases in the 1960s concerned Curt Goetz’s filmography works. The first involved a similar dispute on whether the television rights had been granted along with the general film rights (finding they had not), and the second did not deal directly with the issue of unknown distribution methods, but confirmed the restrictive interpretation of copyright agreements in general. Curt-Goetz-Filme II, BGH Oct. 2, 1968, GEWERBLICHER RECHTSSCHUTZ UND URHEBERRECHT [GRUR] 143, 1969 (Ger.); Curt-Goetz-Filme III, BGH Oct. 2, 1968, GRUR 364, 1969 (Ger.). Other noteworthy cases include the German Federal Court of Justice decision *Keine Ferien für den lieben Gott*, Bundesgerichtshof [BGH] [Federal Court of Justice] Oct. 16, 1959, GRUR 197, 1960 (Ger.), in which the court decided that a clause granting the “exclusive substandard film exploitation rights in their entirety” did not include the television rights to the movie. Furthermore, although a later German Federal Court of Justice decision allowed for expansion to television based on a contract clause that granted the rights to “[A]ll ways, systems, and methods known at the time of the contract, and all ways, systems, and methods not yet found and invented at the time of the contract, in particular film broadcast and color film,” the court justified this decision solely through a wide interpretation of the term “film broadcast,” confirming that the blanket

After the explicit establishment of § 31(4) in the Copyright Act, German courts continued to confirm the prohibition in subsequent cases. Prominent examples include *Videozweitauswertung*,²⁸ in which the German Federal Court of Justice concluded that the copyright to the new VHS technology was not transferred in a 1968 license granting the rights to all known and future uses and *Spiegel-CD-ROM*,²⁹ finding that, based on § 31(4) of the 1965 Copyright Act, the publication rights to newspaper articles did not extend to CD-ROM technology. In the years prior to the reform, cases favored less restrictions on expansion into other media, as courts increasingly declared technological advancements not to be “unforeseen” or “new” uses in a legal sense.³⁰ In the mid-1990s, the German Federal Court of Justice began to establish the practice of allowing “risk agreements” (*Risikogeschäfte*) that covered technically known but, at the time, economically unimportant distribution methods.³¹ This stood in contrast to its previous practice of requiring that “known”

clause covering uninvented methods was invalid. *Altverträge*, BGH May 13, 1982, GRUR 727, 1982 (Ger.).

²⁸ BGH Oct. 11, 1990, GRUR 133 (135–36), 1991 (Ger.).

²⁹ Oberlandesgericht [OLG] [Higher Regional Court] Nov. 5, 1998, MULTIMEDIA UND RECHT [MMR] 225, 1999 (Ger.), *aff'd by* BGH July 5, 2001, 148 ENTSCHIEDUNGEN DES BUNDESGERICHTS IN ZIVILSACHEN [BGHZ] 221 (Ger.) (the court focused on the “purpose of grant” rule (Zweckübertragungsregel) in the original version of the Copyright Act, UrhG Sept. 9, 1965, BGBL. I at 1273, § 31(5) (as adopted in 1965) (Ger.)); *see also, e.g.*, OLG Oct. 10, 1995, NEUE JURISTISCHE WOCHENSCHRIFT-RECHTSPRECHUNGS-REPORT, ZIVILRECHT [NJW-RR] 420, 1996 (Ger.) (finding a CD to be a new use compared to records and cassette tapes); *see also* *Kassettenfilm*, BGH Apr. 26, 1974, GRUR 786, 1974 (Ger.) (leaving the question of new use open, but invoking the purpose of grant rule to find that a 1966 license granting all broadcast and film rights does not include distribution of super-8 cassettes).

³⁰ *See* Lütje, *supra* note 22, at 115.

³¹ *Videozweitauswertung III*, BGH Jan. 26, 1995, 128 BGHZ 336 (Ger.); *EROC III*, BGH Oct. 10, 2002, GRUR 234, 2003 (Ger.); *Klimbim*, BGH July 4, 1996, 133 BGHZ 281 (Ger.); *Der Zauberberg*, BGH May 19, 2005, 163 BGHZ 109 (Ger.); *see also* GERHARD SCHRICKER & ULRICH LOEWENHEIM, URHEBERRECHT: KOMMENTAR [COPYRIGHT LAW: COMMENTARY], 4th ed., Beck (2010) (Ger.), p. 32; MANFRED REHBINDER, URHEBERRECHT: EIN STUDIENBUCH [COPYRIGHT LAW: A STUDY GUIDE], 16th rev. ed., Beck (2010) (Ger.), p. 214; Gernot Schulze, § 31a *Verträge über unbekanntes Nutzungsarten*, in: THOMAS DREIER & GERNOT SCHULZE, URHEBERRECHTSGESETZ, URHEBERRECHTSWAHRNEHMUNGSGESETZ, KUNSTURHEBERGESETZ: KOMMENTAR, 4th ed., Beck (2013) (Ger.) 595, p. 607–609; ULRICH LOEWENHEIM, HANDBUCH DES URHEBERRECHTS [COPYRIGHT LAW HANDBOOK], 2d ed., Beck (2010) (Ger.), p. 1263–1264; *infra* Part III.2.f.

technology be economically meaningful.³² Although these tendencies lessened the restriction on new use right grants, the prohibition continued to be upheld for significant technology advancements that were not invented at the time of the contract.³³

In 2008, a reform introduced a new regime for new use right grants. It abolished Section 31(4) and officially allowed the transfer of rights to unknown uses of copyrighted works. The reform, however, also introduced an inalienable revocation right, whereby authors are able to revoke the grant within three months after the publisher notifies them of a new distribution method.³⁴ Because Germany restricted new use right grants for nearly a century before deciding to overturn this rule, it is a particularly interesting example to examine in this context. The long history of restricting new use right grants in Germany is different from the approach of other legal systems, such as that of the United States.³⁵

2. France

The French Intellectual Property Code contains no explicit prohibition of transferring rights to unknown uses of a copyrighted work. Interestingly, despite strict regulations governing the content and scope of

³² See, e.g., GEMA Vermutung I, BGH June 5, 1985, 95 BGHZ 274 (275) (Ger.); GEMA-Vermutung IV, BGH Oct. 15, 1987, GRUR 296 (298), 1988 (Ger.); Videozweitauswertung I, BGH Oct. 11, 1990, GRUR 133 (136), 1991 (Ger.); see also PHILIPP MÖHRING & KÄTE NICOLINI, URHEBERRECHTSGESETZ [COPYRIGHT ACT], Beck (1970) (Ger.), p. 231.

³³ See, e.g., Spiegel-CD-ROM, OLG Nov. 5, 1998, MMR 225, 1999 (Ger.); Video-on-demand, OLG Mar. 19, 1998, ZEITSCHRIFT FÜR URHEBER- UND MEDIENRECHT [ZUM] 413 (416), 1998 (Ger.); Elektronische Zeitung im Internet, OLG May 11, 2000, ZUM 870, 2000 (Ger.); Fernsehproduktion im Internet, Landgericht [LG] [Regional Court] Mar. 10, 1999, MMR 291, 2000 (Ger.); EROC III, BGH Oct. 10, 2002, GRUR 234 (235), 2003 (Ger.) (not denying that CD could be a new use, despite much controversy in lower courts and commentary); see also OLE JANI, DER BUY-OUT-VERTRAG IM URHEBERRECHT [THE BUY-OUT CONTRACT IN COPYRIGHT LAW], Berlin-Verlag Spitz (2003) (Ger.), p. 107; Jan Bernd Nordemann, *Die erlaubte Einräumung von Rechten für unbekannte Nutzungsarten* [The Permissible Appropriation of Rights for Unknown Uses], in: COPYRIGHT LAW IN THE INFORMATION AGE, *supra* note 14, at 193, 206 (Ger.).

³⁴ The specifics of the reform and the developments that led to this change are discussed in more detail *infra* Part III.2.f.

³⁵ See *infra* Part I.3.

copyright agreements,³⁶ the Code contains a provision that explicitly allows for a grant of rights to unforeseen uses. Article L. 131-6 states: “Any assignment clause affording the right to exploit a work in a form that is unforeseeable and not foreseen on the date of the contract shall be explicit and shall stipulate participation correlated to the profits from exploitation.”³⁷ At first glance, this provision is seemingly the opposite of the clear prohibition found in other European countries. Although the provision requires an explicit contract clause and a profit participation agreement, it does not prevent the author from signing away the rights to unforeseen uses. However, French commentary and case law indicates that the applicability of this provision is somewhat restricted. As implied by the wording of the clause, Article L. 131-6 intends to cover two types of unforeseeability: (1) unforeseeability in the sense that it was impossible for anyone to know of the future use at the time of the contract (*non prévisible*) and (2) unforeseeability in the sense that the use already existed at the time, but was unforeseen by the contracting parties (*non prévue*).³⁸ However, the French Intellectual Property Code also has a specification requirement in Article L. 131-3 which states: “Transfer of authors’ rights shall be subject to each of the assigned rights being separately mentioned in the instrument of assignment and the field of exploitation of the assigned rights being defined as to its scope and purpose, as to place and as to duration.”³⁹

³⁶ See ANDRÉ LUCAS, PROPRIÉTÉ LITTÉRAIRE ET ARTISTIQUE [LITERARY AND ARTISTIC PROPERTY], 4th ed., Dalloz (2010) (Fr.), p. 95, 97; PIERRE-YVES GAUTIER, PROPRIÉTÉ LITTÉRAIRE ET ARTISTIQUE [LITERARY AND ARTISTIC PROPERTY], 6th ed., Presses Universitaires de France (2007) (Fr.) p. 534; FRÉDÉRIC POLLAUD-DULIAN, LE DROIT D’AUTEUR [COPYRIGHT LAW], Économica (2005) (Fr.), p. 582–584.

³⁷ Loi 92-597 du 1 juillet 1992 relative au code de la propriété intellectuelle [Law 92-597 of July 1, 1992 on the Intellectual Property Code], JOURNAL OFFICIEL DE LA RÉPUBLIQUE FRANÇAISE [J.O.] [OFFICIAL GAZETTE OF FRANCE], July 3, 1992, p. 8801, art. L. 131-6, translated in *Intellectual Property Code: Legislative Part*, LEGIFRANCE, available at <http://legifrance.gouv.fr/affichTexte.do?cidTexte=JORFTEXT000000357475> (last updated September 15, 2003). The continental European term “exploitation” covers use and distribution of copyrighted works. See *supra* note 21.

³⁸ See HENRI DESBOIS, LE DROIT D’AUTEUR EN FRANCE [COPYRIGHT LAW IN FRANCE], 3d ed., Dalloz (1978)(Fr.), p. 641; CLAUDE COLOMBET, PROPRIÉTÉ LITTÉRAIRE ET ARTISTIQUE ET DROITS VOISINS [COPYRIGHT AND NEIGHBORING RIGHTS], 8th ed. Dalloz (1997) (Fr.), p. 235.

³⁹ Law 92-597 of July 1, 1992, art. L. 131-3 (Fr.).

The specification requirement clearly stipulates that a transfer of rights must explicitly list each individual distribution method in the contract.⁴⁰ As a result, Article L. 131-6 cannot pertain to uses that were merely unforeseen by the parties but only pertains to uses that were entirely unanticipated because they did not exist at the time.⁴¹ But herein lays another problem: distribution methods that are entirely unforeseen will generally be unable to meet the explicit description requirement because the circumstances and scope of unforeseen distribution methods are, in most cases, impossible to define.⁴² Additionally, the requirement of agreeing on a correlated share of the profits may render the grant ineffective as well, since the practical feasibility of such a share is not at all clear at the time of the contract.⁴³ As a result, much of the literature regards the applicable scope of Article L. 131-6 as either insignificantly small⁴⁴ or even entirely nonexistent.⁴⁵

A considerably limited application of Article L. 131-6 also seems in line with the contract-regulating rules found in the French Intellectual Property Code. For example, copyright agreements are subject to the principle of restrictive interpretation set forth in Article L. 122-7, which requires agreements purporting a full transfer of rights to remain strictly limited to the distribution methods determined by the contract.⁴⁶ It seems

⁴⁰ See POLLAUD-DULIAN, *supra* note 36, at 583; HERBERT SCHADEL, DAS FRANZÖSISCHE URHEBERVERTRAGSRECHT [THE FRENCH COPYRIGHT CONTRACT LAW], Beck (1966) (Ger.), p. 29.

⁴¹ See DESBOIS, *supra* note 38, at 641; POLLAUD-DULIAN, *supra* note 36, at 589; SCHADEL, *supra* note 40, at 29.

⁴² See Roger Fernay, *La cession et le contrat d'édition* [The Assignment and the Publishing Contract], 19 REVUE INTERNATIONALE DU DROIT D'AUTEUR [RIDA] 257 (1958) (Fr.), p. 295; COLOMBET, *supra* note 38, at 235.

⁴³ See POLLAUD-DULIAN, *supra* note 36, at 590; SCHADEL, *supra* note 40, at 29; *see also* DREWES, *supra* note 22, at 95; Frédérique Genton, *Multimedia im französischen Urheberrecht: der zweite Sirinelli-Bericht* [Multimedia in French Copyright Law: The Second Sirinelli Report], 6 GEWERBLICHER RECHTSSCHUTZ UND URHEBERRECHT, INTERNATIONALER TEIL [GRUR INT.] 693 (1996) (Ger.), p. 696 (discussing the problems of the financial evaluation of multimedia works under French law).

⁴⁴ See DESBOIS, *supra* note 38, at 641; SCHADEL, *supra* note 40, at 28–29.

⁴⁵ See COLOMBET, *supra* note 38, at 235; DREWES, *supra* note 22, at 95–96; Fernay, *supra* note 42, at 295.

⁴⁶ See Law 92-597 of July 1, 1992 on the Intellectual Property Code, J.O., July 3, 1992, p. 8801, art. L. 122-7 (Fr.), translated in *Intellectual Property Code: Legislative Part*, LEGIFRANCE, available at <http://legifrance.gouv.fr/affichTexte.do?cidTexte=JORFTEXT00000357475> (last updated September 15, 2003) (“Where a contract contains the

contradictory to Article L. 122-7 and with Article L. 131-3 (requiring the author's explicit permission)⁴⁷ to allow a liberal application of Article L. 131-6, especially considering the legislative reasoning behind these restrictive principles.⁴⁸

There are few court cases concerning Article L. 131-6 (or its predecessor).⁴⁹ The most prominent decision, *Plurimédia*, involved journalists that contested the online publication of articles that were originally published in a printed newspaper.⁵⁰ The court ruled that the online use of the articles was an unforeseen distribution method and that the rights to this method were not transferred because there was neither an explicit contractual clause covering new uses nor any stipulated profit participation thereof.⁵¹ Although this decision confirms the basic restrictions found in the wording of Article L. 131-6, it does little to reveal how much further these restrictions may reach in practice. The court makes no further comment on the scope or applicability of the norm.⁵² In a similar case, *Le Figaro*,⁵³ journalists again complained that they had not granted permission for the online publication of their articles. Again, the court found no explicit agreement to the contrary and decided in favor of the journalists.⁵⁴

complete transfer of either of the rights referred to in this Article, its effect shall be limited to the exploitation modes specified in the contract.”); LUCAS, *supra* note 36, at 97; *see also* POLLAUD-DULIAN, *supra* note 36, at 583.

⁴⁷ *See* GAUTIER, *supra* note 36, at 534–535; LUCAS, *supra* note 36, at 97; POLLAUD-DULIAN, *supra* note 36, at 583–584.

⁴⁸ *See* discussion *infra* Part II.2.

⁴⁹ The predecessor to Article L. 131-6 is Loi 57-298 du 11 mars 1957 sur la propriété littéraire et artistique [Law 57-298 of March 11, 1957 on Literary and Artistic Property], J.O., Mar. 14, 1957, p. 2723, art. 38 (Fr.), *translated in Intellectual Property Code: Legislative Part*, LEGIFRANCE, available at <http://legifrance.gouv.fr/affichTexte.do?cidTexte=JORFTEXT000000357475> (last updated Sept. 15, 2003).

⁵⁰ *See id.*

⁵¹ Tribunal de grande instance [TGI] [ordinary court of original jurisdiction] Strasbourg, Feb. 3, 1998, JCP 1998, II, 10044 (Fr.), *translated in Symposium on Electronic Rights in International Perspective*, 22 COLUM.-VLAJ.L. & ARTS app. at 199 (1998).

⁵² In fact, it bases much of its decision on provisions found in employment law and the collective labor agreement between the parties.

⁵³ TGI Paris, Apr. 14, 1999, *Légipresse* 162, I, 69 & 162, III, 81 (Fr.).

⁵⁴ *Id.*; *see also* Bertrand Delcros, *France: Journalists' Copyright and the Internet*, 5 IRIS 3 (1999).

It is unclear why the legislature introduced Article L. 131-6 at all. The legislative history does not provide a completely satisfying explanation. The provision first appeared as Article 38 of the Law of 1957, with no change in wording when it was incorporated into the current act as Article L. 131-6. The preparatory documentation of the 1957 Law sheds little light on the provision's reasoning. An extra-parliamentary commission introduced the provision relatively late in the process, without explaining the rationale or precise meaning. It generated no recorded debate.⁵⁵ According to some speculation, the provision's originated as a requirement that authors explicitly approve every new use, as set forth by a draft law from 1936.⁵⁶ The provision in the draft law was apparently intended to legislatively counteract a decision by the French Supreme Court for Judicial Matters in 1930,⁵⁷ which found a contract made prior to the invention of the gramophone record to include the right to distribute the work using this new method. However, earlier case law established that the use of new distribution methods requires an explicit agreement.⁵⁸ Because the decision was not in accordance with prior case law, the legislature may have felt the need to implement a unifying provision. The court may have simply overlooked the basic underlying concern, which had already been comprehensively addressed by other provisions in the course of the reform.⁵⁹

Despite the lack of illuminating case law on Article L. 131-6 or its predecessor, French courts have indeed confirmed the strict treatment of contract clauses with regard to the restrictive interpretation principle set forth in Article L. 122-7 and the specification requirement set forth in Article L. 131-3. Overly broad clauses that purport to grant all rights generally violate these provisions and would likely be rendered void.⁶⁰

⁵⁵ See DESBOIS, *supra* note 38, at 641.

⁵⁶ See DREWES, *supra* note 22, at 94; *see also* Draft Law, in: JEAN ESCARRA, JEAN RAULT & FRANÇOIS HEPP, *LA DOCTRINE FRANÇAISE DU DROIT D'AUTEUR: ETUDE CRITIQUE A PROPOS DE PROJETS RECENTS SUR LE DROIT D'AUTEUR ET LE CONTRAT D'ÉDITION APP.* [THE FRENCH DOCTRINE OF COPYRIGHT: CRITICAL REVIEW ABOUT THE RECENT DRAFTS TO THE LAW ON COPYRIGHT AND PUBLISHING CONTRACTS], 2d ed., Éditions B. Grasset (1937) (Fr.).

⁵⁷ Cour de cassation [Cass.] [supreme court for judicial matters], May 10, 1930, D.P. 1932, I, 29 (Fr.).

⁵⁸ See DREWES, *supra* note 22, at 96.

⁵⁹ See *id.* at 95.

⁶⁰ See Cour d'appel [CA] [regional court of appeal] Paris, 1e ch., Feb. 20, 1981 (Fr.); *see also* POLLAUD-DULIAN, *supra* note 36, at 584; Neil Netanel, *Alienability Restrictions and*

The French Supreme Court for Judicial Matters has held that distribution methods without explicitly defined scope and purpose are not part of the contract and constitute infringement⁶¹ and that clauses such as “all rights included” (tous droits compris) are invalid.⁶² Furthermore, the principle of strict interpretation has led French courts to favor journalists in the many controversial cases of online publication rights.⁶³

Thus, France, like pre-reform Germany, employs a generally restrictive approach toward new use right grants. Right transfers in copyright agreements are subject to strict rules of interpretation—courts tend to invalidate clauses that are worded broadly, as grants of unknown use rights generally must be. However, some other countries allow broad grants of copyright without restrictions on what they are to be used for. The following describes the legal situation for the rights to unknown uses in the United States.

3. *The United States*

United States copyright law, often portrayed as the counterpart to author-protective systems, such as in France, does not restrict the voluntary transfer of new use rights.⁶⁴ The United States generally allows a transfer of copyright in its entirety.⁶⁵ In the case of a full transfer, there

the Enhancement of Author Autonomy in United States and Continental Copyright Law, 12 CARDOZO ARTS & ENT.L.J. 1 (1994), p. 68.

⁶¹ Cass., 1e civ., Nov. 28, 2000, Bull. civ. I, No. 308 (Fr.).

⁶² Cass., 1e civ., Bull. civ. I, No. 2536 (Fr.).

⁶³ See, e.g., CA Paris, 22e ch., June 9, 2009, 51 *Revue Lamy droit de l'immatériel* 2009, 1671 (Fr.); *Le Progrès*, TGI Lyon, July 21, 1999, *Légipresse* 166, I, 132 & 166, III, 156 (Fr.); see also *Plurimédia*, TGI Strasbourg, Feb. 3, 1998, *Légipresse* 149, I, 19 & 149, III, 22 (Fr.), translated in 22 *COLUM.-VLAJ.L. & ARTS* 199 (1998); *Le Figaro*, TGI Paris, Apr. 14, 1999, *Légipresse* 162, I, 69 & 162, III, 81 (Fr.); LUCAS, *supra* note 36, at 98.

⁶⁴ See Neil R. Nagano, Comment, *Past Copyright Licenses and the New Video Software Medium*, 29 *UCLA L. REV.* 1160 (1982), p. 1166; JENS WEICHE, *US-AMERIKANISCHES URHEBERVERTRAGSRECHT [AMERICAN COPYRIGHT CONTRACT LAW]*, Nomos (2002) (Ger.), p. 108.

⁶⁵ 17 U.S.C. § 201(d)(1) (2006) (“The ownership of a copyright may be transferred in whole or in part. . . .”); see also MELVILLE B. NIMMER & DAVID NIMMER, *NIMMER ON COPYRIGHT*, rev. ed., Matthew Bender (2009) § 10.10[B], p. 85; PAUL GOLDSTEIN, *GOLDSTEIN ON COPYRIGHT*, 3d ed., Aspen Publishers (2010), §§ 5.1, 5.1.1.1.

is no question that all exclusive rights pass on to the transferee, regardless of whether these rights pertain to known or unknown uses of the work.⁶⁶ Thus, if an author transfers her entire copyright to another party, that party will obtain the rights to use the work in all media developed after the transfer.

The question of unknown uses only arises when specific exclusive rights are transferred or licensed. In this situation, United States copyright law imposes no restrictions on the author regarding the alienation of rights to future uses. These rights can be transferred if it is the explicitly expressed will of the contracting parties.⁶⁷ The accumulation of case law on new use right grants in the United States therefore mainly deals with situations where there is no explicitly expressed will of the parties. Here, legal scholars and courts apply the principles of general contract law. The rights to new uses are thereby generally allocated according to the implicit will of the parties.⁶⁸ Therefore, even when the contract does not explicitly provide for it, a transferee may be able to appropriate such rights from the author. Many such decisions follow the lead of *Bartsch v. Metro-Goldwyn-Mayer, Inc.*, in which the Second Circuit held that the granted motion picture rights to a musical included the television rights.⁶⁹ The agreement referred to “motion picture rights throughout the world” and allowed MGM to “otherwise reproduce the . . . play . . . visually or audibly by the art of cinematography or any process analogous thereto.”⁷⁰ The court read the agreement as implying intent on the author’s part to grant the broadest rights possible regarding his work, namely the film adaption of his play.⁷¹

Problems arise, however, when the parties have no discernible will at all—for instance, when they use overly vague contract clauses or when both parties simply do not anticipate the possibility of a new distribution method at the time of the contract. Such cases have been the subject of

⁶⁶ See 17 U.S.C. § 106; Nagano, *supra* note 64, at 1166.

⁶⁷ See *Rooney v. Columbia Pictures Indus.*, 538 F. Supp. 211, 229 (S.D.N.Y. 1982); Netanel, *supra* note 60 at 70; Nagano, *supra* note 64, at 1166.

⁶⁸ See NIMMER & NIMMER, *supra* note 65, at § 10.10[B]; Joanne Benoit Nakos, Comment, *An Analysis of the Effect of New Technology on the Rights Conveyed by Copyright License Agreements*, 25 CUMB.L. REV. 433 (1995), p. 438.

⁶⁹ *Bartsch v. Metro-Goldwyn-Mayer, Inc.*, 391 F.2d 150 (2d Cir. 1968).

⁷⁰ *Id.* at 152.

⁷¹ *Id.* at 154.

much litigation and legal analysis in the United States.⁷² Generally, these cases settle or become subject to ambiguous rulings by the court system.⁷³ Various approaches exist to allocate the rights in these situations. For instance, applying the principle of interpreting unclear clauses in favor of the non-drafting party would have authors retain any rights not expressed by their intent.⁷⁴ The leading case applying a restrictive approach to interpret grants is the Ninth Circuit's decision in *Cohen v. Paramount Pictures Corp.*⁷⁵ The court held that a license to a musical composition that includes a right to exhibit a film on television does not include the right to expand to videocassettes, explaining: "Although the language of the license permits the *recording and copying* of the movie with the musical composition in it, in any manner, medium, or form, nothing in the express language of the license authorizes *distribution* of the copies to the public by sale or rental."⁷⁶ The court thus read the lack of a clause granting videocassette rights to Paramount to mean that they were retained, even adding that "[t]he holder of the license should not now 'reap the entire windfall' associated with the new medium."⁷⁷

Another view advocates that licensees should have all the rights that are reasonably within the scope of the distribution method and purpose.⁷⁸ In *Boosey & Hawkes Music Publishers v. Walt Disney Co.*,⁷⁹ the Second Circuit held that the right to record the musical composition "in any manner, medium or form for use in [a] motion picture" included

⁷² For an overview of the case law, see NIMMER & NIMMER, *supra* note 65, at § 10.10[B]; see also Nakos, *supra* note 68, at 436; Nagano, *supra* note 64, at 1169; Carolina Saez, *Enforcing Copyrights in the Age of Multimedia*, 21 RUTGERS COMPUTER & TECH.L.J. 351 (1995), p. 374–377; Sidney A. Rosenzweig, Comment, *Don't Put My Article Online! Extending Copyright's New-Use Doctrine to the Electronic Publishing Media and Beyond*, 143 U.PA.L. REV. 899 (1995), p. 908–920; *Boosey & Hawkes Music Publishers v. Walt Disney Co.*, 145 F.3d 481, 486 (2d Cir. 1998).

⁷³ See NIMMER & NIMMER, *supra* note 65, at § 10.10[B].

⁷⁴ At least when they are dealing with standard form contracts and other publisher-drafted agreements, such is the norm in many publishing industries. See, e.g., *Rey v. Lafferty*, 990 F.2d 1379 (1st Cir. 1993).

⁷⁵ *Cohen v. Paramount Pictures Corp.*, 845 F.2d 851 (9th Cir. 1988).

⁷⁶ *Id.* at 853.

⁷⁷ *Id.* at 854 (quoting Nagano, *supra* note 64, at 1184).

⁷⁸ See, e.g., NIMMER & NIMMER, *supra* note 65, at 86–87; see also *Platinum Record Co. v. Lucasfilm, Ltd.*, 566 F. Supp. 226 (D.N.J. 1983); *Rooney v. Columbia Pictures Indus.*, 538 F. Supp. 211, 229 (S.D.N.Y. 1982).

⁷⁹ 145 F.3d 481 (2d Cir. 1998).

videocassette rights.⁸⁰ The court stated that the licensee should be able to “pursue any uses which may reasonably be said to fall within the medium as described in the license.”⁸¹

None of the approaches appears to have decisively gained the upper hand.⁸² Nevertheless, the relevant observation for the purpose of this Part is that the voluntary transfer of new use rights is neither forbidden nor prohibitively restricted in the United States. This is not to say that United States copyright law ignores the problem of unforeseen future value of creative works—author termination rights provide a mechanism for dealing with these issues. The 1976 Copyright Act contains a provision that grants the author (and successors) a general contract termination right after a period of thirty-five years.⁸³ Congress was concerned that the future value of creative works would be difficult to predict and that authors are often the party less experienced in publishing matters and with less leverage in bargaining for terms.⁸⁴ The next paper in this doctoral thesis examines United States author termination rights, their legal history, and their economic effects in detail.⁸⁵

4. Summary

This Part shows that France and pre-reform Germany have a restrictive approach to new use right grants. Broadly worded contract clauses that assign the rights to all future and unknown uses of a work are invalidated, generally preventing publishers from using unforeseen distribution

⁸⁰ *Id.* at 486 (internal quotation marks omitted).

⁸¹ *Id.* at 486 (quoting *Bartsch v. Metro-Goldwyn-Mayer*, 391 F.2d 150, 155 (2d Cir. 1968)).

⁸² See NIMMER & NIMMER, *supra* note 65, at 85–94; Nagano, *supra* note 64, at 1183–92; Nakos, *supra* note 68, at 455–61; Barbara D. Griff, Note, *A New Use for an Old License: Who Owns the Right?* 17 CARDOZO L. REV. 53 (1995), p. 82–84; Saez, *supra* note 72, at 371–373; Rosenzweig, *supra* note 72, at 920–26; Stacey M. Byrnes, *Copyright Licenses, New Technology and Default Rules: Converging Media, Diverging Courts?* 20 LOY.L.A.ENT.L. REV. 243 (2000), p. 271–274.

⁸³ 17 U.S.C. §§ 203, 304 (2006) (“notwithstanding any agreement to the contrary”); see also GOLDSTEIN, *supra* note 65, at § 5.4.

⁸⁴ See REGISTER OF COPYRIGHTS, COPYRIGHT LAW REVISION: REPORT ON THE GENERAL REVISION OF THE U.S. COPYRIGHT LAW 92 (Comm. Print 1961); H.R. REP.NO. 94-1476, at 124 (1976).

⁸⁵ See *infra* Chapter B of this thesis.

methods without regaining explicit permission. While such copyright license restrictions are common in Europe, there are other legal systems with less regulation regarding new uses. The United States permits the voluntary transfer of unknown use rights, not restricting the use or purpose of copyright grants. The next Part explores the reasoning behind restraining the grant of rights to new uses in France and pre-reform Germany in order to understand the legislatures' desired goals.

II. LEGISLATIVE REASONING

The official legislative reasoning behind limiting the contractual freedom of the parties to known uses of a work is commonly distributive: according to lawmakers in countries that prohibit the grant of new use rights, the main goal is to allocate to authors the financial returns of their artistic works. This aim is regularly based on societal preferences, such as notions of fairness.⁸⁶ Although creators initially have control over their copyright,⁸⁷ some fear that creators might transfer their rights to publishers because creators face a variety of bargaining disadvantages when negotiating with publishers. Therefore, they deem legal intervention necessary to ensure that authors are not “cheated” out of the intended wealth distribution. This Part traces the historical development of restrictions on transfers of new use rights in Germany and France and brings to light the intent and reasoning of the legislatures and courts behind implementing and upholding this contractual restriction.

To better understand the distributional reasoning for legal rules pertaining to the transfer of copyrights, it is helpful to summarize how and why these rights were allocated to authors in the first place.⁸⁸ Tracing

⁸⁶ The non-distributive economic argument of giving artists the returns from their works in order to incentivize artistic creation does not seem prevalent. Instead, legislative reasoning commonly follows natural rights theories. *See infra* Parts II.1-2.

⁸⁷ Legal systems that prohibit new use right grants generally do not employ a “work made for hire” doctrine as is known to U.S. copyright law.

⁸⁸ What may seem logical today, in a legal world that automatically grants authors intellectual property, is based on entitlement choices that legal systems have made over the last two centuries. These are allocations that could just as well have been made

these underlying principles helps to explain why many European countries have a strong focus on protecting authors and allocating wealth in their copyright laws.⁸⁹ This Part, therefore, briefly delves into the history of how copyrights initially emerged in Germany and France before it addresses the developments that led to the restrictions on transferring new use rights.

1. *Germany*

The first copyright protection in Germany came in the form of the privilege system. Local sovereigns granted letterpress printers (and later publishers) a temporary exclusive monopoly to prevent competitors from eroding the gains from their investments.⁹⁰ This system was abolished at the end of the nineteenth century, and philosophers began to propagate the concept of an author's moral rights, arguing that the author's intellectual property should comprise the right to control all reproduction and dissemination of the work.⁹¹ As a result of this movement, new laws towards the end of the nineteenth century vested certain (restricted) rights in authors to prevent unauthorized reproduction of their works.⁹²

differently. Indeed, looking at the history of copyright law, one finds that although the legal result—allocating distribution rights to the creators of artistic works—is quite similar across borders, the reasoning on which different countries have based their choices varies considerably.

⁸⁹ In other countries, such as the United States, the law has a slightly different history and purpose. U.S. copyright scholars may therefore find the premise of European copyright law of interest.

⁹⁰ This form of copyright protection was employed in the fifteenth and sixteenth century in Italy, Germany, France, England, and other European countries. *See* ELIZABETH ARMSTRONG, *BEFORE COPYRIGHT: THE FRENCH BOOK-PRIVILEGE SYSTEM, 1498–1526*, Cambridge University Press (1990), p. 1–10; EUGEN ULMER, *URHEBER- UND VERLAGSRECHT [COPYRIGHT LAW AND PUBLISHING]*, 3d ed., Springer (1980) (Ger.), p. 51.

⁹¹ In reference to propositions made by Immanuel Kant, *see* JOHANN CASPAR BLUNTSCHLI & FELIX DAHN, *DEUTSCHES PRIVATRECHT [GERMAN PRIVATE LAW]*, 3d ed. Cotta (1864) (Ger.), p. 113; 1 OTTO GIERKE, *DEUTSCHES PRIVATRECHT [GERMAN PRIVATE LAW]*, Duncker & Humblot (1895) (Ger.), p. 762–766; ULMER, *supra* note 90, at 109–110.

⁹² Gesetz betreffend das Urheberrecht an Schriftwerken, Abbildungen, musikalischen Kompositionen und dramatischen Werken [Law on the Copyright of Written Works, Pictures, Musical Compositions, and Dramatic Works], June 11, 1870, BGBl. I at 339 (Ger.); Kunstschutzgesetz [Art Conservation Act], Jan. 9, 1876, REICHSGESETZBLATT [RGL.] I at 4 (Ger.); Photographieschutzgesetz [Photography Protection Act], Jan. 10,

Proponents of authors' moral rights regarded the protection of fiscal interests as a logical emanation of the basic right.⁹³ The German Federal Court of Justice officially recognized the author's right to compensation for the use of his work in a 1926 decision,⁹⁴ holding that the purpose of copyright was to allocate to the creator the monetary proceeds derived from a copyrighted work. The concept of granting authors the financial returns to their creations was confirmed by further case law⁹⁵ and finally established statutorily by new copyright laws in 1965, which granted all distribution rights to the author,⁹⁶ including the rights to future unknown uses of the work.⁹⁷ Thus, next to ideological interests, the main function of German copyright law, since the beginning of the nineteenth century, has been to secure for creators the financial returns generated by their work.⁹⁸

When authors became legally entitled to the economic benefits derived from the use and distribution of their works at the end of the nineteenth century, their rights were initially fully transferable by contract ("translative").⁹⁹ However, the natural rights movement soon introduced

1876, RGBL. I at 8 (Ger.); Gesetz betreffend das Urheberrecht an Werken der Literatur und der Tonkunst [LUG] [Law Relating to Copyright in Works of Literature and Music], June 19, 1901, RGBL. I at 227 (Ger.); Gesetz betreffend das Urheberrecht an Werken der bildenden Künste und der Photographie [KUG] [Law Relating to Copyright in Works of Fine Art and Photography], Jan. 9, 1907, RGBL. I at 27 (Ger.). Although another reason that this was politically possible was that the printers and publishers were also strongly in favor of a conception of authors' rights. For one, the territorial fragmentation of the country meant obtaining printing rights from many different local lordships, most of which charged high monopoly fees. Furthermore, the sovereigns were using the privilege system as a means of censorship by supervising and controlling printed media. Vesting reproduction rights in the authors would allow the printers and publishers to exclusively obtain these rights through contract, thereby granting them protection from competitors without leaving them at the mercy of the regional lords.

⁹³ See ULMER, *supra* note 90, at 110; GIERKE, *supra* note 91, at 766.

⁹⁴ Der Tor und der Tod, RG May 12, 1926, 113 RGZ413 (418) (Ger.).

⁹⁵ Grundig-Reporter, BGH May 18, 1955, 17 BGHZ 266 (Ger.).

⁹⁶ UrhG, Sept. 9, 1965, BGBL. I at 1273, § 15 (as adopted in 1965) (Ger.); *see also* Begründung zum Entwurf eines Gesetzes über Urheberrechte und verwandte Schutzrechte, Mar. 23, 1962, DEUTSCHER BUNDESTAG: DRUCKSACHE [BT] IV/270 (Ger.).

⁹⁷ BT IV/270, at 45.

⁹⁸ *See* Schulbuch, Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court] July 7, 1971, 31 ENTSCHEIDUNGEN DES BUNDESVERFASSUNGSGERICHTS [BVERFGE] 229 (240) (Ger.); *see also* Schulze, *supra* note 31, at 556.

⁹⁹ Gesetz betreffend das Urheberrecht an Schriftwerken, Abbildungen, musikalischen Kompositionen und dramatischen Werken, BUNDES-GESETZBLATT DES NORDDEUTSCHEN BUNDES 339 § 3 (1870) (Ger.) ("Das Recht des Urhebers geht auf dessen Erben über.

the concept of a moral connection between author and creation. According to the monistic theory developed by German legal scholars, the material and immaterial interests protected by copyright were inextricably intertwined.¹⁰⁰ The resulting theory of constitutive transfer,¹⁰¹ which holds that copyright is never fully transferable,¹⁰² leaves the author with some moral and monetary authority despite granting licensing rights to others.¹⁰³

The issue of which rights authors could assign soon became a question of legislative importance. Publishers quickly adopted contract clauses that assigned publishers all economic rights over the author's work,¹⁰⁴ including rights to uses unknown at the time of the contract.¹⁰⁵ Discussing the 1900 legislation, some legislators expressed concern that inexperienced authors might sign away all their rights without understanding the magnitude and consequences of their legal actions.¹⁰⁶

Dieses Recht kann beschränkt oder unbeschränkt durch Vertrag oder durch Verfügung von Todes wegen auf andere übertragen werden.”). Similar paragraphs can be found in the Art Conservation Act (Ger.); Photography Protection Act (Ger.); LUG § 8(3) (Ger.); KUG § 10(3) (Ger.); see also MÖHRING & NICOLINI, *supra* note 32, at 223; ZSCHERPE, *supra* note 22, at 22.

¹⁰⁰ See ULMER, *supra* note 90, at 116; HAIMO SCHACK, URHEBER- UND URHEBERVERTRAGSRECHT [COPYRIGHT AND COPYRIGHT CONTRACT LAW], 5th rev. ed., Mohr Siebeck (2010) (Ger.), p. 62.

¹⁰¹ See ULMER, *supra* note 90, at 359; GIERKE, *supra* note 91, at 762–766; SCHACK, *supra* note 100, at 170–172. For case law, see Wilhelm Busch, RG Feb. 16, 1929, 123 RGZ 312 (320) (Ger.).

¹⁰² See ZSCHERPE, *supra* note 22, at 22; Philipp Möhring, *Urheberrechtsverwertungsverträge in der Sicht der Urheberrechtsreform* [Copyright Contracts in View of Copyright Law Reform], in: DAS RECHT AM GEISTESGUT: STUDIEN ZUM URHEBER-, VERLAGS- UND PRESSERECHT: EIN FESTSCHRIFT FÜR WALTER BAPPERT [THE LAW ON INTELLECTUAL GOODS: STUDIES OF COPYRIGHT, PUBLISHING AND MEDIA LAW: A COMMEMORATIVE PUBLICATION FOR WALTER BAPPERT], Fritz Hodeige ed., Rombach (1964) (Ger.), 129, p. 130–131.

¹⁰³ See MÖHRING & NICOLINI, *supra* note 32, at 224; STEFAN SCHWEYER, DIE ZWECKÜBERTRAGUNGSTHEORIE IM URHEBERRECHT [THE PURPOSE OF TRANSFER THEORY IN COPYRIGHT LAW], Beck (1982) (Ger.), p. 16.

¹⁰⁴ See ULMER, *supra* note 90, at 386; Eugen Ulmer, *Das neue deutsche Urheberrechtsgesetz* [The New German Copyright Act], 45 ARCHIV FÜR URHEBER-, FILM-, FUNK-, UND THEATERRECHT [UFITA] 184 (1965) (Ger.), p. 288, 291, 294; see also MÖHRING & NICOLINI, *supra* note 32, at 224.

¹⁰⁵ See DREWES, *supra* note 22, at 26, 46.

¹⁰⁶ See Bericht der elften Kommission über den Entwurf eines Gesetzes, betreffend das Urheberrecht an Werken der Literatur und der Tonkunst, BT 97/214, at 1281 (Ger.). Part of the commission even wanted to introduce a written specification obligation for all uses

Much of the literature over the next decades advocated a very restrictive interpretation of licensing contracts.¹⁰⁷ The publisher was to have only the rights that were explicitly granted in the contract or were necessary to fulfill the joint purpose of the contract.¹⁰⁸ These principles aimed to protect authors from relinquishing their rights unwittingly or due to economic hardship.¹⁰⁹

Over the first half of the twentieth century, German courts extensively adopted these restrictive interpretation principles in the above-mentioned new use decisions, favoring authors and declaring sweeping, generalized clauses in copyright agreements to be void.¹¹⁰ Because blanket clauses covering all distribution methods were no longer allowed, granting another person the rights to unknown uses of a work became *de facto* impossible. The copyright reform of 1965 finally codified the judicially developed principles of restrictive contract interpretation¹¹¹ by explicitly

transferred in the contract. This was rejected due to its incompatibility with the principles of interpreting contracts in good faith. *See, e.g.*, BÜRGERLICHES GESETZBUCH [BGB] [CIVIL CODE], Jan. 2, 2002, BGBL. I at 2909, § 157 (Ger.).

¹⁰⁷ *See* PHILIPP ALLFELD, KOMMENTAR ZU DEM GESETZE BETREFFEND DAS URHEBERRECHT AN WERKEN DER BILDENDEN KÜNSTE UND DER PHOTOGRAPHIE VOM 9. JANUAR 1907 [COMMENTARY ON THE LAW CONCERNING THE COPYRIGHT OF WORKS OF FINE ARTS AND PHOTOGRAPHY OF JANUARY 9, 1907], Beck (1908) (Ger.), p. 71; ALBERT OSTERRIETH, DAS URHEBERRECHT AN WERKEN DER BILDENDEN KÜNSTE UND DER PHOTOGRAPHIE: GESETZ VOM 9. JANUAR [COPYRIGHT ON WORKS OF VISUAL ARTS AND PHOTOGRAPHY: THE LAW OF JANUARY 9TH], C. Heymanns (1907) (Ger.), § 10.C.IV; Wenzel Goldbaum, *Neues aus Theorie und Praxis des Urheberrechts* [*New Issues in the Theory and Practice of Copyright Law*], 1923 GRUR 182, 187 (Ger.).

¹⁰⁸ These positions led to the development of the specification requirement (Spezifizierungspflicht) and purpose of transfer theory (Zweckübertragungstheorie), respectively. They were developed mainly by Goldbaum. *See* SCHWEYER, *supra* note 103, at 1–2; ULMER, *supra* note 90, at 364; SCHACK, *supra* note 100, at 296; ZSCHERPE, *supra* note 22, at 30–31.

¹⁰⁹ *See* SCHACK, *supra* note 100, at 296.

¹¹⁰ *See supra* Part I.1; *see also* SCHWEYER, *supra* note 103, at 18–32. In one prominent decision that validated the grant, the court argued that the blanket clause covered the new use because—and only because—the contract included an explicit remuneration agreement. *See* Der Hampelmann, RG Apr. 5, 1933, 140 RGZ 255 (257–58) (Ger.). Had the author’s financial interests not been sufficiently protected with regard to the new use, then the decision would have likely fallen into line with the others and rendered the clause invalid. *See* ZSCHERPE, *supra* note 22, at 32. The court thereby confirmed that the purpose of restricting contractual right grants was to secure authors’ participation in the financial benefits.

¹¹¹ Such as the specification and the purpose of transfer rules. *See* UrhG, Sept. 9, 1965, BGBL. I at 1273, § 31(5) (as adopted in 1965) (Ger.). Section 29 stipulates that copyright is

forbidding the grant of rights to unknown distribution methods. The courts had based their practice of restricting new use right grants on the above-described fundamental principle of German copyright law: that authors are to be secured participation in the financial profits of their work.¹¹²

Although some commented that the interdependence of distribution methods might make coordination for publishers difficult,¹¹³ there was generally little argument at the time regarding the adoption of § 31(4), because the new clause essentially codified what literature and case law had developed in practice over the previous decades.¹¹⁴ The official explanatory statement on preventing new use right grants was that authors should be able to decide whether they are willing to permit distribution over a newly developed medium, and at what price.¹¹⁵

According to subsequent commentary and case law, the purpose of § 31(4) is to prevent authors from signing away rights of unknown economic value¹¹⁶ and to assure them an opportunity to participate in the proceeds from distribution methods that arise after they sign the contract.¹¹⁷ Although this prohibition constituted a rather severe

not transferable except in the case of succession upon death. *See id.* § 29; Begründung zum Entwurf eines Gesetzes über Urheberrechte und verwandte Schutzrechte, Mar. 23, 1962, BT IV/270, at 30, 55, 56 (Ger.).

¹¹² *See* CATHARINA MARACKE, DIE ENTSTEHUNG DES URHEBERRECHTSGESETZES VON 1965 [THE FORMATION OF THE COPYRIGHT ACT OF 1965], Duncker & Humblot (2003) (Ger.), p. 729.

¹¹³ *See* MÖHRING & NICOLINI, *supra* note 32, at 225.

¹¹⁴ *See* DREWES, *supra* note 22, at 40.

¹¹⁵ *See* BT IV/270, at 56.

¹¹⁶ *See* SCHACK, *supra* note 100, at 298; Wandtke et al., *supra* note 22, at 422; SCHRICKER & LOEWENHEIM, *supra* note 31, at 28–29; PHILIPP MÖHRING, KÄTE NICOLINI & HARTWIG AHLBERG, URHEBERRECHTSGESETZ: KOMMENTAR [COPYRIGHT ACT: COMMENTARY], Käte Nicolini & Hartwig Ahlberg eds., 2d ed., Vahlen Franz (2000) (Ger.), p. 395; ZSCHERPE, *supra* note 22, at 34; Kabelfernsehen, OLG May 11, 1989, GRUR 590 (590), 1989 (Ger.).

¹¹⁷ *See* Gunda Dreyer, § 31 *Einräumung von Nutzungsrechten*, in: GUNDA DREYER ET AL., URHEBERRECHT: URHEBERRECHTSGESETZ, URHEBERRECHTSWAHRNEHMUNGSGESETZ, KUNSTURHEBERGESETZ, Hans-Joachim Zeisberg ed., 2d ed., Hüthig-Jehle-Rehm (2009) (Ger.), 420, p. 434; Schulze, *supra* note 31, at 556; ANNEKE SCHUCHARDT, VERTRÄGE ÜBER NEUE NUTZUNGSARTEN NACH DEM “ZWEITEN KORB” [CONTRACTS FOR NEW USES AFTER THE “SECOND BASKET”], Nomos (2008) (Ger.), p. 28; ZSCHERPE, *supra* note 22, at 35; Klimbim, BGH July 4, 1996, 133 BGHZ 281 (283) (Ger.); Der Zauberberg, OLG Oct. 31, 2002, GRUR 50 (53), 2003 (Ger.).

restriction on the principle of freedom of contract,¹¹⁸ its introduction was justified on the ground that authors are at a general disadvantage in dealing with publishers and are therefore unable to protect their own financial interests.¹¹⁹ The literature argues that historically, authors have generally been the weaker contracting party and publishers generally stronger. This results in considerable disparity in bargaining power between the two parties.¹²⁰ In the first half of the twentieth century, publishers purchased the exclusive rights to artistic works at little cost and some of those works later enjoyed huge international success.¹²¹ In general, the form and terms of publishing contracts are considered to be one-sided, in that they are constructed solely by the publisher without regard for the author's interests.¹²² Without legal intervention, many believe this practice leads to clauses that grant all-encompassing rights to the publisher, including the rights to uses unknown at the time of the contract.¹²³

There are various assumptions put forth as to why authors are at a bargaining disadvantage and fail to sufficiently represent their own interests in contractual agreements. First, authors are subject to financial constraints that urge them to accept whatever contractual terms will offer them immediate payment.¹²⁴ Second, the author is presumably more

¹¹⁸ See, e.g., INITIATIVE URHEBERRECHT, STELLUNGNAHME: ENTWURF EINES ZWEITEN GESETZES ZUR REGELUNG DES URHEBERRECHTS IN DER INFORMATIONSGESELLSCHAFT [OPINION: SECOND DRAFT LAW GOVERNING COPYRIGHT LAW IN AN INFORMATION SOCIETY] 5 (2006) (Ger.), available at <http://www.urheberrecht.org/topic/Korb-2/st/ra-2006-nov/teil-3/Schimmel.pdf> (explaining that the principle of freedom of contract has been continuously confirmed through case law to be a fundamental German legal doctrine and is seen as an extension of the general principle of "freedom of action" in Article 2(1) of the German Constitution).

¹¹⁹ See DREWES, *supra* note 22, at 47–50; CHOI, *supra* note 10, at 181.

¹²⁰ See ULMER, *supra* note 90, at 386; SCHWEYER, *supra* note 103, at 17.

¹²¹ See ULMER, *supra* note 90, at 386.

¹²² See SCHWEYER, *supra* note 103, at 17, 118.

¹²³ See JANI, *supra* note 33, at 104; ULMER, *supra* note 90, at 386; ZSCHERPE, *supra* note 22, at 33–34; DREYER ET AL., *supra* note 117, at 434; Schulze, *supra* note 31, at 547; SCHWEYER, *supra* note 103, at 118; Lütje, *supra* note 22, at 133.

¹²⁴ See Christian C. W. Pleister, *Buchverlagesverträge in den Vereinigten Staaten—ein Vergleich zu Recht und Praxis Deutschlands* [Book Publication Contracts in the United States—A Comparison to the Law and Practice in Germany], 2000 GRUR INT. 673, 673 (Ger.); Gernot Schulze, § 32a *Weitere Beteiligung des Urhebers*, in: DREIER & SCHULZE, *supra* note 31, at 661 (Ger.); Begründung zum Entwurf eines Gesetzes über Urheberrechte und verwandte Schutzrechte, Mar. 23, 1962, BT IV/270, at 57 (Ger.).

dependent on the contractual agreement than the publisher due to insufficient competition in the publishing industry and the practice of take-it-or-leave-it offers.¹²⁵ Authors, as the economically weaker party, are thus forced to accept the contractual terms because they find themselves faced with the choice of granting all of their rights for a small—but better than nothing—fee, or not getting their work distributed at all.¹²⁶ The third assumption is that authors are less experienced and less knowledgeable than publishers when it comes to copyright agreements.¹²⁷ Therefore, publishers are generally considered to have a more powerful contracting position,¹²⁸ allowing them to reap most of the financial benefits that arise from distribution of authors' works.

Given this disparity between the contracting parties, freedom of contract will predictably lead to “undesired results.”¹²⁹ Because the ensuing wealth distribution is not consistent with the legislature's preferences,¹³⁰ the state deems it necessary to intervene and restrict the grant of new use rights.¹³¹ The prohibition in § 31(4) was therefore viewed as an important instrument to protect authors from the superior bargaining position of the publishing industry.¹³² Section 31(4) accounted for the financial interests of creators and aimed to reallocate wealth from publishers to authors by improving their bargaining position. The next

¹²⁵ See P. Bernt Hugenholtz, *The Great Copyright Robbery: Rights Allocation in a Digital Environment*, Paper Presented at N.Y.U. School of Law Conference: A Free Information Ecology in a Digital Environment (Mar. 31–Apr. 2, 2000), p. 2, 9–10, available at <http://www.ivir.nl/publications/hugenholtz/thegreatcopyrightrobbery.pdf>; DREWES, *supra* note 22, at 47–48.

¹²⁶ See DREWES, *supra* note 22, at 49.

¹²⁷ See Schulze, *supra* note 124, at 609; BT IV/270, at 57; DREWES, *supra* note 22, at 48.

¹²⁸ See Pleister, *supra* note 124, at 673.

¹²⁹ See ULMER, *supra* note 90, at 386.

¹³⁰ See *id.* The purpose of German copyright law is to protect the author's right to the financial profits of her creations. See *supra* note 98.

¹³¹ See ZSCHERPE, *supra* note 22, at 33–34; DREYER ET AL., *supra* note 117, at 434; see also MARACKE, *supra* note 112, at 720.

¹³² See Schulze, *supra* note 31, at 547, 561; Gernot Schulze, *Vergütungssystem und Schrankenregelungen: Neue Herausforderungen an den Gesetzgeber* [Compensation System and Fair Use: New Challenges for Lawmakers], 2005 GRUR 828, 831 (Ger.); Oliver Castendyk & Jenny Kirhherr, *Das Verbot der Übertragung von Rechten an nicht bekannten Nutzungsarten—Erste Überlegungen für eine Reform des § 31 Abs. 4 UrhG* [The Ban on the Transfer of Rights to Unknown Uses—Initial Considerations for a Reform of § 31 Para. 4 or the Copyright Act], 47 ZUM 751, 755 (2003) (Ger.).

Part discusses whether these legislative fears of unfavorable wealth distribution are justified and whether the chosen method is an appropriate means of rectifying the situation from an economic point of view.

2. France

France, like Germany, also employed a system of privileges for printers and publishers beginning in the sixteenth century and becoming common in the seventeenth century. Its abolishment, however, came about far sooner and more abruptly than in fragmented Germany.¹³³ On the eve of the French Revolution, the privilege system was disestablished in 1789 by the August decrees¹³⁴ and replaced by legislation in 1791¹³⁵ and 1793.¹³⁶ One of the main goals of these revolutionary laws was to grant authors literary and artistic property, which was deemed “the most sacred, the most legitimate, the most unassailable, [and] . . . the most personal of all properties,”¹³⁷ because it stems from the fruits of authors’ thoughts and intellectual creativity.¹³⁸ The laws of 1791 and 1793 therefore explicitly assigned copyright rights to authors.¹³⁹

¹³³ See ULMER, *supra* note 90, at 58.

¹³⁴ Original documents in French printed in 1 JOHN MORRIS ROBERTS & RICHARD COBB, *FRENCH REVOLUTION DOCUMENTS*, Blackwell (1966), p. 151–53.

¹³⁵ Décret du 13–19 janvier 1791 relatif aux spectacles [Decree of January 13–19, 1791 Relating to Performances], *COLLECTION COMPLÈTE DES LOIS, DÉCRETS, ORDONNANCES, RÉGLEMENS ET AVIS DU CONSEIL-D’ÉTAT [DUV. & BOC.] [COMPLETE COLLECTION OF LAWS, DECREES, ORDINANCES, REGULATIONS, AND NOTICES OF COUNCIL OF STATE] II*, p. 174 (Fr.) (concerning the works of living playwrights).

¹³⁶ Décret du 19–24 juillet 1793 relatif aux droits de propriété des auteurs, compositeurs de musique, peintres et dessinateurs [Decree of July 19–24, 1793 on the Property Rights of Authors, Musicians, Painters, and Illustrators], *DUV. & BOC. VI*, p. 35, art. 1 (Fr.).

¹³⁷ LE CHAPELIER, *RAPPORT FAIT: AU NOM DU COMITÉ DE CONSTITUTION, SUR LA PÉTITION DES AUTEURS, DRAMATIQUES, DANS LA SÉANCE DU JEUDI 13 JANVIER 1791, AVEC LE DÉCRET RENDU DANS CETTE SÉANCE [A REPORT OF FACTS: CONSTITUTIONAL COMMITTEE MEETING ON THE PETITION OF AUTHORS, THURSDAY JANUARY 13, 1791 WITH THE RENDERED DECREE] 16* (1971) (Fr.) (citing a 1777 parol by the famous French lawyer Cochu), *available at* <http://www.juriscom.net/documents/RapportLeChapelier.pdf> (“La plus sacrée, la plus légitime, la plus inattaquable, [et] . . . la plus personnelle de toutes les propriétés.”).

¹³⁸ See *id.* It must be noted that this sentence, although widely cited as the origin of the author-oriented copyright system, is somewhat taken out of context, for Le Chapelier also

Initially, this intellectual “property” was freely transferable, either in part or completely.¹⁴⁰ The French Supreme Court for Judicial Matters confirmed this in 1842 and 1880, stating that, with certain exceptions unrelated to transferability, literary and artistic property was viewed under the law like any other form of property.¹⁴¹ However, around the end of the nineteenth century, many scholars began to oppose the free transferability of copyright on moral grounds, as part of the same natural rights movement that hit Germany.¹⁴²

As in Germany, French legal scholars and policymakers were concerned about bargaining disadvantages between authors and publishers. They alleged that publishers were becoming increasingly cunning in their contracting, taking advantage of badly informed or incautious creators who were dependent on transferring their rights in order to distribute their works. According to the official statement of grounds for the 1954 draft law, it was deemed necessary to protect the

strongly advocated the public interest in his report. See Jane C. Ginsburg, *A Tale of Two Copyrights: Literary Property in Revolutionary France and America*, 64 TUL. L. REV. 991 (1990), p. 1007–1008. Indeed, the French laws of 1791 and 1793 set forth both the principle of authors’ rights and the principle of limiting these rights due to a public interest in the dissemination of artistic works. See COLOMBET, *supra* note 38, at 5. It is also interesting to note that the first draft law which proposed to give authors legal recognition of their rights over their texts in 1790 was motivated not only by ideological theory, but also by an attempt to stem the tide of licentious ideas from the press by making authors responsible for their publications. See Anne Latournerie, *Petite histoire des batailles du droit d’auteur [Short History of Copyright Battles]*, 5 REVUE MULTITUDES 37 (2001) (Fr.), p. 42.

¹³⁹ See COLOMBET, *supra* note 38, at 4–5 (assigning the right of representation); SCHADEL, *supra* note 40, at 22–24 (assigning the right of production).

¹⁴⁰ See Decree of July 19–24, 1793, art. 1 (Fr.) (“Authors . . . enjoy the exclusive right to . . . transfer that property in full or in part.”).

¹⁴¹ See PIERRE RECHT, *LE DROIT D’AUTEUR, UNE NOUVELLE FORME DE PROPRIÉTÉ: HISTOIRE ET THÉORIE [COPYRIGHT, A NEW FORM OF PROPERTY: HISTORY AND THEORY]*, Librairie générale de droit et de jurisprudence (1969) (Fr.), p. 50; see also COLOMBET, *supra* note 38, at 12.

¹⁴² For a detailed overview, see RECHT, *supra* note 141, at 61–89; see also COLOMBET, *supra* note 38, at 13–14. According to the French legal scholars at the time, the author and his creation are united by an intimate moral bond that should not be fully severable. See RECHT, *supra* note 141, at 56–57; DESBOIS, *supra* note 38, at 538; see also Netanel, *supra* note 60, at 16. The French Copyright Act of 1957 codified this principle in Article 1(2) of the 1957 Law on Literary and Artistic Property. See generally Loi 57-298 du 11 mars 1957 sur la propriété littéraire et artistique [Law 57-298 of March 11, 1957 on Literary and Artistic Property], J.O., Mar. 14, 1957, p. 2723, art. 1(2); RECHT, *supra* note 141, at 61–89.

proprietary interests of authors through state intervention, lest they be left at the mercy of the other party and come away nearly empty-handed.¹⁴³

This legislative preference for wealth redistribution, arising from belief in authors' moral rights and the closely related goal of protecting authors' financial interests, led to a number of restrictions on copyright agreements in the Copyright Law of 1957, such as the specification requirement.¹⁴⁴ The explanatory statement accompanying the draft law expresses the paternalistic aim of providing authors some form of protection against themselves:

The Articles 34, 35, 36, 37, 38 and 39 express to various degrees the same concern, namely the concern for protecting the author from his own incautiousness or diffidence which he sometimes displays in everyday life. The prohibition of granting the rights to future works, the reconsideration of the contract in cases of damage, the requirement of an explicit clause for the grant of a right to an unforeseeable and unforeseen use of a work—be it for the same reason or for a different reason than that of the right to revoke the contract—all protect the author from the dangers vested in uncertainty over the true value, the possible effects, and the deficiencies of his work that can inevitably arise in the moment of publication. Following this reasoning, it is regarded necessary that the author approve every performance, reproduction, translation, adaptation or rearrangement of his work.¹⁴⁵

These provisions were carried over into the current law and French legal scholars continue to interpret the provisions as author-protective. According to French legal commentary, the paternalistic purpose of these rules is all the more important today in light of the increasing use of

¹⁴³ See Draft Law on Literary and Artistic Property of June 9, 1954, Decree of the National Convention, official parliament document 8618, printed in 20 UFITA 75, 80–81 (1955).

¹⁴⁴ See *supra* Part I.2.

¹⁴⁵ See Draft Law on Literary and Artistic Property of June 9, 1954, Decree of the National Convention, official parliament document 8618, printed in 20 UFITA 75, 81 (1955).

contracts of adhesion in the publishing industry:¹⁴⁶ “Creators must be protected, their consent carefully weighed, and their rights scrupulously respected.”¹⁴⁷ The specification requirement in Article L. 131-3¹⁴⁸ serves not only to facilitate contract interpretation, but also to prevent the author from carelessly assigning rights without being fully aware of their scope.¹⁴⁹

The principle of strict interpretation in Article L. 122-7 also protects authors from signing away unlimited rights or misjudging the scope of the assignment.¹⁵⁰ The general protective measure resulting from these legislative fears is that an author must explicitly approve every method for distributing a work. Based on this provision, many commentators note that grants of rights to unknown uses are generally invalid.¹⁵¹ If the parties list a few known distribution methods and also include a provision to cover known but unmentioned distribution methods, the protection intended by the specification requirement and other articles would be rendered completely ineffective.¹⁵²

3. Summary

Copyright law in European countries such as Germany and France places a strong emphasis on securing for creators the financial returns from the distribution and sale of their work. Authors are often in a weaker bargaining position than publishers and thereby considered unable to adequately protect their financial interests in agreements containing new use right clauses. Allowing the free grant of rights to unknown uses of copyrighted works therefore presumes to create legislatively undesirable wealth distribution. Restricting the grant of new use rights aims to correct this imbalance and reallocate wealth to authors by restoring some of their bargaining power. Importantly, however, something is largely missing in

¹⁴⁶ See GAUTIER, *supra* note 36, at 515.

¹⁴⁷ See *id.* (“[L]es créateurs doivent être protégés, leur consentement soigneusement soupesé, et leurs droits scrupuleusement respectés.”).

¹⁴⁸ See discussion *supra* Part I.2.

¹⁴⁹ See POLLAUD-DULIAN, *supra* note 36, at 579; Fernay, *supra* note 42, at 261; COLOMBET, *supra* note 38, at 257.

¹⁵⁰ See POLLAUD-DULIAN, *supra* note 36, at 584.

¹⁵¹ See *supra* Part I.2.

¹⁵² See DESBOIS, *supra* note 38, at 641.

most, if not all, of the legislative reasoning described in this Part: consideration of the market effects of this legislation. For this reason, the next Part turns to economic theory to ask whether it supports the distributional assumptions of the lawmakers.

III. LAW AND ECONOMICS

The main reason legislatures give for intervening in the parties' freedom of contract is the intuitive assumption that authors lack the means to sufficiently protect their financial interests when entering into copyright agreements. Their bargaining disadvantage presumably results in an unequal wealth distribution that is more favorable to publishers. Restrictions on grants of new use rights thus aim to redistribute some of this wealth to authors. This Part looks at the legislative reasoning for this restriction from an economic perspective. Part III.1 examines, and finds plausible, the assumption that publishers enjoy a relative greater share of distributable wealth than authors in a system without intervention. Then, Parts III.2 and III.3 call into question whether the chosen solution is likely to achieve the intended goal of redistribution. Part III.4 concludes that a variety of costs prevent authors from reaping the intended financial benefits of their work, and that the distributional goal of the legislature may in effect be thwarted.

1. Distribution Effects Without Intervention

When picturing the freelance author at the contracting mercy of the powerful media conglomerate, intuition may suggest that authors are getting the short end of the stick. To best evaluate whether this is the case and why or why not, this Part draws upon economic concepts and considers the situation from a general market perspective.

Despite the use of economic welfare theory elements, it is important for the purpose of this Part to distinguish between loss of wealth due to economic market failure and the loss of distributable wealth to authors due to bargaining disadvantages that are irrelevant from a classic pareto-efficiency perspective.¹⁵³ The former case involves not only the author's loss, but also deadweight loss to society, which is the main concern of economic welfare theory and the basis of the justification for state intervention in contractual freedom.¹⁵⁴ The distribution effects that the legislators enacting restrictions on new-use-right grants are most concerned with, however, can also occur in a pareto-optimal situation. If the parties agree to terms that are optimal in this sense, this only means that they have maximized general available wealth in accordance with the first theorem of welfare economics;¹⁵⁵ it says nothing about to whom this wealth is allocated. The agreement over distribution of the surplus is contingent on the "bargaining ability of the parties."¹⁵⁶ Even without a classic market failure, authors may therefore still lack leverage and get the short end of the stick.¹⁵⁷ Whether this is a warranted ground for intervention from an economic welfare perspective, it is this issue of distribution that legislators are concerned with and aim to correct. Accordingly, this Part refrains from general welfare evaluations and instead examines whether authors are likely to receive a lesser share of the distributable wealth than publishers under full freedom of contract.

¹⁵³ Pareto efficiency is an economic welfare criterion that focuses on the joint surplus of the market participants. A situation is deemed pareto-optimal when joint surplus has been maximized so that it is impossible to improve one party's situation without making someone else worse off. However, how this surplus is distributed among the parties is not relevant at this stage, only that it is maximized. See GLOBAL ENCYCLOPAEDIA OF WELFARE ECONOMICS, Sunil Chaudhary ed., Global Vision Publishing House (2009), p. 217–219.

¹⁵⁴ Although even here government intervention is not necessarily supported; especially where the "inevitable drawbacks" of intervention are argued to outweigh the costs of the market failure. See HENRY SIDGWICK, *THE PRINCIPLES OF POLITICAL ECONOMY*, Macmillan (1883), p. 419; see also BERNARD SALANIÉ, *THE MICROECONOMICS OF MARKET FAILURES*, MIT Press (2000) (1998) (Fr.), p. 8.

¹⁵⁵ See SALANIÉ, *supra* note 154, at 1–4.

¹⁵⁶ Ariel Rubinstein, *Perfect Equilibrium in a Bargaining Model*, 50 *ECONOMETRICA* 97, 97 (1982)(internal quotation marks omitted).

¹⁵⁷ See RICHARD A. POSNER, *ECONOMIC ANALYSIS AND THE LAW*, 7th ed., Aspen (2007), p. 118.

A somewhat simplifying, but realistic¹⁵⁸ assumption is that publishers in the media industry are commonly large firms, whereas authors are individuals. This Part therefore examines the postulation that, in comparison to publishers, authors are likely to be subject to more budget constraints, fewer outside options, less complete (asymmetric) information, and increased risk aversion. First, this Part discusses these concepts and their implications on the distributional outcomes of the bargaining process.

a. Relative Budget Constraints and Standardized Contracts

In classic economic models, individuals are often assumed to be subject to budget constraints, whereas firms are not.¹⁵⁹ Although this assumption can be (and has been) criticized as not entirely realistic,¹⁶⁰ it finds support in the fact that firms generally have much more capital at their disposal than individuals. One reason for this is the relative difference in credit constraints. In theory, market participants have the option to borrow against future capital, making budget constraints irrelevant. However, there are three reasons why individuals are at a disadvantage in the credit market.

¹⁵⁸ See, e.g., INST. FOR INFO. LAW, STUDY ON THE CONDITIONS APPLICABLE TO CONTRACTS RELATING TO INTELLECTUAL PROPERTY IN THE EUROPEAN UNION: FINAL REPORT 1 (2002), available at http://ec.europa.eu/internal_market/copyright/docs/studies/etd2000b53001e69_en.pdf; P. BERNT HUGENHOLTZ & L. GUIBAULT, INST. FOR INFO. LAW, AUTEURSCONTRACTENRECHT: NAAR EEN WETTELIJKE REGELING? [COPYRIGHT CONTRACT LAW: TOWARDS A STATUTORY REGULATION?] iii–iv (2004) (Neth.), available at <http://www.ivir.nl/publicaties/overig/auteurscontractenrecht.pdf>, translation available at <http://www.ivir.nl/publications/hughenoltz/Summary%2005.08.2004.pdf>; ALBERT N. GRECO ET AL., THE CULTURE AND COMMERCE OF PUBLISHING IN THE 21ST CENTURY, Stanford Business Books (2007), p. 10–15.

¹⁵⁹ See Kenneth J. Arrow, *The Firm in General Equilibrium Theory*, in: THE CORPORATE ECONOMY: GROWTH, COMPETITION AND INNOVATIVE POTENTIAL, Robin Marris & Adrian Wood eds., Harvard University Press (1971), p. 68; see also Kiyoshi Kuga, *Budget Constraint of a Firm and Economic Theory*, 8 ECON. THEORY 137 (1996).

¹⁶⁰ See MICHIO MORISHIMA, CAPITAL AND CREDIT: A NEW FORMULATION OF GENERAL EQUILIBRIUM THEORY, Cambridge University Press (1992); see also Kuga, *supra* note 159, at 138.

First, individuals cannot easily borrow against earnings generated by human capital, because human capital is intangible and therefore unsuitable as collateral in credit markets.¹⁶¹ Second, credit markets are subject to imperfections such as incomplete information. Missing knowledge about individuals and their projects can lead to moral hazard or adverse selection problems.¹⁶² This causes credit rationing by lenders, who may make loans contingent on the size of the borrower's credit supply.¹⁶³ Because firms regularly have larger supplies, and are therefore more likely to get loans when credit is rationed, this also leads to a difference between the budget constraints of firms and those of individuals. Third, firms are less able to evade debt payments by moving,¹⁶⁴ whereas individuals who move are likely to create costly locating problems for creditors. These monitoring and tracking difficulties also lead to credit rationing,¹⁶⁵ and higher interest rates for individuals have been attributed to these costs.¹⁶⁶

In sum, individuals are regularly limited by how much they can borrow, whereas firms are less financially constrained. Comparing the creators of copyrighted works to those who profit from the works, publishing firms are typically large businesses with far more access to credit than individual creators. Except for a few disproportionately successful (or otherwise endowed) artists, the majority of authors are unlikely to have financial means comparable to that of most publishing firms.¹⁶⁷ Unlike entities that have access to large reserves of capital, authors are commonly individuals engaged in high-risk projects and have only human capital to offer as collateral. Authors are therefore limited in how much they can borrow against future earnings compared to publishers.

¹⁶¹ See GARY S. BECKER, *HUMAN CAPITAL: A THEORETICAL AND EMPIRICAL ANALYSIS, WITH SPECIAL REFERENCE TO EDUCATION*, 3d ed., University of Chicago Press (1993), p. 93; George J. Stigler, *Imperfections in the Capital Market*, 75 *J. POL. ECON.* 287 (1967), p. 288.

¹⁶² See Joseph E. Stiglitz & Andrew Weiss, *Credit Rationing in Markets with Imperfect Information*, 71 *AM. ECON. REV.* 393 (1981), p. 393.

¹⁶³ *Id.* at 395.

¹⁶⁴ Because they are comparatively immobile, but also for reasons of reputation.

¹⁶⁵ See generally Stephen D. Williamson, *Costly Monitoring, Financial Intermediation, and Equilibrium Credit Rationing*, 18 *J. MONETARY ECON.* 159 (1986).

¹⁶⁶ See Oded Galor & Joseph Zeira, *Income Distribution and Macroeconomics*, 60 *REV. ECON. STUD.* 35 (1993), p. 38.

¹⁶⁷ For empirical data on artist incomes, see RICHARD E. CAVES, *CREATIVE INDUSTRIES: CONTRACTS BETWEEN ART AND COMMERCE*, Harvard University Press (2000), p. 79–81.

That many authors are dependent on immediate income to provide for living expenses is often perceived as potential leverage against authors.¹⁶⁸ Some might even argue that such asymmetric bargaining positions could give rise to economic duress, if an individual's financial situation gives them no choice but to agree to the terms offered by the other party.¹⁶⁹ Because publishing firms often use standard form contracts, authors could face take-it-or-leave-it offers that they are ultimately financially dependent on accepting.¹⁷⁰ However, the mere fact that relative poverty and standard form contracts are common in an industry does not necessarily mean that there is asymmetrical bargaining power among the market participants. In a competitive market, operating with standardized contracts can have benefits for everyone¹⁷¹—for instance, when the costs of negotiating are high.¹⁷² An important factor, therefore, is not whether one side has less capital or whether contracts can be bargained over, but rather whether there is sufficient competition among publishers to ensure favorable terms for authors.¹⁷³ Under the assumption of perfect competition (and general perfect market conditions)¹⁷⁴, budget

¹⁶⁸ See *supra* Part II; see also Schulze, *supra* note 124, at 609; Pleister, *supra* note 124, at 673.

¹⁶⁹ See MARACKE, *supra* note 112, at 612; POSNER, *supra* note 157, at 115.

¹⁷⁰ See Wilhelm Nordemann, *Vorschlag für ein Urhebervertragsgesetz* [Proposal for a Copyright Contract Law], 1991 GRUR 1, 2 (Ger.); see also ULMER, *supra* note 90, at 386.

¹⁷¹ See Friedrich Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629 (1943), p. 632; Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1173 (1983), p. 1220–1225.

¹⁷² E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS, Vol. 1, 3d ed., Aspen (2004), p. 568; Duncan Kennedy, *Distributive and Paternalist Motives in Contract and Tort Law, with Special Reference to Compulsory Terms and Unequal Bargaining Power*, 41 MD. L. REV. 563 (1982), p. 616; Michael J. Trebilcock, *The Doctrine of Inequality of Bargaining Power: Post-Benthamite Economics in the House of Lords*, 26 U. TORONTO L. J. 359 (1976), p. 364–365.

¹⁷³ See FARNSWORTH, *supra* note 172, at 572; Maureen A. O'Rourke, Column, *Copyright Liability of Bulletin Board Operators for Infringement by Subscribers*, 1 B.U. J. SCI. & TECH. L. 71 (1995), para. 12 (“In a competitive market, form contract terms may simply reflect the terms the parties would have agreed to had they expressly negotiated a contract.”); POSNER, *supra* note 157, at 116.

¹⁷⁴ See *infra* Part III.1.c (discussing complete information as an assumption of general perfect market conditions). See generally ANDREU MAS-COLELL ET AL., MICROECONOMIC THEORY, Oxford University Press (1995), p. 307–507; ROBERT S. PINDYCK & DANIEL L. RUBINFELD, MICROECONOMICS, 7th ed., Pearson Education (2008), p. 612–613; ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS, 5th ed. Pearson Prentice Hall (2008), p. 224–231; NICHOLAS MERCURO & STEVEN G. MEDEMA, ECONOMICS AND THE LAW: FROM

constraints and contracts of adhesion alone should not affect the parties' bargaining power. However, they deserve mention, because they can weigh in quite heavily if certain prerequisites are missing. Budget constraints may also influence the parties' decision-making under risk, which will be discussed below.¹⁷⁵ The assumption of perfect competition is examined in the following

b. Monopsony Power

As discussed above, financial differences and standardized contracts are often cited to support the argument that authors are the weaker party in negotiating copyright licenses. Although sometimes viewed as an indication of bargaining power asymmetry,¹⁷⁶ contracts of adhesion do not immediately imply that the drafting party is offering unfavorable terms.¹⁷⁷ The same goes for budget restrictions. In theory, if there are competitors in the market, all publishers will seek to acquire authors' rights by providing more attractive terms than their rivals, successively improving the standard offer.¹⁷⁸ Therefore, so long as authors have sufficient outside options,¹⁷⁹ they will not suffer a bargaining disadvantage solely because of the wealth disparity between bargaining parties or because the contract terms are offered on a take-it-or-leave-it basis.

Insufficient outside options render one party better able to refuse cooperation, which can cause considerable bargaining power asymmetry.¹⁸⁰ According to monopsony theory,¹⁸¹ a lack of outside options

POSNER TO POSTMODERNISM AND BEYOND, 2d ed., Princeton University Press (2006), p. 60–67.

¹⁷⁵ See *infra* Part III.1.d.

¹⁷⁶ See Kessler, *supra* note 171, at 632; W. David Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 HARV. L. REV. 529 (1971); Lewis A. Kornhauser, Comment, *Unconscionability in Standard Forms*, 64 CALIF. L. REV. 1151 (1976), p. 1162.

¹⁷⁷ See Lucian A. Bebchuk & Richard A. Posner, *One-Sided Contracts in Competitive Consumer Markets*, 104 MICH. L. REV. 827 (2006), p. 828–829; Kennedy, *supra* note 172, at 616.

¹⁷⁸ See POSNER, *supra* note 157, at 116.

¹⁷⁹ “Outside options” refers to the alternatives that a party has to coming to an agreement with another party.

¹⁸⁰ See, e.g., John C. Harsanyi, *Measurement of Social Power, Opportunity Costs, and the Theory of Two-Person Bargaining Games*, 7 BEHAV. SCI. 67 (1962), p. 74; COOTER &

for the seller of a good (in this case, the author) will lead to a lower price than would occur if the market for the seller's services was competitive.¹⁸² This causes both a direct loss of bargaining surplus for the author and a general deadweight loss to society.¹⁸³ Although no single publisher dominates the publishing industry, concentration of an industry to a handful of buyer entities may suffice to give them an advantage similar to that of a monopsony.

This situation also occurs in comparable markets, such as labor markets.¹⁸⁴ A low number of buyers in a market (also known as oligopsony) is likely to drive down the price and amount sold.¹⁸⁵ This means that a low number of publishers would secure copyrights from fewer authors for lower compensation than would be offered under perfect competition. The monopsony power in an oligopsony depends on the number of buyers and also on how they interact.¹⁸⁶ If the publishers in

ULEN, *supra* note 174, at 230. For a description of this problem in labor markets, see ALAN MANNING, *MONOPSONY IN MOTION: IMPERFECT COMPETITION IN LABOR MARKETS*, Princeton University Press (2003), p. 5–6.

¹⁸¹ Monopsony theory corresponds to monopoly theory, but refers to concentrated market power on the side of the buyer. See JACK HIRSHLEIFER ET AL., *PRICE THEORY AND APPLICATIONS: DECISIONS, MARKETS, AND INFORMATION*, 7th ed., Cambridge University Press (2005), p. 364–365; JEAN TIROLE, *THE THEORY OF INDUSTRIAL ORGANIZATION*, MIT Press (1988), p. 65; DAVID M. KREPS, *A COURSE IN MICROECONOMIC THEORY*, Princeton University Press (1990), p. 551.

¹⁸² See HAL R. VARIAN, *INTERMEDIATE MICROECONOMICS: A MODERN APPROACH*, 7th ed., W. W. Norton & Company (2006), p. 473.

¹⁸³ *Deadweight loss*—meaning that even if one were to somehow redistribute the wealth after the fact, the system would be producing less in general. This matters to the distribution-oriented legislator insofar as there is less wealth to go around.

¹⁸⁴ See MANNING, *supra* note 180. A large number of workers with different job preferences are competing for labor contracts with a comparatively small number of possible employers.

¹⁸⁵ See PINDYCK & RUBINFELD, *supra* note 174, at 373–374.

¹⁸⁶ See VARIAN, *supra* note 182, at 480–502 (pertaining to oligopoly, but with the same effect). Monopsony power also depends on the elasticity of market supply. Theoretically, in a market, the supply of a good will increase when a higher price is offered, and vice versa. Elasticity refers to how quickly the supply side can react to price changes. If the amount of supply can adapt very quickly, this can serve to undermine monopsony power. See PINDYCK & RUBINFELD, *supra* note 174, at 373–374, at 377–378. Although the number of artistic creations may increase or decrease in the long run given the average amount offered to artists for their rights, it is unlikely that price changes would be able to cause short-term reactions in the supply of works of authorship, which are not cranked out on an assembly line and require much personal input. Since supply in this particular market is therefore highly inelastic, it cannot serve to weaken the monopsony power of publishers.

the market engage in lively price competition, their monopsony power and the negative effects on the amount offered for new use rights will be small.¹⁸⁷ However, if they engage in quantity competition, are less competitive, or even collaborate with each other, then it is realistic to assume that authors will be left with fewer options and suffer price cuts.¹⁸⁸

As mentioned, in this regard, artistic markets can be compared to labor markets, to which oligopsonistic qualities are attributed.¹⁸⁹ Furthermore, looking at publishing industries across the globe, the buyer market is often substantially concentrated.¹⁹⁰ A number of studies using a variety of different methods have found that the concentration in most media industries has grown over the last century.¹⁹¹ This indicates that many sectors of the artistic and entertainment publishing industry are dominated by an increasingly small number of international conglomerates.

For example, today's music recording industry is commonly known to comprise four major labels (the "big four"): Universal Music Group, Sony Music Entertainment, Warner Music Group, and EMI, which many assert to be oligopsonistic or even a "cartel."¹⁹² While the latter claim is unconfirmed, studies do reflect the substantial market power of these conglomerates, finding that the industry is indeed controlled by a mere

¹⁸⁷ For the corresponding case of oligopoly, see MAS-COLELL ET AL., *supra* note 174, at 389 (noting that Bertrand competition is unrealistic in many settings); see also VARIAN, *supra* note 182, at 495.

¹⁸⁸ See VARIAN, *supra* note 182, at 501.

¹⁸⁹ See MANNING, *supra* note 180.

¹⁹⁰ See, e.g., *Ultra Concentrated Media: Selling Brands*, NEW INTERNATIONALIST (April 1, 2001), p. 18, available at <http://www.newint.org/features/2001/04/01/facts/>; BERND-PETER LANGE, MEDIENWETTBEWERB, KONZENTRATION UND GESELLSCHAFT: INTERDISZIPLINÄRE ANALYSE VON MEDIENPLURALITÄT IN REGIONALER UND INTERNATIONALER PERSPEKTIVE [MEDIA COMPETITION, CONCENTRATION AND SOCIETY: INTERDISCIPLINARY ANALYSIS OF MEDIA PLURALISM WITH A REGIONAL AND INTERNATIONAL PERSPECTIVE], Springer (2008) (Ger.), p. 101–115; Pleister, *supra* note 124, at 673–674 (describing a stronger concentration in the United States than in Germany, but finding concentration tendencies in both countries); Michael Szenberg & Eric Youngkoo Lee, *The Structure of the American Book Publishing Industry*, 18 J. CULTURAL ECON. 313 (1994), p. 314; GRECO ET AL., *supra* note 158; see also Nordemann, *supra* note 170, at 1–2; Hugenholtz, *supra* note 125, at 9–10.

¹⁹¹ See JOHN D.H. DOWNING ET AL. (eds.), THE SAGE HANDBOOK OF MEDIA STUDIES, SAGE (2004), p. 296.

¹⁹² See, e.g., Patrick Burkart, *Loose Integration in the Popular Music Industry*, RED ORBIT (October 3, 2005), available at http://www.redorbit.com/news/technology/258795/loose_integration_in_the_popular_music_industry/.

handful of firms.¹⁹³ Many assert a similar situation for book publishers. Studies find that the industry has become concentrated on an increasingly global scale over the last few decades, and a few large publishing corporations now own what used to be a large number of independent entities.¹⁹⁴ Another prominent example is the film production industry, which since its inception has been oligopsonistic.¹⁹⁵ Since the 1920s, seven major production companies dominated the motion picture sector, provoking a large antitrust case in 1948.¹⁹⁶ Although over time, this structure has somewhat altered and the number of independent film studios has increased, studies find that the “majors” continue to exert large economic power, thus maintaining the oligopsonistic qualities of the industry.¹⁹⁷ Similar developments and structures are reported for sectors

¹⁹³ See *Written Statement of the American Antitrust Institute Before the Senate Judiciary Comm., Subcomm. on Antitrust, Competition Policy and Consumer Rights*, Hearing on Universal Music Group’s Proposed Acquisition of EMI’s Recorded Music Division, 112th CONG. 4 (2012); Jack Bishop, *Building International Empires of Sound: Concentrations of Power and Property in the “Global” Music Market*, 28 *POPULAR MUSIC & SOC’Y* 443 (2006), p. 448; Peter J. Alexander, *Entropy and Popular Culture: Product Diversity in the Popular Music Recording Industry*, 61 *AM. SOC. REV.* 171 (1996), p. 174 (comment on Richard A. Peterson & David G. Berger, *Cycles in Symbol Production: The Case of Popular Music*, 40 *AM. SOC. REV.* 158 (1975)) (noting “six large international firms account for nearly 98 percent of the output” of the music recording industry); Alexander Belinfante & Richard L. Johnson, *Competition, Pricing and Concentration in the U.S. Recorded Music Industry*, 6 *J. CULTURAL ECON.* 11 (1982), p. 13; Mike Jones, *Market Research*, in: *CONTINUUM ENCYCLOPEDIA OF POPULAR MUSIC OF THE WORLD: MEDIA, INDUSTRY AND SOCIETY*, John Shepherd et al. eds., Continuum International Publishing Group (2003), 554, p. 555 (“[R]ecord-making is dominated by five major, globally active firms . . . with the effect that certain techniques and practices . . . have come to be standardized among and between these companies.”).

¹⁹⁴ See, e.g., JOHN THOMPSON, *CONCENTRATION AND INNOVATION IN THE BOOK PUBLISHING INDUSTRY: FULL RESEARCH REPORT* (2008), available at <http://www.esrc.ac.uk/my-esrc/grants/RES-000-22-1292/outputs/read/08a1471c-cb6a-433f-999e-eb322e9c00d0>; Szenberg & Lee, *supra* note 190, at 314; Pleister, *supra* note 124, at 673–674.

¹⁹⁵ See TINO BALIO (ed.), *THE AMERICAN FILM INDUSTRY*, rev. ed., University of Wisconsin Press (1985), p. 253.

¹⁹⁶ See Michael Storper & Susan Christopherson, *Flexible Specialization and Regional Industrial Agglomerations: The Case of the U.S. Motion Picture Industry*, 77 *ANNALS ASS’N AM. GEOGRAPHERS* 104 (1987), p. 106.

¹⁹⁷ See Asu Aksoy & Kevin Robins, *Hollywood for the 21st Century: Global Competition for Critical Mass in Image Markets*, 16 *CAMB. J. ECON.* 1 (1992); Murray Smith, *Theses on the Philosophy of Hollywood History*, in: *CONTEMPORARY HOLLYWOOD CINEMA*, Steve Neale & Murray Smith eds., reprint, Routledge (2003) (1998), 3, p. 8; see also Allen J. Scott, *A New Map of Hollywood: The Production and Distribution of American Motion Pictures*, 36 *REGIONAL STUD.* 957 (2002), p. 959.

of the entertainment and news media industry, where publishers are increasingly large and international and there are fewer firms in the publishing industry.¹⁹⁸

A related parallel development is media convergence. The borders between different publishing sectors are disappearing as traditional distribution methods become multimedia-based or digital, and firms begin to expand their areas of expertise to encompass more than one form of distribution.¹⁹⁹ Many publishers no longer focus on just one type of work, such as news media, books, music, or films; rather, they are involved in publishing works of multiple, or even all, types.²⁰⁰ This development could cause the degree of power concentration in the publishing industry to be underestimated in many of the above-mentioned studies, which measure within specific markets and not across segments.²⁰¹

Furthermore, there is anecdotal evidence of insufficient competition between publishers in practice.²⁰² Even though some claim that these developments do not prove the prevalence of monopsony power in all creative markets,²⁰³ the concentration of the industry to fewer publishing

¹⁹⁸ See BEN H. BAGDIKIAN, *THE NEW MEDIA MONOPOLY*, Beacon Press (2004); Alan B. Albarran & John Dimmick, *Concentration and Economics of Multifirmity in the Communication Industries*, 9 J. MEDIA ECON. 41 (1996), p. 48–49; Henry Jenkins, *The Cultural Logic of Media Convergence*, 7 INT'L J. CULTURAL STUD. 33 (2004), p. 33 (pointing out the “alarming concentration of the ownership of mainstream commercial media, with a small handful of multinational media conglomerates dominating all sectors of the entertainment industry”).

¹⁹⁹ See Hugenholtz, *supra* note 125, at 9–11.

²⁰⁰ See CAVES, *supra* note 167, at 314; Nordemann, *supra* note 170, at 1.

²⁰¹ See Alan B. Albarran, *Media Economics Research: Methodological Perspectives and Areas for Future Development*, 8 PALABRA CLAVE 115 (2005), available at <http://palabraclave.unisabana.edu.co/index.php/palabraclave/article/viewFile/1463/1631>.

²⁰² See Authors Guild, *Statement of the Authors Guild on “The Continuing Trend To Concentration of Power in the Book Publishing Industry,”* paper presented at the Federal Trade Commission Symposium on Media Concentration, Washington, D.C. (Dec. 14–15, 1978); Scott, *supra* note 197, at 961; Michael Black & Douglas Greer, *Concentration and Non-price Competition in the Recording Industry*, 3 REV. INDUS. ORG. 13 (1986); STEPHEN G. HANNAFORD, *MARKET DOMINATION! THE IMPACT OF INDUSTRY CONSOLIDATION ON COMPETITION, INNOVATION, AND CONSUMER CHOICE*, Greenwood Publishing Group (2007), p. 26–27.

²⁰³ See Michael Rushton, *The Law and Economics of Artists' Inalienable Rights*, 25 J. CULTURAL ECON. 243 (2001), p. 250 (questioning the existence of monopsony power

entities can fully suffice to weaken the bargaining position of authors. As mentioned above, the deadweight loss associated with market failure due to monopsony power is not primarily what the legislators are concerned with in this context. The current examination is restricted to the question of whether the distributional outcome they claim is economically plausible. As shown above, if there is indeed monopsony power, authors may suffer considerable losses due to both general market failure and their individual lack of distributive bargaining power. However, even a weaker form of concentration or low-level competition among publishers, oligopsony or not, is likely to lead to authors receiving less of the distributable wealth. As the number of buyers in a market decreases, an author's outside options decrease relative to those of the publisher with whom he is bargaining.

This Part, so far, confirms that the legislative fears of author bargaining disadvantages are, at the very least, plausible. The next Part examines an additional factor that may contribute to market failure, in the worst case, and may cause bargaining disadvantages (and as a result, distributive effects) in any case: the presence of asymmetric information.

c. Incomplete and Asymmetric Information

Another argument encountered in the legislative discussion is that authors are at a bargaining disadvantage due to the difficulty of determining the future value of their work.²⁰⁴ Economic theory assumes that uncertainty of future values is factored into the negotiation as probabilities. So long as both parties know the expected value,²⁰⁵ there is no reason to assume that one of them is at a bargaining disadvantage simply because the true monetary worth is unknown at the time of the contract. However, if there is reason to believe that one party has more

among art dealers); see also GRECO ET AL., *supra* note 158, at 15; Szenberg & Lee, *supra* note 190, at 321 (both questioning economically relevant monopsony power in book publishing).

²⁰⁴ See *supra* Part II; see also DREWES, *supra* note 22, at 48–49; H.R. REP. NO. 94-1476, at 124 (1976); *Mills Music, Inc. v. Snyder*, 469 U.S. 153, 172–73 (1985).

²⁰⁵ For purposes of this paper, expected value equals the weighted average of all possible payoffs multiplied by their respective probabilities.

accurate information about the expected value than the other, problems may arise.

In many markets, the seller often has better information about the true worth of the good than the buyer.²⁰⁶ In the case of exclusive rights, it is likely to be the other way around. Publishing firms, which employ teams of experts and have years of experience and know-how in distributing and marketing artistic works, will generally have far better knowledge of the probabilities that a certain work will be successful enough to achieve distribution over future media, and of the expected revenues. Indeed, it has been argued that one of the reasons that publishing firms exist is that they offer the asset of superior knowledge of the industry and thus can function as gatekeepers.²⁰⁷ The author selling the rights, on the other hand, is generally (and plausibly) believed to be less experienced in such business matters.²⁰⁸ Because authors are aware that publishers have better information and that they suffer disadvantages due to this asymmetry, a theoretical question is why they do not simply acquire the missing information. That they tend to remain “ignorant” is not necessarily attributed to irrational behavior such as laziness or lack of mathematical ability, but can be sufficiently explained by the fact that the costs of acquiring the necessary information are too high.²⁰⁹ It would be impossibly difficult for most authors to gather enough experience and knowledge to successfully compete with a publishing firm. Essentially, the author is burdened with much greater costs of missing information than the publisher.

Given that authors are generally uninformed regarding the true value of their rights, the prices that authors are willing to sell for are not

²⁰⁶ See VARIAN, *supra* note 182, at 694–695; MICHAEL FRITSCH ET AL., *MARKTVERSAGEN UND WIRTSCHAFTSPOLITIK: MIKROÖKONOMISCHE GRUNDLAGEN STAATLICHEN HANDELNS* [MARKET FAILURE AND ECONOMIC POLICY: MICROECONOMIC FOUNDATIONS OF NATIONAL GOVERNANCE], 7th ed., Vahlen (2007) (Ger.), p. 284.

²⁰⁷ See CAVES, *supra* note 167, at 52–56.

²⁰⁸ See, e.g., Dino Joseph Caterini, *Contributions to Periodicals*, 10 COPYRIGHT L. SYMP. (ASCAP) 321 (1959), p. 378; *Marvel Characters, Inc. v. Simon*, 310 F.3d 280, 292 (2d Cir. 2002) (stating that the need to protect authors from “more sophisticated entities” is a policy concern).

²⁰⁹ See VARIAN, *supra* note 182, at 694; COOTER & ULEN, *supra* note 174, at 228; POSNER, *supra* note 157, at 116.

optimal.²¹⁰ This could mean that a number of authors may be selling their rights for too little, but also, theoretically, that some may be overestimating the expected value of their work.²¹¹ However, since publishers are better informed, they will have a lower reservation price, leaving authors who value their rights too highly with the choice of selling for less, or not having their work distributed at all.²¹² Additionally, authors having fewer outside options and being subject to financial constraints can serve to further drive down the price, even for those authors who value their rights highly. Those who underestimate the value of their exclusive rights because of the information asymmetry will suffer a loss in any case.

This Part has assumed that author and publisher are operating with different expected values. But even if this were not the case, and both parties were fully informed as to the true probabilities on which the expected future value is based, the balance in bargaining power between authors and publishers would be impacted by another concern: how the parties manage uncertainty and risk. The next Part examines this factor.

d. Uncertainty and Risk Aversion

When initially entering into the contract, the author is faced with a choice: sell the rights to the unknown uses of a work, for which a certain amount of money will be paid immediately, or hold out in anticipation of a potential future distribution method with the hopes of selling for a higher price in the future. In this situation, opting to withhold the rights and turning down the offer of immediate payment involves considerable uncertainty around three aspects of the transaction in particular. First, there is uncertainty regarding the long-term commercial value of the work itself, because generally, the market success of creative works is extremely difficult to predict.²¹³ Then, there is uncertainty regarding the invention

²¹⁰ See MAS-COLELL ET AL., *supra* note 174, at 436; MERCURO & MEDEMA, *supra* note 174, at 66.

²¹¹ See FRITSCH ET AL., *supra* note 206, at 287–288.

²¹² A classic outcome of information asymmetry in consumer markets is that less trade takes place than is optimal. See MAS-COLELL ET AL., *supra* note 174, at 437.

²¹³ See CAVES, *supra* note 167, at 2–3; see also ARTHUR DE VANY, HOLLYWOOD ECONOMICS: HOW EXTREME UNCERTAINTY SHAPES THE FILM INDUSTRY 2 (2004); ALBERT N.

and marketability of new methods with which the work could be distributed, and the point in time this would occur.²¹⁴ Furthermore, there is uncertainty regarding the potential profits to be made with the new distribution methods.

The parties calculate the expected future value of the rights by using the probabilities of these outcomes.²¹⁵ In theory, the expected value is simply the weighted average value of all possible payoffs. When comparing actual value (the price offered *ex ante*) for new use rights with expected value (the future price expected, adjusted for the risk that the amount will be less or nothing) when the values are equal, there is no immediately apparent reason to prefer one over the other. A risk-neutral person will in fact be indifferent when choosing between a certain payoff and an uncertain payoff of equal expected value. A risk-averse person, however, will not be. In particular, a risk-averse person will prefer an option in which they are certain to receive the amount offered over an option in which it is highly uncertain whether they will receive the amount offered, even if the expected value of the latter is larger.²¹⁶

Of course, in the case of new use right contracts, both parties face the same probabilities.²¹⁷ The expected values and variabilities are no different for the publisher, because the firm bears the exact same risks when making the decision whether to purchase either now or later. However, discrepancies in choice may emerge when authors and publishers hold differing attitudes towards risk.

GRECO, *THE BOOK PUBLISHING INDUSTRY*, 2d ed., Lawrence Erlbaum Assoc. (2005), p. 5–6; Jones, *supra* note 193, at 555–556.

²¹⁴ Although copyrights can last for over a century (the long time-period increases the chances of commercial possibilities in unforeseen media), authors may not care as much about profits made after they are dead.

²¹⁵ To the extent the outcomes are known, *see supra* Part III.1.c.

²¹⁶ *See* VARIAN, *supra* note 182, at 224–225. For experimental evidence on risk aversion, *see, for example*, Charles A. Holt & Susan K. Laury, *Risk Aversion and Incentive Effects*, 92 AM. ECON. REV. 1644 (2002).

²¹⁷ *But see supra* Part III.1.c for incomplete information. Assuming, as above, that the author has less information upon which to base the calculation of the probabilities than the publisher, this will increase variability, leading to higher risk. *See* PINDYCK & RUBINFELD, *supra* note 174, at 373–374, at 174.

Individuals are generally assumed to be risk-averse when it comes to their basic income.²¹⁸ Firms, on the other hand, are assumed to be risk-neutral.²¹⁹ There are two reasons for this assumption. First, firms are able to reduce risk through diversification. This means that they disperse risk by engaging in a large number of different projects, the successes and failures of which are independent from one another. Even though the individual projects may be highly risky, they will balance themselves out in the aggregate.²²⁰ Because firms are able to diversify on a much larger scale than most individuals, they are comparatively less exposed to concentration risk. Second, firms are believed to be more risk-neutral regarding individual transactions because of the difference in available capital. As discussed above,²²¹ individuals are subject to more limiting budget constraints than firms. Since absolute risk aversion is negatively correlated with wealth,²²² this creates a difference in risk attitudes between the author and publisher because the publishing firm has more capital at its disposal. The author's preference for certain income over uncertain income would lead to *ex ante* transfers of new use rights for prices that are lower than the expected future value.²²³ The distributional implications would confirm the legislative intuition that publishers garner a comparatively higher share of the wealth generated by copyrighted works

²¹⁸ See, e.g., KENNETH J. ARROW, *ESSAYS IN THE THEORY OF RISK-BEARING*, 3d ed., North-Holland (1976), p. 91 (claiming durability of the risk aversion hypothesis); Michael G. Allingham & Agnar Sandmo, *Income Tax Evasion: A Theoretical Analysis*, 1 *J. PUB. ECON.* 323 (1972), p. 324; Joop Hartog, Ada Ferrer-i-Carbonell & Nicole Jonker, *Linking Measured Risk Aversion to Individual Characteristics*, 55 *KYKLOS* 3 (2002), p. 9.

²¹⁹ See COOTER & ULEN, *supra* note 174, at 51; see also, e.g., Thomas J. Rothenberg & Kenneth R. Smith, *The Effect of Uncertainty on Resource Allocation in a General Equilibrium Model*, 85 *Q. J. ECON.* 440 (1971); Kenneth R. Smith, *The Effect of Uncertainty on Monopoly Price, Capital Stock and Utilization of Capital*, 1 *J. ECON. THEORY* 48 (1969).

²²⁰ See VARIAN, *supra* note 182, at 228–230.

²²¹ See *supra* Part III.1.a.

²²² See MAS-COLELL ET AL., *supra* note 174, at 192–93; see also VARIAN, *supra* note 182, at 189; PINDYCK & RUBINFELD, *supra* note 174, at 373–374, at 168 (“The extent of an individual’s risk aversion depends . . . on the person’s income.”); JEAN-JACQUES LAFFONT, *THE ECONOMICS OF UNCERTAINTY AND INFORMATION*, John P. Bonin & Hélène Bonin trans., MIT Press (1989) (1986), p. 24.

²²³ See Kalyan Chatterjee & William Samuelson, *Bargaining Under Incomplete Information*, 31 *OPERATIONS RES.* 835 (1983), p. 848.

e. Implications

If authors are comparatively subject to budget constraints, fewer outside options, and incomplete information, publishers will likely reap a larger part of the bargaining surplus in contract negotiations. Furthermore, risk aversion may motivate authors to sell their rights for less than if they were to take the full expected value into account. The combined effect would be a wealth distribution that is more favorable to publishers. Therefore, the legislative assumption regarding the distributional outcome in absence of intervention appears likely from an economic perspective. Next, this paper analyzes the effects of the legislative solution.

2. *Grant Restrictions and Transaction Costs*

Because of the above-discussed legislatively undesired distributional outcome, restricting the grant of exclusive rights to unknown uses aims to reallocate wealth to authors. Indeed, inalienably vesting the rights to unforeseen distribution methods in the author until such methods become known seems likely to reduce uncertainty and provide further opportunity for creators to bargain over the financial benefits derived from their work.²²⁴ Accordingly, the legislative decision to restrict the granting of rights for new uses appears to strengthen the author's financial position. However, this Part examines the effects of the restriction from a market-cost viewpoint to determine whether the legislative goal is likely to be achieved through these means.

One of the economic differences between a legal system that allows or prohibits the grant of new use rights is that the latter inevitably leads to contract renegotiation. When an unforeseen use arises, the distribution of the work over the new medium is contingent on a new license agreement between the publisher and the copyright owner. The compulsory contract negotiation raises a variety of theoretical issues. This Part focuses on

²²⁴ At least in so far as the author can capture part of the bargaining surplus within the constraints of the above-described bargaining asymmetries.

important issues that are practically relevant—namely, the costs incurred by additional contracting at a later stage.

Generally, high transaction costs will lead not only to higher expenses for individual contracting parties, but can also result in costs to society by making socially desirable market exchange more difficult. For this reason, much of traditional and contemporary law and economics research aims to increase social welfare by structuring legal rules so that endogenous and unnecessary transaction costs are minimized.²²⁵ However, the analysis in this paper focuses on the positive question of whether the legal rule imposed by the legislature is likely to bring about an improvement in authors' financial situations by redistributing the bargaining surplus. Social costs are therefore only considered to the extent that a general reduction of wealth may decrease the wealth available for distribution to authors. Below, this paper describes the transaction costs that are likely to arise in new use contracting situations, as well as their implications for the distributional outcome.

a. Search and Information Costs

Under a system that prohibits the *ex ante* grant of rights, the parties are required to renegotiate a new license agreement when a new use of the copyrighted work arises. This means that the publisher who wishes to distribute a licensed copyrighted work over a new medium must first identify and locate the current right holder. The phrase "current right holder" extends beyond the original author; copyrights are transferable and inevitably change hands.²²⁶ Because there is no mandatory registry for copyright ownership,²²⁷ locating and contacting the responsible party

²²⁵ See COOTER & ULEN, *supra* note 174, at 96–97.

²²⁶ For instance, by contractual agreement or when the original author is deceased. As mentioned above, copyright terms generally last for over a century. *Supra* note 5.

²²⁷ The Berne Convention for the Protection of Literary and Artistic Works, which has been ratified by 167 countries (as of November 2013), establishes in Article 5(2) that copyright ownership cannot be dependent on formal registration. See *Berne Convention Contracting Parties*, WORLD INTELL. PROP. ORG., available at http://www.wipo.int/treaties/en/ShowResults.jsp?lang=en&treaty_id=15; Berne Convention for the Protection of Literary and Artistic Works art. 5(2), July 24, 1971, 1161 U.N.T.S. 30 (as amended on Sept. 28, 1979).

years or decades after the initial grant of rights may require considerable effort.

b. Bargaining Costs

The publisher's next cost-incurring step is to renegotiate a license agreement or, at the very least, to obtain clearance from the right holder.²²⁸ There is also a risk that the right holder will be unwilling to enter into an agreement. This risk raises uncertainty and decreases the expected return from bargaining.

c. Enforcement Costs

Under a restrictive system, there is likely to be uncertainty regarding the enforcement of the original copyright agreement, because the legal definition of new use has proven extremely difficult to establish.²²⁹ Because each media development can give rise to a legal battle over whether the use is considered new in a legal sense, the probability that an initial grant of rights may lead to costly litigation in the future is likely to generate enforcement costs.²³⁰

²²⁸ One could argue that the pure bargaining costs are at least as high for an initial negotiation in which a new use right agreement must be reached (as opposed to a system in which it is clear that these belong to the author, reducing bargaining costs). However, practice suggests that new use rights are often not bargained over and simply included in contracts as boilerplate clauses, while costly negotiation seems more likely to occur after a new use has arisen and there is something tangible to negotiate.

²²⁹ Legal commentators claim of the previous system in Germany that, as a result of this difficulty, every major new media development led to uncertainty and litigation that lasted for up to two decades. See Nikolaus Reber, *Digitale Verwertungstechniken—neue Nutzungsarten: Hält das Urheberrecht der technischen Entwicklung noch stand?* [Digital Distribution Technologies—New Uses: Can Copyright Law stand the Technical Development?], 1998 GRUR 792 (Ger.), p. 793, 798; Mathias Schwarz, *Das "Damoklesschwert" des § 31 Abs. 4 UrhG—Regelungsbedarf für neue Nutzungsarten* [The "Sword of Damocles" of § 31 Para. 4 of the Copyright Act—Regulatory Requirements for New Uses], 47 ZUM 733 (2003) (Ger.), p. 735–736.

²³⁰ A good example is a German Federal Court of Justice decision from 2005, *Der Zauberberg*, BGH May 19, 2005, GRUR 917, 2005 (Ger.), which—after twenty years of legal ambivalence—finally clarified whether or not the distribution of video content over DVD qualified as an "unforeseen new use." See SCHUCHARDT, *supra* note 117, at 35–46.

Another uncertainty relates to the scope of the first license. Assuming the two uses are substitutable, meaning the old use may be replaced by the new use, the old agreement may produce more restricted rights and returns than initially assumed. Instead of being able to secure an all-encompassing copyright, independent of media form, the publisher must factor in the risk that the market segment for the granted use is appropriated by a new media development at some uncertain time in the future. While this uncertainty would lower the amount the publisher is willing to pay, it would theoretically lower the author's price limit as well, because the smaller expected value of the grant will raise willingness to sell.

The uncertainty with regard to litigation costs, on the other hand, has an effect on the parties' joint bargaining space. In negotiating the initial agreement, the expected cost of enforcement may drive down the publisher's reservation price (the maximum price the publisher is willing to pay). At the same time, the author's reservation price (the minimum price the author is willing to accept) would be influenced in the opposite direction. This leaves less bargaining room and may preclude *ex ante* agreements. The risk of a costly legal battle over who owns the right to which use will not occur where new use rights are clearly granted before the occurrence.²³¹

d. Tragedy of the Anticommons

The transaction costs described above are all magnified by what is commonly called the tragedy of the anticommons.²³² This concept

²³¹ However, as mentioned above, there is a considerable amount of case law in the United States, a country that allows the voluntary transfer of new use rights, regarding instances where the intent of the parties is not clear. Although one could argue that this merely relocates part of the legal battles to a different terrain, it nevertheless remains easier to avoid costly procedures by writing clear and concise contracts, especially when one has enough foresight to factor in potential enforcement costs.

²³² See Michael A. Heller, *The Tragedy of the Anticommons: Property in the Transition from Marx to Markets*, 111 HARV. L. REV. 621 (1998); James M. Buchanan & Yong J. Yoon, *Symmetric Tragedies: Commons and Anticommons*, 43 J. L. & ECON. 1 (2000); Sven Vanneste et al., *From "Tragedy" to "Disaster": Welfare Effects of Commons and Anticommons Dilemmas*, 26 INT'L REV. L. & ECON. 104 (2006); Francesco Parisi,

pertains to a market inefficiency that arises when (property) rights to complementary assets are fragmented and there are too many different owners. Excessive fragmentation of ownership in a market leads to higher transaction costs, including coordination difficulties and the danger of individuals preventing joint transactions. In the publishing practice, many new media distribution methods will involve the clearance of more than just one right. For instance, making a periodical journal available in an online database will include many articles written by different authors. Without the possibility of securing all rights at the time of the initial publication, a publisher who wishes to make use of such a database later on will be required to seek and clear the new use rights for every single copyrighted work involved.

The situation becomes even more intricate when dealing with assembled works. Much of modern creativity draws from or collects together a variety of sources, all of which are separately copyrightable.²³³ A good example is the documentary film. A standard documentary film comprises hundreds of clips of video footage, music, art, and photos, all belonging to different right holders. Securing these licenses even to simply produce the film is already quite costly. Securing them again, years or decades later, to distribute the film in a new media form has proven to be nearly impossible in practice.²³⁴ To illustrate, the copyright to the material in the Martin Luther King documentary *Eyes on the Prize*, directed by Henry Hampton,²³⁵ initially only included television broadcasting. Despite its cultural and historical importance, re-releasing the film in DVD format necessitated a considerable and incredibly costly

Norbert Schulz & Ben Depoorter, *Duality in Property: Commons and Anticommons*, 25 INT'L REV. L. & ECON. 578 (2005); Norbert Schulz, Francesco Parisi & Ben Depoorter, *Fragmentation in Property: Towards a General Model*, 158 J. INSTITUTIONAL & THEORETICAL ECON. 594 (2002); Ben Depoorter & Sven Vanneste, *Putting Humpty Dumpty Back Together: Experimental Evidence of Anticommons Tragedies*, 3 J. L. ECON. & POL'Y 1 (2006).

²³³ See MICHAEL HELLER, *THE GRIDLOCK ECONOMY: HOW TOO MUCH OWNERSHIP WRECKS MARKETS, STOPS INNOVATION, AND COSTS LIVES*, Basic Books (2008), p. xiv.

²³⁴ Another (of many) examples is the film *John F. Kennedy and other documentaries* by Charles Guggenheim, the rights to which his daughter, Grace Guggenheim, has devoted most of her life to clearing just so that the films can be released on DVD. See Lawrence Lessig, *The Google Book Search Settlement: Static Good, Dynamic Bad?* BLIP.TV (July 31, 2009), <http://blip.tv/file/2471815> (video of Lessig's talk at the Berkman workshop in Cambridge, Massachusetts).

²³⁵ EYES ON THE PRIZE (PBS 2006) (originally broadcast in 1987 and 1990).

joint effort. The right-clearance took twenty years, a \$600,000 donation from the Ford Foundation, hundreds of thousands of dollars in contributions from others, and considerable volunteer efforts.²³⁶ Additionally, with joint works, any one of the right holders whose contribution is essential to the work as a whole can easily “block” the entire publication by refusing permission.²³⁷

e. Implications

As seen above, there are many potential kinds of costs involved in renegotiating new use licenses. Furthermore, it is plausible that the magnitude thereof can be prohibitive. If the sum of all transaction costs exceeds the expected value of an agreement, these costs will hinder otherwise desirable licensing relationships. Publishers will either offset the costs with a reduction in what they are willing to pay, or they may reduce their investment in more “risky” relationships (such as promoting works with uncertain success), leading to a reduction in the number of authors who can benefit from a copyright agreement. Assuming that the legislative goal is, as noted above, distribution of wealth to authors, the generation of high transaction costs would undermine the legislative intent.

In theory, these costs are not restricted to prohibitive regimes. Countries that allow the parties full freedom of contract where new use right grants are involved will theoretically also enable authors to refuse the *ex ante* transfer of their rights. Furthermore, in practice, there are always cases in which the contracting parties simply did not anticipate the possibility of future financial benefit or think to minimize future costs by stipulating the transfer of such rights at the time of contract. However, licensing contracts are increasingly including long-sighted provisions as

²³⁶ See HELLER, *supra* note 233, at 9–10.

²³⁷ This is less of a problem where individual contributions can be easily separated from the work without a disproportionate loss of value. But there are also cases in which the work suffers considerably from the removal of individual pieces; for example, if Igor Stravinsky’s heirs refused the DVD rights to the musical score of the movie *Fantasia*. Another example is archived news media, which arguably loses value as a historical and cultural reference if not made available as a whole.

the publishing industry learns from its mistakes.²³⁸ The broad scope of rights transfer clauses in agreements in practice backs the assumption that publishers have a strong interest in securing the rights to future uses *ex ante*. As discussed above, there are various reasons why authors may share this interest,²³⁹ or have too little bargaining leverage to prevent it when they do not.²⁴⁰

This implies that a regime that allows freedom of contract will essentially lead to a system in which most new use rights are assigned *ex ante*. Although contract renegotiation may continue to occur in certain cases, overall costs are likely considerably reduced by allowing publishers to secure new use rights before the event. A restrictive legal regime, on the other hand, will presumably incur far more of the above-described transaction costs. In light of this outcome, legislatures that are concerned about the distribution of wealth to authors may need to question whether the chosen solution is likely to reach its goal.

Although this analysis is theoretical and further empirical research may be required to strengthen its conclusions, it is also supported by anecdotal evidence. The following relates the story of the reform in Germany and how a growing awareness of distribution problems due to the above-described transaction costs was the driving force behind the change.

²³⁸ Publishing contracts in the United States now commonly contain all-encompassing clauses: recording industry boilerplates contain wordings such as “in various formats now or hereafter known or developed . . . without any payment other than as provided herein.” See Alan H. Kress, in: 8 ENTERTAINMENT INDUSTRY CONTRACTS: NEGOTIATING AND DRAFTING GUIDE 159, Donald C. Farber & Peter A. Cross eds., M. Bender (2008), form 159-1, 159-84. Newspaper article contracts claim the “transferable right to publish or include the Work in non-print media now known or hereinafter devised.” See Leon Friedman, in: 3 ENTERTAINMENT INDUSTRY CONTRACTS, *supra*, at 57-58. Publishers commonly go so far as to use phrasings such as “throughout the universe, in perpetuity.” See Dionne Searcey & James R. Hagerty, *Lawyeresse Goes Galactic as Contracts Try to Master the Universe*, WALL ST. J. (October 29, 2009), A1. Although this language may seem absurd, it serves to eliminate any future uncertainty regarding the extent of the grant.

²³⁹ Including the additional argument that they may also factor in future transaction costs.

²⁴⁰ See *supra* Part III.1.

f. Anecdotal Evidence (German Reform)

In German copyright law, there has been an interesting turn of events in the area of new use right grants. Germany introduced new copyright legislation in January 2008.²⁴¹ One of the most significant changes was the abolishment of § 31(4), which had prohibited the granting of copyrights for unknown uses. This Part describes the developments that led to the revision.

As mentioned previously, an analysis of the case law prior to the reform in Germany shows a gradual tendency toward a less restrictive application of the general prohibition.²⁴² Courts were increasingly hesitant to declare media developments to be unforeseen or new uses under the law.²⁴³ In 1995, the German Federal Court of Justice decided (in contrast to its earlier practice) that “risk agreements” covering known technology of yet unknown economic importance were permitted, even in standard form contracts.²⁴⁴ This was followed by *Klimbim* in 1997, a controversial case in which the court held that a contract granting the rights to all known television distribution methods, including those not generally applied, covered direct satellite and cable broadcast rights.²⁴⁵ Although these methods arguably constituted additional sources of profit for the publisher,²⁴⁶ the court did not see them as new uses. In 2005, the German Federal Court of Justice also prominently declared that DVD distribution was not a sufficiently new form of distribution media under a contract granting videocassette rights.²⁴⁷

Although criticized in the literature from all sides for its chosen methods,²⁴⁸ the court’s reasoning reflects growing sensitivity to the

²⁴¹ Zweites Gesetz zur Regelung des Urheberrechts in der Informationsgesellschaft, Oct. 26, 2007, BGBl. I at 2513 (Ger.).

²⁴² See *supra* Part I.1.

²⁴³ See Artur-Axel Wandtke, *Aufstieg und Fall des § 31 Abs. 4 UrhG? [Rise and Fall of § 31 Para. 4 of the Copyright Act]*, in: COPYRIGHT LAW IN THE INFORMATION AGE, *supra* note 14, at 267, 272–73 (Ger.); see also discussion *supra* Part I.1.

²⁴⁴ Videozweitauswertung III, BGH Jan. 26, 1995, 128 BGHZ 336 (Ger.); Videozweitauswertung I, BGH Oct. 11, 1990, GRUR 133 (136), 1991 (Ger.).

²⁴⁵ *Klimbim*, BGH July 4, 1996, 133 BGHZ 281 (Ger.).

²⁴⁶ See Lütje, *supra* note 22, at 128.

²⁴⁷ Der Zauberberg, BGH May 19, 2005, 163 BGHZ 109 (Ger.). For further cases, see *supra* Part I.1.

²⁴⁸ See Reber, *supra* note 229, at 794–795; SCHUCHARDT, *supra* note 117, at 42; Schulze, *supra* note 31, at 559–560.

economic problems arising from the legal situation in practice.²⁴⁹ Allowing “risk agreements” was intended to reduce the legal uncertainty (and thereby enforcement costs) that publishers face when investing in new media.²⁵⁰ In *Klimbim*, the court stated that, while § 31(4) aims to prevent the profits from new distribution methods from being withheld from the author, the prohibition of new use right transfers should not hinder economic and technological improvement. New, independently licensable distribution methods must not be impeded by the strict legal consequence of invalidity, not least because their development is in the author’s interest as well.²⁵¹

Following this line of cases, an increasing number of voices began to call for a reform of the law.²⁵² In 1995, the German Parliament appointed a committee to analyze the influence of technological development and new media on copyright law in Germany.²⁵³ They also stressed the issue of § 31(4), calling attention to substantial practical difficulties that had arisen due to the prohibition of new use right grants.²⁵⁴

According to the committee, the problem had become virulent with the development of digital media and the possibility of making compilations such as periodical journals available on CD-ROM. Because of the sheer cost and impracticality of the task, many publishers were not attempting to seek new use rights for every single work involved and were instead publishing the compilations without the authors’ consent.²⁵⁵ In an attempt to stay within the confines of the law, art book publishers have gone so far as to have all original photos retaken for new publications, because this reportedly cost less than having to renegotiate with the copyright owners.²⁵⁶ The committee noted that it would have been

²⁴⁹ See generally JANI, *supra* note 33, at 107; Lütje, *supra* note 22, at 132.

²⁵⁰ See SCHACK, *supra* note 100, at 302 (referring to Risikogeschäfte).

²⁵¹ *Klimbim*, BGH July 4, 1996, 133 BGHZ 281 (283) (Ger.).

²⁵² See Lütje, *supra* note 22, at 145.

²⁵³ The committee was not limited to these functions. An inquiry committee established by enactment of the German Parliament worked closely with a variety of institutes, organizations, and experts, attempting a balanced involvement of all potentially affected interest groups. See *Beschlussempfehlung und Bericht*, Dec. 5, 1995, BT 13/3219 (Ger.).

²⁵⁴ *Zweiter Zwischenbericht der Enquete-Kommission* [Second Interim Report of the Inquiry Committee], June 30, 1997, BT 13/8110 (Ger.), available at <http://dipbt.bundestag.de/dip21/btd/13/081/1308110.pdf>.

²⁵⁵ *Id.* at 38.

²⁵⁶ *Id.* at 39.

impractical for the publishers to have followed the path foreseen by the legal requirement. They would have had to acquire permission from every single rights-holder, some of whom were deceased or untraceable. Additionally, any one of the authors could have prevented the entire publication of the work by refusing to give permission.²⁵⁷ For this reason, the committee recommended abolishing the prohibition of granting the rights to unknown uses in § 31(4).²⁵⁸

In a 2006 draft law that aimed to implement this recommendation, the accompanying explanatory statement also emphasized the problem of prohibitively high search and information costs involved in locating rights-holders.²⁵⁹ The problem of having to acquire rights from multiple parties as a result of the prohibition in § 31(4) was also one of the central arguments of the discussion.²⁶⁰ The immense organizational effort required to obtain clearance from multiple rights-holders was argued to be more than just a financial burden for publishers: it was recognized as leading to the exclusion and non-publication of commercially less successful works, because law-abiding publishers were shying away from the costs of distributing them over new methods.²⁶¹ Thus, the purpose of § 31(4) was reversed: instead of securing authors a share in the financial profits of new technological developments, it was preventing some works from making any new profit at all.²⁶²

Another argument that various interest groups presented prior to the reform was the legal uncertainty regarding the scope of copyright agreements and the risk of costly litigation procedures.²⁶³ Depending on

²⁵⁷ *Id.* at 39.

²⁵⁸ However, the committee also recognized the legislature's intended distributional goal of protecting the author's financial interests. Therefore, it suggested amending the law to allow the grant of unknown use rights, so long as the author is guaranteed reasonable participation in the proceeds. *See id.* at 40.

²⁵⁹ Gesetzesentwurf, June 15, 2006, BT 16/1828, at 22 (Ger.).

²⁶⁰ *Id.*; Schulze, *supra* note 31, at 547.

²⁶¹ See, for example, the argumentation of a legal committee on the impracticability of applying § 31(4) to performing artists due to the obvious difficulties of renegotiating new use rights with a large number of work participants. *Beschlussempfehlung und Bericht des Rechtsausschusses*, Jan. 23, 2002, BT 14/8058, at 21 (Ger.).

²⁶² *See Nordemann, supra* note 33, at 198.

²⁶³ *See Reber, supra* note 229, at 793, 798; Castendyk & Kirchherr, *supra* note 132, at 754; BÖRSENVEREIN DES DEUTSCHEN BUCHHANDELS, ERWERB VON UNBEKANNTEN UND UMGANG MIT NEUEN URHEBERRECHTLICHEN NUTZUNGSARTEN [ACQUISITION OF THE UNKNOWN AND DEALING WITH NEW TYPES OF COPYRIGHT USE] (Ger.), available at <http://>

the technology in question, there was considerable difficulty determining what constituted a new distribution method and whether or not it was “unforeseen.”²⁶⁴ Take the case of the DVD, for example. German legal opinions differed considerably on the question of whether it constituted a new distribution method as compared to the previous VHS technology.²⁶⁵ As discussed, it was not until 2005 that the DVD was declared not a sufficiently different distribution method to qualify as new.²⁶⁶ The German Federal Court of Justice’s decision was preceded by over twenty years of legal uncertainty regarding DVD distribution rights.²⁶⁷ Due to the lack of sufficient measures for defining unforeseen and new uses, practically every new medium had inevitably become a source of legal uncertainty.²⁶⁸ Because courts were unable to standardize the issue, every new technological development led to an increase in litigation.²⁶⁹ Thus, in a world in which technological innovation occurs more and more rapidly, having each new medium become the subject of court proceedings lasting fifteen years or longer²⁷⁰ made it increasingly clear that § 31(4) was creating an inefficient legal framework. This uncertainty was criticized as an additional high cost, often having prohibitive effects.

Interestingly, the German media industries were not alone in pushing for change. Naturally, the media lobby was very much in favor of

www.boersenverein.de/sixcms/media.php/976/Merkblatt_unbekannte_Nutzungsarten.pdf (last updated Mar. 2011); Schwarz, *supra* note 229, at 735–736; Nikolaus Reber, *Die Bekanntheit der Nutzungsart im Filmwesen—ein weiterer Mosaikstein in einem undeutlichen Bild* [*The Recognition of Usage Types in the Film Industry—Another Mosaic Stone in an Unclear Picture*], 1997 GRUR 162 (Ger.), p. 169 [hereinafter Reber, *The Recognition of Usage Types*]; Peter Weber, *Statement ZDF*, 47 ZUM 1037 (2003) (Ger.); *Stellungnahme der Filmwirtschaft zum Gesetzesentwurf der Bundesregierung für ein Zweites Gesetz zur Regelung des Urheberrechts in der Informationsgesellschaft “Zweiter Korb”* [*Opinion of the Film Industry of the Bill of the Federal Government for a Second Act Governing Copyright in the Information Society “Second Basket”*], INSTITUT FÜR URHEBER- UND MEDIENRECHT 6 (2006) (Ger.), available at <http://www.urheberrecht.org/topic/Korb-2/st/ra-2006-nov/teil-1/SPIO.pdf> [hereinafter *SPIO Proposal*].

²⁶⁴ See ZSCHERPE, *supra* note 22, at 202; Reber, *The Recognition of Usage Types*, *supra* note 263, at 162–169.

²⁶⁵ See SCHUCHARDT, *supra* note 117, at 45 & n.245.

²⁶⁶ Der Zauberberg, BGH May 19, 2005, 163 BGHZ 109 (Ger.).

²⁶⁷ See Schwarz, *supra* note 229, at 736.

²⁶⁸ BT 16/1828, at 22 (Ger.).

²⁶⁹ *Id.*; ZSCHERPE, *supra* note 22, at 202; SCHUCHARDT, *supra* note 117, at 35–46; Reber, *The Recognition of Usage Types*, *supra* note 263, at 163.

²⁷⁰ See SCHUCHARDT, *supra* note 117, at 18; Schwarz, *supra* note 229, at 738.

abolishing § 31(4), its main interest being a reduction in publishing expenses.²⁷¹ The ability to secure the rights to new uses in advance would reduce all three types of transaction costs that publishers faced.²⁷² However, there were also many voices arguing for reform for reasons other than publishers' interests. A number of German legal scholars strongly advocated reforming the law, not on behalf of the media industry, but instead in the interest of author protection.²⁷³ Many recognized that the economic hindrances that publishers faced could have negative effects on authors. Where costs are prohibitively high, authors could miss out on follow-up contracts altogether.²⁷⁴ As seen above, fewer contracts and lower reservation prices of contracting partners are not advantageous to authors, who usually have an interest in widespread dissemination of their work and are financially dependent on granting their copyrights to publishers.²⁷⁵ As in the example of CD-ROM distribution, publishers facing high costs were either illegally evading new licensing contracts or

²⁷¹ *SPIO Proposal*, *supra* note 263; *see also* Schwarz, *supra* note 229, at 741; *Zweiter Korb: Comments* [Second Basket: Comments], INSTITUT FÜR URHEBER- UND MEDIENRECHT [INSTITUTE FOR COPYRIGHT AND MEDIA LAW] (Ger.), *available at* <http://www.urheberrecht.org/topic/Korb-2/st/>.

²⁷² Search and information costs, bargaining costs, and enforcement costs. *See supra* Part III.2. The reduction in enforcement costs would result from the possibility to use clauses with which all copyrights are clearly transferred in their entirety and less subject to court interpretation. Although courts must still deal with all cases in which the scope of the transfer is not clear (such as in the United States, as mentioned above), reducing legal uncertainty would nevertheless lie more in the power of the parties.

²⁷³ *See, e.g.*, Joachim Bornkamm, *Erwartungen von Urhebern und Nutzern an den zweiten Korb* [Expectations for Authors and Users of the Second Basket], 47 ZUM 1010 (2003) (Ger.), p. 1012; ZSCHERPE, *supra* note 22, at 205; Adolf Dietz et al., *Entwurf eines Gesetzes zur Stärkung der vertraglichen Stellung von Urhebern und ausübenden Künstlern (Stand: 22. Mai 2000)* [Draft Law to Strengthen the Contractual Position of Authors and Performing Artists (as of May 22, 2000)], 2000 GRUR 765 (Ger.), p. 765; Castendyk & Kirchherr, *supra* note 132, at 751–755; Schwarz, *supra* note 229, at 738–739; THOMAS DREIER, URHEBERRECHT UND DIGITALE WERKVERWERTUNG: DIE AKTUELLE LAGE DES URHEBERRECHTS IM ZEITALTER VON INTERNET UND MULTIMEDIA: GUTACHTEN [COPYRIGHT LAW AND DIGITAL WORK RECOVERY: THE CURRENT STATE OF COPYRIGHT LAW IN THE ERA OF INTERNET AND MULTIMEDIA: REPORT], Friedrich-Ebert Stiftung (1997) (Ger.), p. 34, *available at* <http://www.fes.de/fulltext/stabsabteilung/00391toc.htm>; DANIELA DONHAUSER, DER BEGRIFF DER UNBEKANNTEN NUTZUNGSART GEMÄSS § 31 ABS. 4 URHG [THE CONCEPT OF UNKNOWN USES UNDER § 31 PARA. 4 OF THE COPYRIGHT ACT], Beck (2001) (Ger.); Reber, *supra* note 229, at 792–798.

²⁷⁴ *See* ZSCHERPE, *supra* note 22, at 205.

²⁷⁵ *Id.*; *see also* MARACKE, *supra* note 112, at 596–597; Castendyk & Kirchherr, *supra* note 132, at 755; Bornkamm, *supra* note 273, at 1012.

finding alternatives to contracting with the original right holders.²⁷⁶ Experts realized that instead of giving the author more control, as originally intended by the legislature, § 31(4) was taking it away.²⁷⁷

Advocates for change also argued that new media development may be slowed down by the restrictive system.²⁷⁸ This concern was initially expressed in the case law prior to the reform²⁷⁹ and was also included in the official reasoning for the draft law and the aforementioned commission report.²⁸⁰ By making distribution through new use methods difficult and costly, many viewed the prohibition in § 31(4) as an impediment to new technologies entering the market.²⁸¹ Considering the author's strong interest in information dissemination, improved distribution methods should not be economically discouraged.²⁸²

The legislature and many of the discussion participants recognized, however, that simply getting rid of the prohibition would also thwart the original distributional aim of the legal intervention. There were concerns that the author's financial interests, the protection of which remains a fundamental purpose of German copyright law, would be endangered if legal intervention in copyright agreements were to be completely withdrawn. In reforming the law, the German legislature was confronted with the task of protecting this distribution preference, but also mitigating the previously unrecognized negative effects on the market.²⁸³

The much-debated and finally implemented solution came in the form of a revocation right.²⁸⁴ As of the copyright law reform in 2008, the grant of unknown-use rights is possible in Germany, but authors can revoke the grant within three months of a new distribution method. According to the

²⁷⁶ BT 13/8110, at 39 (Ger.).

²⁷⁷ See SCHUCHARDT, *supra* note 117, at 18; ZSCHERPE, *supra* note 22, at 205; *see also* Gesetzesentwurf, June 15, 2006, BT 16/1828, at 22 (Ger.).

²⁷⁸ *See, e.g.*, Nordemann, *supra* note 33, at 198; Castendyk & Kirchherr, *supra* note 132, at 755.

²⁷⁹ Klimbim, BGH July 4, 1996, 133 BGHZ 281 (283) (Ger.).

²⁸⁰ *See* BT 16/1828, at 22; BT 13/8110, at 39.

²⁸¹ *See, e.g.*, SCHUCHARDT, *supra* note 117, at 18; *see also* Schwarz, *supra* note 229, at 735.

²⁸² This was, of course, also strongly pushed as a public interest argument. As such, it escapes the scope of this Article, which focuses on the legislative goal of distributing wealth to authors.

²⁸³ *See* Schulze, *supra* note 31, at 565; BT 16/1828, at 22.

²⁸⁴ *See* SCHACK, *supra* note 100, at 299.

newly introduced statute, § 31a, the author is explicitly allowed to grant the rights to unknown uses, provided the grant is made in written form.²⁸⁵ Section 31a(1) establishes an inalienable revocation right, allowing the author to back out of the copyright contract within three months of being notified of the new use, no matter what was originally stipulated in the contract.²⁸⁶

This solution allows those authors who were at an informational or economic disadvantage when entering the contract to correct the situation *ex post* and increases the general bargaining leverage of authors.²⁸⁷ But because the revocation right is limited to the original author,²⁸⁸ and the publisher's notification duty is fulfilled with notice to the last known address,²⁸⁹ the new system should have the effect of considerably reducing transaction costs in comparison to the previous, more restrictive regime. Limitation of the revocation right to the original author means that there is no need to track down copyrights that have repeatedly changed hands. In particular, the many cases in which an author is deceased or untraceable are no longer a hindrance. Furthermore, for all authors who do not explicitly object to the new distribution method, there is no need to draw up or negotiate a new contract. In addition, § 31a(3) holds that for conglomerate works with multiple authors, no individual may make use of the revocation right in "bad faith."²⁹⁰ This serves to

²⁸⁵ Urheberrechtsgesetz [UrhG] [Copyright Act], Sept. 9, 1965, BGBl. I at 1273, as amended by Zweites Gesetz zur Regelung des Urheberrechts in der Informationsgesellschaft [Second Law Regulating Copyright in the Information Society], Oct. 26, 2000, BGBl. I at 2513, art. 1, § 31a(1) (Ger.) ("Ein Vertrag, durch den der Urheber Rechte für unbekannte Nutzungsarten einräumt oder sich dazu verpflichtet, bedarf der Schriftform."); *see, e.g.*, LOEWENHEIM, *supra* note 31, at 1260.

²⁸⁶ UrhG, Sept. 9, 1965, BGBl. I at 1273, as amended, art. 1, § 31a(1) (Ger.) ("Der Urheber kann diese Rechtseinräumung oder die Verpflichtung hierzu widerrufen."); *see also* REHBINDER, *supra* note 31, at 214; SCHACK, *supra* note 100, at 299.

²⁸⁷ *See* BT 16/1828, at 24; *see also* Schulze, *supra* note 31, at 566, 570.

²⁸⁸ The revocation right is also non-transferable. *See* SCHACK, *supra* note 100, at 300; SCHUCHARDT, *supra* note 117, at 91. It also expires upon death. *See* UrhG, § 31a(2) (Ger.); *see also, e.g.*, LOEWENHEIM, *supra* note 31, at 1264.

²⁸⁹ *See* UrhG, § 31a(1) (Ger.). It is more or less the author's responsibility to inform the publisher of any address changes. BT 16/5939, at 44 (Ger.); *see also* Schulze, *supra* note 31, at 566, 575; SCHUCHARDT, *supra* note 117, at 104.

²⁹⁰ "Sind mehrere Werke oder Werkbeiträge zu einer Gesamtheit zusammengefasst, die sich in der neuen Nutzungsart in angemessener Weise nur unter Verwendung sämtlicher Werke oder Werkbeiträge verwerten lässt, so kann der Urheber das Widerrufsrecht nicht wider Treu und Glauben ausüben." *See also* Schulze, *supra* note 31, at 548, 570, 579–582.

prevent dire cases of blocking within the tragedy of the anticommons problem.²⁹¹

It must be said that a system granting the author a revocation right is still likely to incur more transaction costs than a non-paternalistic system that freely allows the grant. First, there will still be some search and information costs involved in fulfilling the notification duty. Second, the threat of revocation may be used by the author to induce a negotiation over a new contract,²⁹² which will raise bargaining costs. Furthermore, this threat introduces legal uncertainty regarding the initial grant of the rights from the beginning of the contractual relationship until three months after the new distribution method has been introduced.²⁹³ Finally, there is still the risk of enforcement costs due to the remaining uncertainty regarding the definition of a new use.²⁹⁴ However, the chosen solution is still suitable for eliminating a considerable amount of “unnecessary” transaction costs.

To sum up, one of the main factors that appears to have led to the reform in Germany was the realization that the restrictive law had caused high transaction costs, leading to a distributional outcome that was different—even contrary—to what had been originally intended by the regulation. While the chosen solution is debatable on many levels, the intent of the new legislation is clear: to conserve the original distributional aim of the legal intervention in new use right contracts, while structuring the law to account for economic costs that had previously been insufficiently considered. The developments leading to this reform nicely demonstrate the importance of looking more closely at the distributive arguments behind restricting grants of new use rights, and considering their potential market effects in practice.

²⁹¹ BT 16/1828, at 25.

²⁹² See Lars Klöhn, *Verträge über unbekannte Nutzungsarten—§§ 31a, 32c UrhG: Eine Behavioral Law and Economics-Perspektive* [Contracts for Unknown Uses—§§ 31a, 32c of the Copyright Act: The Behavioral Law and Economics Perspective], in: *DAS URHEBERVERTRAGSRECHT IM LICHT DER VERHALTENSÖKONOMIK* [COPYRIGHT CONTRACT LAW IN LIGHT OF BEHAVIORAL ECONOMICS], Karl Riesenhuber & Lars Klöhn eds., 9th ed., Walter de Gruyter (2009) (Ger.), p. 79, 85; see also Schulze, *supra* note 31, at 571.

²⁹³ See Schulze, *supra* note 31, at 548.

²⁹⁴ For example, cases of newly developed media are “new” and “unknown” in the sense of the law. See Schulze, *supra* note 31, at 548–549, 555.

3. Further Considerations

Requiring contract renegotiation between publisher and author in cases of unforeseen uses may have more effects on the market than merely that of high transaction costs. This Part considers other potential influences on the distributional outcome. Although perhaps not as directly observable or evident as the above-described issue of transaction costs, economic theory provides further insights into what could prove useful to investigate in subsequent research. For example, empirical studies could look at the likelihood and practical impact of “hold up” effects.

a. Hold Up in Incomplete Contracts

The classic theory of hold up in incomplete contracts can be outlined as follows. A contract is regarded as incomplete when it does not stipulate what is to happen in every possible future scenario. In the case that an event with unspecified consequences occurs, the parties must renegotiate the contractual relationship. The trouble arises when one party has made a relationship-specific investment prior to the renegotiation²⁹⁵ and is thereby dependent on the continuance of the contractual relationship to recoup her investment. The other party could threaten to withhold cooperation *ex post* and expropriate the bargaining surplus, essentially holding up the party that has invested. The investing party will likely try to avoid being held up or at least attempt to minimize the loss in profit, which results in investments that are not socially optimal. This is the classic hold up problem.²⁹⁶

²⁹⁵ See PATRICK BOLTON & MATHIAS DEWATRIPONT, *CONTRACT THEORY*, MIT Press (2005), p. 490–491. Salanié defines relationship-specific investment as “an investment that increases the productivity of the relationship under study, has a lower value outside of this relationship, [or] is costly for the party that makes it.” See BERNARD SALANIÉ, *THE ECONOMICS OF CONTRACTS: A PRIMER*, MIT Press (1997) (1994) (Fr.), p. 196.

²⁹⁶ See BOLTON & DEWATRIPONT, *supra* note 295, at 490–491.

The most obvious solution to this predicament is to induce the parties to create a written contract in advance that fixes the terms with regard to the future event. However, this may not be possible if the relevant circumstances of the event are unknown prior to its occurrence. Property rights theory provides the following classic solution to the hold up problem: assignment of a property right to the party more likely to make relationship-specific investments, the underinvestment in which would be socially undesirable.²⁹⁷ The owner can thus determine the consequences when the event occurs and enjoy the right to all unanticipated proceeds. Within this framework, it is socially desirable to give the investing party all of the *ex post* bargaining power, as this will prevent him from falling prey to the hold up situation and thereby enable a socially optimal level of investment.

This theory can be applied to new use copyright licenses. A copyright contract can be incomplete in that it does not specify what happens to the contractual relationship in the case that a future, unforeseen use of a copyrighted work arises.²⁹⁸ Assuming the absence of a legal rule to fill the gap, if the contract says nothing about which party owns the rights to unstipulated distribution forms, the parties have no choice but to renegotiate their agreement when new media are developed. With regard to the distribution of copyrighted works, the party that makes relationship-specific investments is likely to be the publisher, who invests in new distribution methods or media technology.

Consider, for example, the newspaper publisher who buys into CD-ROM technology to make previous, archived issues available by month or year. She will likely incur costs to look into the technical possibilities, assess the marketability, bargain with suppliers, or even develop and customize the new technology herself. Because of the initial uncertainty regarding the feasibility and value of the new method, this will generally happen before the publisher can begin the rights-clearing process. Therefore, by the time of the contract renegotiation, the publisher has (at

²⁹⁷ See Sanford J. Grossman & Oliver D. Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94 J. POL. ECON. 691 (1986); see also Oliver Hart & John Moore, *Incomplete Contracts and Renegotiation*, 56 ECONOMETRICA 755 (1988).

²⁹⁸ This could be because the parties did not anticipate a new use at all or because they were unable to evaluate the future situation and chose to leave the consequences unspecified.

least some) sunken investment costs. Assuming that the archived issues are to be made available in their entirety,²⁹⁹ the cooperation of all involved right holders is needed. Now that the publisher is dependent on all of the follow-up contracts in order to distribute the new media and regain the sunken investment, each of the involved journalists (or the successors who own the copyrights) can hold up the publisher by threatening to withhold their rights. Because the publisher will anticipate this situation, she will try to avoid being held up or at least attempt to minimize losses, leading to less *ex ante* investment in CD-ROM technology.

In the situation at hand, the copyrights to future uses of copyrighted works can be viewed as the property right in the classic solution to the hold up problem. The legislature can therefore influence the hold up potential of incomplete contract situations by making the *ex ante* decision to grant the copyright to either the author or the publisher. By legally prohibiting the grant of new use rights, the legislature very firmly assigns this right to the author.³⁰⁰ However, as seen above, the decision as to which party receives the property right should be conditioned on which side's underinvestment would be more detrimental. If it is indeed the case that publishers tend to be more in danger of making relationship-specific investments, then allocating the copyright to the author will aggravate, not solve, the hold up problem.

However, the applicability of this framework may be subject to limitations. First, the efficient allocation of the right depends on which party is more likely to make desirable investments that could be subject to a hold up situation. Given the current structure of most publishing industries, it is intuitively plausible that publishers run more risk of sunk investments before a contract renegotiation can be initiated. However, it is theoretically possible that the under-investing party could be the artist. For example, the assignment of all rights to a publisher could undermine

²⁹⁹ This assumption is valid either because it would be difficult and costly to leave out individual contributions, or because the market value is contingent on complete volumes (e.g., because the targeted consumers have a strong preference for unperforated issues).

³⁰⁰ It is even true without leaving the parties (who may be better informed than the state) the opportunity to bargain and allocate it differently *ex ante*.

the incentives of authors to invest in the value of their work through, for example, self-promotion.³⁰¹

Furthermore, the theory may be limited in that it is too static. In the case of new use right grants, the hold up situation outlined above assumes that the copyrighted work already exists. A more dynamic view would consider sequential investments.³⁰² Although authors are less prone to underinvestment in distribution, their incentives may nevertheless be influenced by the assignment of copyrights to publishers, leading to underinvestment in the creation of works and, perhaps, less authorship altogether.³⁰³ A legislature that intends to protect authors' financial interests will likely not desire a decrease in general authorship and, thus, other means of incentivizing creation would be necessary. Depending on the costs of such intervention, they could outweigh the benefits of preventing hold up, the impact of which is theoretical and may not be of great importance in practice. For example, the amount of actual publisher investments that are relationship-specific, thus prone to hold up, may be quite small.³⁰⁴

Finally, assuming that the above-discussed financial and informational asymmetries between firms and individuals put authors at a bargaining

³⁰¹ Currently, given the somewhat limited author investment possibilities in practice, this moral hazard is likely to be outweighed by the risk of the publisher's underinvestment in new media technology. However, it should be kept in mind that most creative industries are currently undergoing or standing on the brink of considerable changes. It is not completely unthinkable that the underinvestment may in some future cases lie with the author.

³⁰² See, e.g., Yeon-Koo Che & József Sákovic, *A Dynamic Theory of Holdup*, 72 *ECONOMETRICA* 1063 (2004); see also Georg Nöldeke & Klaus M. Schmidt, *Sequential Investments and Options to Own*, 29 *RAND J. ECON.* 633 (1998).

³⁰³ A counterargument to this dynamic effect on investment incentives could be that allocating copyrights to publishers would achieve a reduction in transaction costs, increasing the ex ante surplus, thus leading to more incentive for creation. Furthermore, if the costs of hold up are already borne by authors, allowing more publisher investment may make less of a difference for authors than immediately assumed.

³⁰⁴ As mentioned above, the situation could be that a publisher invests in a new technology covering inseparable works with multiple owners, or in author-specific marketability. However, it is indeed difficult to find good examples for relationship-specific investments in new media that would need to occur prior to a potential renegotiation.

disadvantage, this may mitigate or outbalance an author's power to extract the surplus in negotiations.³⁰⁵

b. Implications

Given the assumption that publishers are more likely to make socially desirable investments that could be endangered by hold up situations, classical hold up theory implies that initially granting the author the right to all distribution methods is inefficient, as renegotiation in cases of incomplete contracts will incur the problem of publisher underinvestment. As one can imagine, the overall effect of many publishers underinvesting could be to slow or hinder the socially desirable development and distribution of new media technologies. The societal disadvantage of such underinvestment is clear, but even disregarding social welfare and focusing solely on authors' interests, less investment in distribution and distribution methods is hardly to the advantage of artistic creators. Therefore, at least within this theoretical framework, it would be undesirable even for a purely distribution-oriented legislature to forbid the *ex ante* grant of new use rights (or even allocate these rights to authors in the first place).³⁰⁶ Under a non-restrictive system, the parties are more able (and likely) to draft complete contracts *ex ante*, considerably reducing the overall problem.

However, considering the limitations of this very theoretical framework, further research would be necessary to derive concrete implications. Although this Part suggests that the attempt to find out whether hold up problems apply to new use right practice may be useful, the question of how to conduct such research is not easy. Hold up-related underinvestment may be difficult, if not impossible, to measure in this area. Cross-border comparisons are likely to be too complicated because of the multitude of other factors that may account for differences, such as market structures and the work made for hire doctrine.³⁰⁷ However, one method could be to conduct qualitative studies, such as interviews with

³⁰⁵ See *supra* Part III.1.

³⁰⁶ This assumes that there is a less costly way to achieve the desired wealth distribution. Given the abundance of different possibilities, this is likely. However, exploring such alternatives remains beyond the scope of this paper.

³⁰⁷ See *supra* note 87.

publishers, in an attempt to determine whether hold up expectations discourage investments in practice.

4. Summary

From an economic perspective, the legislative picture of the financially disadvantaged author is plausible. Taking into account that authors in practice are generally individuals, while publishers are often firms,³⁰⁸ it is likely that authors are subject to more budget constraints, fewer outside options, less complete information, and increased risk aversion. When bargaining over contracts with new use right clauses, this may allow their contracting partners to reap a larger share of the joint surplus, leading to a distributional outcome that is more favorable to publishers. For legislatures that deem this situation undesirable and prefer to allocate more wealth to authors, restricting the grant of new use rights intuitively appears to reduce uncertainty and give authors more bargaining leverage.

However, requiring contract renegotiation when new distribution methods arise can generate a variety of costs. According to the economic theory and anecdotal evidence discussed in this Part, a legal regime that restricts the *ex ante* grant of new use rights will lead to high transaction costs, causing a reduction in the amount of trade that takes place or the prices that publishers are willing to pay for exclusive rights and potentially impeding the distribution of copyrighted works, as well as the investment in new media technology. Restricting the grant of rights to unknown uses could also potentially lead to underinvestment arising from hold up situations. All in all, authors may be unable to reap the financial benefits assumed by the legislature, and the distributional goal could in effect be thwarted entirely.

³⁰⁸ This distinction does not necessarily apply in the U.S. legal system, which employs the “work made for hire” doctrine, but is likely to hold true for the other jurisdictions.

CONCLUSION

Comparative legal analysis reveals that the treatment of new use right grants varies across borders. United States copyright law generally allows the parties freedom of contract in assigning the rights to new distribution methods. Other countries have chosen to restrict such assignments. Many European countries set high barriers to granting the rights or simply prohibit unknown uses of copyrighted works. The reasoning for this measure is regularly distributive. Creators are believed to be morally entitled to the financial benefits of their works. Because authors are assumed to be at a bargaining disadvantage when entering into copyright agreements with publishers, there is a fear that they will not be able to reap enough of the distributable profits arising from the use of their creations. Legal intervention is thus deemed necessary to protect their financial interests and achieve redistribution of wealth.

This paper finds that the legislative assumption that wealth distribution will be more favorable to publishers in a system without intervention is economically plausible. However, it also finds that restricting new use right grants may entail economic costs that thwart the intended goal of redistributing wealth to authors. In light of this result, preventing the grant of unknown-use rights may not be a suitable instrument for legislation to protect authors' financial interests.³⁰⁹ These insights can be of value to the ongoing legislative discussion over author-protective copyright laws, particularly in countries that are rethinking the approach to new use right grants.

That said, this paper does not attempt to normatively determine the optimal design of new use right laws for two reasons. First, factors specific to individual countries influence copyright legislation in the real world, which makes a one-size-fits-all solution unfeasible. Empirical research may be helpful in recognizing these factors and designing national laws that reach the desired outcome within their respective borders. This paper helps to determine relevant directions for such research on a local scale. Second, an approach that disregards the "fairness" argumentation of

³⁰⁹ Whether or not this should be the ultimate goal of copyright law remains outside the scope of the analysis.

legislatures and focuses solely on economically efficient mechanism design may be interesting in theory, but it completely ignores the reality of legislative discourse. Although the chosen approach may be frustrating to some economists, one of the major contributions that lawyers can make in the field of law and economics is not detailed knowledge of legal statutes, but rather an understanding of legal discourse and lawmaking in practice. This allows lawyers to identify relevant issues and make well-founded arguments for changes that can be implemented realistically, given the structure of today's political world.³¹⁰ For this reason, this paper looks closely at the legal arguments surrounding these laws and raises issues that are tangible enough to find their way into the legislative discussion and get the consideration they deserve.

³¹⁰ This is not to say that optimal mechanism design is not both valuable and important---only that building bridges is essential as well.

COPYRIGHT WITHDRAWAL

A LAW & ECONOMIC ANALYSIS OF U.S. AUTHOR TERMINATION RIGHTS

U.S. law grants authors a contract termination right thirty-five years after the license or transfer of their copyrights. This paper contributes to the ongoing debate over this law by providing economic perspective. Because of price changes, risk allocation, hold-up problems, and other effects on author and publisher incentives, it predicts that the economic costs of introducing termination rights will outweigh the benefits. This paper concludes that the current structure of author termination rights in the United States is at odds with its political justification, as well as the utilitarian purpose of copyright law.

B. Copyright Withdrawal: A Law & Economic Analysis of U.S. Author Termination Rights

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INTRODUCTION

In 1933, two high school teenagers came up with the idea for a comic book hero with superhuman powers. They labored over the design, refined the character's story, and then decided to get their work published. After multiple rejections, they finally found a publisher who was willing to purchase the exclusive rights to their superhero for \$130.¹ The first comic featuring Superman was published in 1938. Over the following years, D.C. Comics² made millions of dollars on the character contrived by these two young men, both of whom were reported to be nearly penniless in 1975.³

In 1976, the United States Congress revised the Copyright Act, extending the duration of terms for copyrighted works. Additionally, the new law introduced a termination right for authors⁴ and their statutory successors. Thinking of cases like the above,⁵ which are widely perceived as unfair to the original creators, Congress was interested in "safeguarding authors against unremunerative transfers"⁶ by allowing

¹ See *Siegel v. Warner Bros. Entertainment Inc.*, 542 F. Supp. 2d 1098, (C.D. Cal. 2008), p. 1107; see also Timothy Armstrong, *Shrinking the Commons: Termination of Copyright Licenses and Transfers for the Benefit of the Public*, 47 HARV. J. ON LEGIS. 359 (2010), p. 399.

² The 1938 successor of the original publisher „Detective Comics“, see *Siegel v. National Periodical Publications, Inc.*, 508 F.2d 909 (2d Cir. 1974), p. 911.

³ See Michael Dean, *An Extraordinarily Marketable Man: The Ongoing Struggle for Ownership of Superman and Superboy*, 263 THE COMICS JOURNAL 13 (2004), p. 16. When the story of the poor, bought-out creators started making the rounds in the 1970s, Warner Bros. Entertainment (having acquired D.C. comics and with it the rights to Superman in 1969), fearing for its reputation, proceeded to offer both authors a lifetime pension and healthcare benefits, see *Siegel v. Warner Bros. Entertainment Inc.*, 542 F. Supp. 2d 1098, (C.D. Cal. 2008).

⁴ For the purposes of this Article, "author" pertains to any creator of a copyrightable work.

⁵ STAFF OF H.R. COMM. ON THE JUDICIARY, 87TH CONG., REGISTER'S REPORT ON THE GENERAL REVISION OF THE U.S. COPYRIGHT LAW 92 (Comm. Print 1961), p. 93 ("The situation in which authors are most likely to receive less than a fair share of the economic value of their works is that of an outright transfer for a lump sum.")

⁶ H.R. REP. NO. 94-1476 (1976), p. 124.

them to opt out of their contractual agreements after a period of 35 years.⁷ The original Superman creators (or in this case: their statutory successors) were thus presented the opportunity to renegotiate their payment, or completely withdraw the copyright they had assigned to D.C. Comics, now owned by massive media conglomerate Warner Bros. Entertainment, Inc., effective 2013. Consequently, both authors' estates filed termination notices with the U.S Copyright office.⁸ Legal uproar ensued among the companies with financial stakes in Superman, as a first district court judgment in 2008 held that the notice was valid.⁹ Today, it remains unresolved what these terminations mean for the licenses that D.C. Comics has granted to Time Warner covering TV and movie rights, causing confusion among investors and fans alike.¹⁰

The case is not a lone exception. Taking advantage of the changes made in the 1976 Copyright Act and the copyright extensions instated by Congress over the past few decades,¹¹ authors of copyrighted works can begin terminating their copyright assignments as of 2013. Courts will have multiple issues to clarify in the legal battles that are about to ensue. Despite (or because of) the detailed complexity of the laws introduced in 1976,¹² they remain obscure to many industry participants and have left some looming open questions. Courts have yet to decide on issues such as

⁷ Or 56 years, for grants prior to 1978. *See infra* Part I for details.

⁸ Due to the changes made by the 1976 Copyright Act and later the 1998 Sonny Bono Copyright Term Extension Act (*see* 17 U.S.C. § 302(a) (2006)), the original copyright term of 56 possible total years was extended first by nineteen years and then by an additional twenty, making it possible for the right successors of the Superman creators to retain their rights until this day. *See also infra* note 33.

⁹ *Siegel v. Warner Bros. Entertainment Inc.*, 542 F. Supp. 2d 1098, (C.D. Cal. 2008), concerning notice served by the right successors of author Jerry Siegel.

¹⁰ *See D.C. Comics v. Pacific Pictures Corp., et al.*, CV 10-3633 ODW RZx, 2012 WL 4936588 (C.D. Cal. Oct 17, 2012); Simon Brew, *Warner Bros Wins Latest Round of Superman Rights Battle*, DEN OF GEEK (March 22, 2013), available at <http://bit.ly/11nHr8v>.

¹¹ Through both the 1976 Copyright act and the 1998 Sonny Bono Copyright Term Extension Act, *see infra* note 33.

¹² The district court in *Siegel v. Warner Bros. Entertainment Inc.*, 542 F. Supp. 2d 1098, (C.D. Cal. 2008), remarks on the confusing complexity of the laws, saying "The termination provisions contained in the Copyright Act of 1976 have aptly been characterized as formalistic and complex, such that authors, or their heirs, successfully terminating the grant to the copyright in their original work of authorship is a feat accomplished "against all odds." (Citing WILLIAM F. PATRY, *PATRY ON COPYRIGHT*, Vol. 2, Thomson/West (2007), § 7:52).

which categories of works are subject to termination rights, and how strictly to interpret their ‘inalienability’.¹³ For this reason, much of the discussion surrounding the introduction of author termination rights is only now becoming relevant, as the period approaches in which courts will begin to establish the boundaries of the rules.

Prior literature has drawn attention to the fact that there are already discrepancies in how courts are attempting to resolve open issues.¹⁴ So far, however, the evaluation of the judicial decisions, their outcomes, and how to best proceed moving forward, as well as of author termination rights generally, is largely focused on establishing and interpreting legislative intent.¹⁵ This paper contributes to the ongoing debates by highlighting the economic issues that could influence the outcome of the law in real-world markets. It predicts that introducing a termination right will effect price changes and risk allocation, essentially creating a lottery that rewards a small subset of authors, but reducing individual gains for the majority. First of all, this casts considerable doubt on the distributive-oriented justification for the law, but this paper also discusses why this price and risk allocation may not necessarily have a positive effect within the general incentive theory underlying copyright law. Furthermore, uncertainty, the length of copyright terms, and the long time period between right assignments and the termination possibility may mitigate the potential for positive effects on creation incentives. Finally, this paper

¹³ The Supreme Court has characterized the wording “notwithstanding any agreement to the contrary” to mean inalienability, *see infra* note 64 and Part I.5.

¹⁴ Such as whether there is any room for the parties to contract around termination rights, *see* Allison M. Scott, *Oh Bother: Milne, Steinbeck, and an Emerging Circuit Split over the Alienability of Copyright Termination Rights*, 14 J. INTELL. PROP. L. 357 (2006); Peter S. Menell & David Nimmer, *Pooh-Poohing Copyright Law’s “Inalienable” Termination Rights*, 57 J. COPYRIGHT SOC’Y U.S.A. 799 (2009); Lydia P. Loren, *Renegotiating the Copyright Deal in the Shadow of the ‘Inalienable’ Right to Terminate*, 62 FLA. L. REV. 1329 (2010).

¹⁵ *See* Menell & Nimmer, (2009) *supra* note 14; Loren (2010), *supra* note 14; Peter S. Menell & David Nimmer, *Judicial Resistance to Copyright Law’s Inalienable Right to Terminate Transfers*, 33 COLUM. J. L. & ARTS 227 (2010). Only a few commentators and scholars have raised economic concerns, *see* Guy Rub, *Stronger Than Kryptonite? An Economic Analysis of Termination of Transfer and Similar Inalienable Mechanisms*, paper presented at the 23rd Annual Meeting of the American Law and Economics Association, Vanderbilt University, Nashville (May 17-18, 2013).

demonstrates that adverse effects on publisher¹⁶ incentives may hinder socially desirable investments. It concludes that author termination rights as they are currently structured in the United States are likely not desirable within a utilitarian theory of copyright law.¹⁷

Part I provides a more detailed legal explanation of the author termination rights in the U.S. Copyright Act of 1976. Part II follows with an economic analysis of termination rights and their effects. Implications are discussed in Part III.

I. LEGAL SITUATION

The U.S. Copyright Act of 1976 instated a termination right for all authors who enter into a copyright assignment or licensing agreement. Although this right officially became law on January 1, 1978, its main effects will begin to materialize only now, more than three decades later, as terms begin to end and the windows in which authors are free to make use of their termination rights start to occur. The statutory details are as follows.

1. *History*

The Copyright Act of 1909 gave authors two consecutive 28-year terms of copyright,¹⁸ subject to a renewal by the author.¹⁹ Any rights the author

¹⁶ For the purposes of this Article, “publisher” pertains to any entity that acquires rights from the author for the purpose of disseminating and benefitting from the copyrighted work.

¹⁷ For more on why it makes sense to analyze copyright law from this perspective, and also for a discussion of whether there is reason for those who argue instead for a wealth-distributive purpose of copyright law to find author termination rights undesirable, see *infra* Part III.

¹⁸ See Copyright Act of 1909, 17 U.S.C. § 24 (1970). This dual term of copyright can be traced back as far as the Statute of Anne from 1709, see 8 Anne, c. 19.

¹⁹ See Copyright Act of 1909, 17 U.S.C. § 24 (1970).

granted to others during the first term were at the author's disposal again at the beginning of the second term.²⁰

In 1912, the famous song "When Irish Eyes Are Smiling," (co-)written by George Graff, Jr., was registered for copyright by music publisher M. Witmark & Sons. Given the first term of 28 years, the copyright renewal by the author was not going to be possible until around the year 1940. In 1917, however, Witmark made another agreement with the songwriter Graff to secure "all copyrights and renewals of copyrights and the right to secure all copyrights and renewals of copyrights," including "any and all rights that I [Graff] or my heirs, executors, administrators or next of kin may at any time be entitled to."²¹ When the first term was up, however, both publisher Witmark and songwriter Graff filed for copyright renewal. Subsequently, Graff assigned his copyright for the renewal term to publisher Fred Fisher Music Co., which began selling its own copies of "When Irish Eyes Are Smiling." In the resulting legal case, Fisher and Graff contended that the original 1917 assignment of the copyright renewal right to Witmark was void because it went against the intent of the law.²²

In 1943, the Supreme Court ruled in *Fisher v. Witmark* that an assignment to assign his renewal, made by an author in advance of the twenty-eighth year of the original term of copyright, is valid and enforceable.²³ It argued: "If an author cannot make an effective assignment of his renewal, it may be worthless to him when he is most in need. Nobody would pay an author for something he cannot sell."²⁴ This precedent established alienability of the copyright renewal rights before they had vested.²⁵ It thus became common for publishers to have authors

²⁰ For the reasoning behind this see H.R. REP. NO. 2222, 60th Cong., 2d Sess. 14 (1909).

²¹ *Fred Fisher Music Co. v. M. Witmark & Sons*, 318 U.S. 643 (1943), p. 645.

²² See *Fred Fisher Music Co. v. M. Witmark & Sons*, 318 U.S. 643 (1943); see also H.R. REP. NO. 2222, 60th Cong., 2d Sess. 14 (1909): "It not infrequently happens that the author sells his copyright outright to a publisher for a comparatively small sum. If the work proves to be a great success and lives beyond the term of twenty-eight years, your committee felt that it should be the exclusive right of the author to take the renewal term, and the law should be framed as is the existing law, so that he could not be deprived of that right."

²³ *Fred Fisher Music Co. v. M. Witmark & Sons*, 318 U.S. 643 (1943).

²⁴ *Fred Fisher Music Co. v. M. Witmark & Sons*, 318 U.S. 643 (1943), p. 657.

²⁵ See Melville B. Nimmer, *Termination of Transfers under the Copyright Act of 1976*, 125 U. PA. L. REV. 947 (1977), p. 951.

sign over their renewal rights along with the original copyright assignment.²⁶ Many argued that this decision essentially undermined the original intent of the law, which was to give authors a second chance to capitalize on their works later in time.²⁷

In 1976, the Copyright Act (effective date 1978)²⁸ abolished the dual copyright term, granting instead a single, longer copyright for a total of the author's life plus 50 years.²⁹ The statute also newly introduced a termination right for authors.³⁰ The House Committee Report explains the legislative concept of "safeguarding authors against unremunerative transfers."³¹ The 1961 Report of the Register of Copyrights contains the following paragraph:

"It has been argued that most authors do not need or want to be treated as incompetent to handle their business affairs. Many of them have banded together in organizations which negotiate standard contracts providing for continuing royalties. Their assignments can be and often are given for limited periods of time.

It is still true, however, that most authors are not represented by protective organizations and are in a relatively poor bargaining position. Moreover, the revenue to be derived from the exploitation of a work is usually unpredictable, and assignments for a lump sum are still common. There are no doubt many assignments that give the author less than his fair share of the revenue actually derived from his work.

²⁶ "It has become a common practice for publishers and others to take advance assignments of future renewal rights." STAFF OF H.R. COMM. ON THE JUDICIARY, 87TH CONG., REGISTER'S REPORT ON THE GENERAL REVISION OF THE U.S. COPYRIGHT LAW (Comm. Print 1961), p. 53.

²⁷ See *id.* at 53: "The reversionary purpose of the renewal provision has been thwarted to a considerable extent"; see also Nimmer, *supra* note 25, at 951.

²⁸ Pub. L. No. 94-553, 90 Stat. 2541, (codified at 17 U.S.C. § 101-810) (1976).

²⁹ Pub. L. No. 94-553, 90 Stat. 2541, 2572 (codified as amended at 17 U.S.C. § 302(a) (1976).

³⁰ 17 U.S.C. § 304 (c) and § 203.

³¹ H.R. REP. NO. 94-1476, 94th Cong., 2d Sess. 124 (1976).

Some provision to permit authors to renegotiate their disadvantageous assignments seems desirable."³²

It seems that the Copyright Register was thus indeed concerned with the type of case as illustrated in the introduction, where authors of copyrighted works are bought out by a small lump fee.

There are two provisions governing termination rights – one for copyright grants made prior to the effective date of the 1976 Copyright Act (1978), and one for copyright grants made after the law came into effect. These two provisions and their differences are described in more detail in the following.

2. Copyright Grants Made Prior to 1978

In 1976 and in 1998, the United States Congress enacted two copyright term extensions.³³ Termination rights were thus extended to include the additional term of protection.

§ 304 of the Copyright Act provides that licenses or transfers of copyright that were entered into before January 1, 1978, are subject to termination “during a period of five years beginning at the end of fifty-six years from the date the copyright was originally secured, or beginning on January 1, 1978, whichever is later.”³⁴ Because copyright was extended, § 304 permits authors and their statutory successors to claim part of the value inherent to the extension of the copyright term.

The termination right is limited in terms of eligible parties and timeframe.³⁵ Only authors themselves or, should the author be deceased,

³² STAFF OF H.R. COMM. ON THE JUDICIARY, 87TH CONG., REGISTER’S REPORT ON THE GENERAL REVISION OF THE U.S. COPYRIGHT LAW (Comm. Print 1961), p. 93.

³³ Copyright Act of 1976, Pub. L. No. 94-553, 90 Stat. 2541, 2572 (codified as amended at 17 U.S.C. § 302(a) (2006)); Sonny Bono Copyright Term Extension Act, Pub. L. No. 105-298, § 102(b), 112 Stat. 2827, 2827 (1998) (codified at 17 U.S.C. § 302(a) (2006)).

³⁴ See 17 U.S.C. § 304(c)(3).

³⁵ See also further regulations issued by the Copyright Office, 37 C.F.R. § 210.10 (2009).

the author's statutory successors³⁶ can terminate the copyright grant. Terminations are not automatic. In order for a termination to be effective, action is required on the part of the terminating party.³⁷ Notice of termination must be given maximum ten and at minimum two years before the termination date.³⁸ The effective date of termination must be "during a period of five years beginning at the end of fifty-six years from the date copyright was originally secured."³⁹ If no termination is made within the given time frame, the grantee can continue to exploit the work according to the original contract for the remainder of the copyright term.⁴⁰

Unlike terminations under § 203 of the Copyright Act, which, as discussed below, are limited to grants made by the author, the § 304 termination right applies to pre-1978 transfers made by both authors and authors' statutory successors.⁴¹ Termination rights apply to outright transfers, as well as any type of license (exclusive or non-exclusive).⁴² They do not, however, apply to works made for hire.⁴³

³⁶ 17 U.S.C. § 304(c)(1) establishes that a termination can be executed by at least one-half of successors that own and are entitled to the right as per 17 U.S.C. § 304(c)(2). For more details on the statutory successors, *see also infra* Part II.4.

³⁷ 17 U.S.C. § 304(c).

³⁸ 17 U.S.C. § 304(c)(4)(A).

³⁹ 17 U.S.C. § 304(c)(3).

⁴⁰ Or for however long was originally agreed to by the parties. It is the norm in most publishing industries to assign copyright for the entire possible (or even conceivably possible) extent and duration. *See for example* Alan H. Kress, in: 8 ENTERTAINMENT INDUSTRY CONTRACTS: NEGOTIATING AND DRAFTING GUIDE, Donald C. Farber & Peter A. Cross eds., Matthew Bender & Co. (2008), form 159-1, p. 159-184; Dionne Searcey & James R. Hagerty, *Lawyeresse Goes Galactic as Contracts Try to Master the Universe*, WALL ST. J. (October 29, 2009), A1.

⁴¹ 17 U.S.C. § 304(c)-(d). For reasoning, *see* Loren (2010), *supra* note 14, at 1336; STAFF OF H.R. COMM. ON THE JUDICIARY, 87TH CONG., REGISTER'S REPORT ON THE GENERAL REVISION OF THE U.S. COPYRIGHT LAW (Comm. Print 1961), p. 53.

⁴² 17 U.S.C. § 304(c).

⁴³ 17 U.S.C. § 304(c)-(d). Or to transfers made through a will. This makes sense in that the copyright is seen to originate with the party that receives the copyright through will or work made for hire. On the other end, however, since these "transferees" are not the original creator, they do not get to benefit from termination rights themselves.

3. Copyright Grants Made After 1978

Because the 1976 Copyright Act eliminated the copyright term renewal period⁴⁴ and created a single, longer term for copyright (life of the author plus fifty years,⁴⁵ then later seventy years⁴⁶), § 203 of the Copyright Act provides a way for authors or their statutory successors to terminate a grant after thirty-five years. This essentially replaces the function of the author's previous renewal opportunity, the purpose of which was to "protect authors against unremunerative transfers."⁴⁷ § 203 allows for termination "during a period of five years beginning at the end of thirty-five years from the date of execution of the grant".⁴⁸

Unlike terminations under § 304, the termination under § 203 is limited to grants made by the original author only.⁴⁹ Further transfers of copyright are not subject to termination through the transferer. Just like terminations under § 304, the right to terminate is limited to the author or statutory successors⁵⁰ and must be exercised during the time frame of maximum ten and at minimum two years before the termination date.⁵¹ It applies to all types of transfers and licenses,⁵² but not to works made for hire.⁵³ What this means in practice is described in the following.

4. Implications

To illustrate the mechanics of both types of author termination rights, take the case of the Superman creators. The original authors Jerome

⁴⁴ See *supra* Part I.1.

⁴⁵ 17 U.S.C. § 302(a) (1976).

⁴⁶ 17 U.S.C. § 302(a) (2006), as per the Sonny Bono Copyright Term Extension Act, *supra* note 33.

⁴⁷ See H.R. REP. NO. 94-1476, 94th Cong., 2d Sess. 124 (1976).

⁴⁸ Or, if the grant covers the right of publication of the work, the period begins at the end of thirty-five years from the date of publication of the work under the grant or at the end of forty years from the date of execution of the grant, whichever term ends earlier. See 17 U.S.C. § 203 (a)(3).

⁴⁹ 17 U.S.C. § 203(a).

⁵⁰ 17 U.S.C. § 203 (a)(1). As with § 304 terminations, successors must have a majority interest in order to terminate.

⁵¹ 17 U.S.C. § 203 (a)(3)(A).

⁵² 17 U.S.C. § 203(a).

⁵³ Or transfers made through a will. See 17 U.S.C. § 203(a).

Siegel and Joe Shuster granted publisher Detective Comics the copyright to Superman in 1938.⁵⁴ Because this was a grant made prior to 1978, their termination right is governed by § 304(c), which states that “[t]ermination of the grant may be effected at any time during a period of five years beginning at the end of fifty-six years from the date copyright was originally secured.”⁵⁵ For pre-1978 grants, “secured” means the actual date the work was first published with notice (or registered).⁵⁶ In this case the effective termination period is therefore from 1994 to 1999. Furthermore, termination notice must be given “not less than two or more than ten years before” the effective date of termination.⁵⁷ When Jerome Siegel passed away in 1996, his termination right automatically moved to his statutory successors in accordance with § 304(c)(2), in this case his widow and daughter. They both served notice of termination in 1997, with effective date two years later, in 1999.⁵⁸

Had the original Superman grant been executed in 1978, rather than 1938, the situation would have been as follows: § 203(a)(3) sets the effective termination date “at any time during a period of five years beginning at the end of thirty-five years from the date of execution of the grant;”⁵⁹ which in this case would begin in 2013.⁶⁰ Jerome Siegel’s widow and daughter would be able to regain copyright ownership any time between 2013 and 2018. What this means is that for grants made post 1978, the authors (or their statutory successors) are starting to be able to effectively terminate their grants under § 203 as of the time of this paper.

⁵⁴ See *Siegel v. Warner Bros. Entertainment Inc.*, 542 F. Supp. 2d 1098 (C.D. Cal. 2008), p. 1108.

⁵⁵ 17 U.S.C. § 304(c)(3).

⁵⁶ See PATRY, *supra* note 12, at §7:43; see also MELVILLE NIMMER & DAVID NIMMER, *NIMMER ON COPYRIGHT*, rev. ed., Matthew Bender (2009), Vol. 1, §11.05[B][1].

⁵⁷ 17 U.S.C. § 304 (c)(4)(A).

⁵⁸ Although there was much discussion in the resulting case as to the exact dates of termination and whether notice was valid, these complications are left out of this version, which only serves as an example for the mechanics of termination rights. For more information on the actual case, see *Siegel v. Warner Bros. Entertainment Inc.*, 542 F. Supp. 2d 1098 (C.D. Cal. 2008).

⁵⁹ Or, if the grant covers the right of publication of the work, the period begins at the end of thirty-five years from the date of publication of the work under the grant or at the end of forty years from the date of execution of the grant, whichever term ends earlier. See 17 U.S.C. § 203(a)(3).

⁶⁰ As with terminations under § 304, the authors or their successors must serve notice “not less than two or more than ten years before [the effective termination] date,” see 17 U.S.C. § 203(a)(4)(A).

In the few termination cases that have already arisen, it is becoming clear that the letter of the law leaves unresolved questions. Some of the most relevant issues are described in the following.

5. Open Questions

The 1976 law establishes that the termination rights under §§ 203 and 304 are restricted to the original author and their statutory successors⁶¹ and do not apply to works made for hire.⁶² §§ 203 and 304 also state that the termination rights are valid “notwithstanding any agreement to the contrary.”⁶³ In 1990, the Supreme Court characterized this description to mean inalienability of the right.⁶⁴ While the letter of the law may seem fairly simple and straightforward, these formalities are subject to a considerable range of interpretation by courts in practice.

For one thing, it has not been entirely clear whether the rights to some types of works fall under the work made for hire doctrine.⁶⁵ A problematic example of this so far has been sound recordings. Subject to considerable debate,⁶⁶ the decision about whether or not sound

⁶¹ See 17 U.S.C. § 203(a)(1), § 203(a)(2), § 304 (c)(1), and § 304 (c)(2).

⁶² See 17 U.S.C. § 203(a) and § 304(c).

⁶³ 17 U.S.C. § 203(a)(5) and § 304(c)(5).

⁶⁴ See *Stewart et. al. v. Abend*, DBA Authors Research Co., 495 U.S. 207 (1990), p. 230.

⁶⁵ The 1976 Copyright act introduced a new definition of works for hire. According to 17 U.S.C. § 101, a “work made for hire” is either - (1) a work prepared by an employee within the scope of his or her employment; or (2) a work specially ordered or commissioned for use as a contribution to a collective work, as a part of a motion picture or other audiovisual work, as a translation, as a supplementary work, as a compilation, as an instructional text, as a test, as answer material for a test, or as an atlas, if the parties expressly agree in a written instrument signed by them that the work shall be considered a work made for hire.”

⁶⁶ See for example Mary LaFrance, *Authorship and Termination Rights in Sound Recordings*, 75 S. CAL. L. REV. 375 (2002); Corey Field, *Their Master's Voice? Recording Artists, Bright Lines, and Bowie Bonds: The Debate Over Sound Recordings as Works Made for Hire*, 48 J. COPYRIGHT SOC'Y U.S.A. 145 (2000); Ryan A. Rafoth, *Limitations of the 1999 Work-For-Hire Amendment: Courts Should Not Consider Sound Recordings to Be Works-For-Hire When Artists' Termination Rights Begin Vesting in Year 2013*, 53 VAND. L. REV. 1021 (2000); Randy S. Frisch & Matthew J. Fortnow, *Termination of Copyrights in Sound Recordings: Is There a Leak in the Record Company Vaults?* 17 COLUM.-VLA J.L. & ARTS 212 (1993); Kathryn Starshak, *It's the End of the World as Musicians Know It, or Is It? Artists Battle the Record Industry and Congress to Restore*

recordings should be categorized as works made for hire and thus subject to author termination rights has hinged on courts' interpretation and has massive implications for the recording industry in having to deal with the effects of the 1976 Copyright Act.⁶⁷ In coming years, many established musicians or their statutory successors will be able to attempt termination of right transfers to financially valuable works.⁶⁸ Whether they can do so depends largely on the validity of the record companies' work made for hire argument.⁶⁹ To complicate matters, the definition and interpretation of a work for hire may differ depending on whether the work was made prior to 1978 (and thus governed by the 1909 Copyright Act), or whether it was made later, falling under the stricter definition of the 1976 Act.⁷⁰ Patrick Murray (2013)⁷¹ looks at the relationship between the work made for hire doctrine and author termination rights, confirming that much of the outcome is subject to court interpretation. He argues that the question of whether a work is "made-for-hire" is central to termination right issues,⁷² and that courts can and should be guided by economic considerations that affect the system as a whole.⁷³

The question of inalienability is also not as clear-cut as the statute makes it seem. For example, courts are currently divided on whether and when agreements between the same parties are "agreements to the contrary."⁷⁴ There have already been a few notable cases in which the parties, possibly in an attempt to circumvent the inalienability restriction, have tried to terminate the original agreement and re-enter into a "new"

Their Termination Rights in Sound Recordings, 51 DEPAUL L. REV. 71 (2002); Abbott M. Jones, *Get Ready Cause Here They Come: A Look at Problems on the Horizon for Authorship and Termination Rights in Sound Recordings*, 31 HASTINGS COMM. & ENT. L.J. 127 (2009).

⁶⁷ See *id.*

⁶⁸ Including, for example Bruce Springsteen, Billy Joel, Van Halen, etc., see Rub, *supra* note 15, at 56.

⁶⁹ See *id.*, in particular at fn. 205.

⁷⁰ See NIMMER & NIMMER, *supra* note 56, at §26; see also *Playboy Enterprises, Inc. v. Dumas*, 53 F.3d 549 (2d Cir. 1994), p. 553.

⁷¹ Patrick Murray, *Heroes-For-Hire: The Kryptonite to Termination Rights Under the Copyright Act of 1976*, 23 SETON HALL J. SPORTS & ENT. L. 411 (2013).

⁷² See also, e.g., *Mills Music, Inc. v. Snyder*, 469 U.S. 153 (1985); see also John Molinaro, *Who Owns Captain America? Contested Authorship Work-For-Hire and Termination Rights Under the Copyright Act of 1976*, 21 GA. ST. U. L. REV. 565 (2004); Rub, *supra* note 15, at 13.

⁷³ See Murray, *supra* note 71, at 429.

⁷⁴ See Armstrong, *supra* note 1, at 403.

contract in order to effectively restart the term. While some courts have cracked down on these attempts, declaring them invalid,⁷⁵ a couple of recent cases in the ninth and second circuit have come to more lenient conclusions.⁷⁶ This ambiguity has sparked discussion over what “agreement to the contrary” means, and whether alienability of termination rights should be allowed under certain circumstances.⁷⁷ Some claim that these cases go against the law, effectively “enabling a grantee to renegotiate the terms of the grant so as to frustrate recapture by the author’s family.”⁷⁸ It appears to be in the power of the courts to interpret the inalienability requirement strictly or not. Only very few commentators have looked at the question in light of the theory and purpose of U.S. copyright law, in particular with regard to economic incentives.⁷⁹ So far the debate over the desirable interpretation of these formalities has mainly focused on the reasoning behind the introduction of the termination right.⁸⁰

Further questions include what types of grants author termination rights apply to, in particular whether authors can revoke copyright assignments made under Creative Commons or other open-source licenses.⁸¹

These open questions are relevant because their judicial interpretation will establish the boundaries of termination rights. Near-future decisions in this area will set legal precedence for times to come. In ruling over author termination right cases, courts have space to influence the costs and benefits of the law. For example, courts can be swayed by anecdotes

⁷⁵ See *Classic Media, Inc. v. Mewborn*, 532 F.3d 978 (9th Cir. 2008).

⁷⁶ See *Milne v. Stephen Slesinger, Inc.*, 430 F.3d 1036 (9th Cir. 2005); *Penguin Group (USA) Inc. v. Steinbeck*, 537 F.3d 193 (2d Cir. 2008).

⁷⁷ See for example *Menell & Nimmer* (2009), *supra* note 14, at 827; *Loren* (2010), *supra* note 14, at 1344.

⁷⁸ See *Menell & Nimmer* (2009), *supra* note 14 at 802.

⁷⁹ But see *Rub*, *supra* note 15, who similarly explores the justification of U.S. author termination rights from an economic perspective (more on this *infra* Part II).

⁸⁰ See *Menell & Nimmer* (2009), *supra* note 14; *Loren* (2010), *supra* note 14. For reasoning see H.R. REP. NO. 94-1476, 94th Cong., 2d Sess. 124 (1976); STAFF OF H.R. COMM. ON THE JUDICIARY, 87TH CONG., REGISTER’S REPORT ON THE GENERAL REVISION OF THE U.S. COPYRIGHT LAW (Comm. Print 1961), p. 93.

⁸¹ See *Lydia P. Loren, Building a Reliable Semicommons of Creative Works: Enforcement of Creative Commons Licenses and Limited Abandonment of Copyright*, 14 GEO. MASON L. REV. 271 (2007); *Armstrong*, *supra* note 1, at 411.

of bought-out artists⁸² and interpret the inalienability of termination rights strictly, declaring rescissions and copyright re-grants invalid in all cases,⁸³ or applying the work made for hire doctrine narrowly.⁸⁴ Or, courts can factor economic awareness and concerns into their interpretations, taking the below-addressed issues into consideration. The above-discussed open questions are all examples of areas where there is considerable judicial leeway. More generally, when discussing not only judicative, but also which legislative directions to take moving forward, having some idea of the potential economic effects of these laws is a useful insight.⁸⁵ Rather than draw on the discussion of legislative intent like most of the prior literature,⁸⁶ the following Part therefore looks at the author termination right system from an economic perspective.

II. ECONOMIC ANALYSIS

This Part looks at how existing law & economic theory applies to author termination rights, in particular in the context of contracting and the parties' investment incentives. By instating author termination rights in the 1976 U.C. Copyright Act, the United States Congress is essentially intervening in the parties' freedom of contract. Termination rights effectively allow one of the parties to a contract to terminate at a specific time, regardless of what was originally agreed to. Furthermore, this right belongs to only one of the parties. The intervention has the explicit purpose of giving one party to the contract a renegotiation opportunity.⁸⁷

Economic theory on contracts and investment incentives predicts a number of standard effects that only a few scholars have considered in the

⁸² See, e.g., Sean McGilvray, *Judicial Kryptonite? Superman and the Consideration of Moral Rights in American Copyright*, 32 HASTINGS COMM. & ENT. L.J. 319 (2010), p. 333-336.

⁸³ See Rub, *supra* note 15, at 62-65.

⁸⁴ See Murray, *supra* note 71, at 437, citing *Marvel Worldwide, Inc. v. Kirby*, 777 F. Supp. 2d 720 (S.D.N.Y. 2011) as a counter-example.

⁸⁵ Although this paper uses judicial interpretation as an example for the timely relevance of this research and how it can be useful in practice, see *infra* note 268, the economic analysis is more generally applicable.

⁸⁶ This paper comes back to legislative intent in the discussion of implications, see *infra* Part III.

⁸⁷ See *supra* Part I.1.

discussion surrounding author termination rights.⁸⁸ Guy Rub (2013) delivers a rare economic analysis, arguing that termination rights are costly and unnecessary. Like in the following Part,⁸⁹ he warns against a misallocation of risk between authors and publishers.⁹⁰ While he suggests that termination rights could increase incentives to create if their term were shorter, he argues that a tragedy of the anticommons problem⁹¹ and the cost of risk-shifting outweigh the benefits in the all-over tradeoff. This analysis concurs with the risk allocation effect. It explores both this aspect and the problem of hold-up in more depth. Based on economic factors like uncertainty and intertemporality in decision-making, it also questions a noticeable effect of termination rights on creation incentives.⁹² This paper also explores additional behavioral effects and the role they could play in the termination right setting. Aside from the standard economic concerns of price changes and risk shifting, bounded rationality may have an influence on actor incentives and behavior.

Examining author termination rights from the perspective of law & economics can be a helpful tool. While there are limitations to economic theory, in particular because there may be other factors than efficiency worth considering in practice,⁹³ it can be useful to step back and look at this type of contracting situation through an economic lens. Economic theory can point to relevant effects that may not be intuitively obvious to lawmakers.

⁸⁸ *But see, for example*, Kal Raustiala & Christopher Sprigman, *The Music Industry Copyright Battle: When is Owning More Like Renting?* FREAKONOMICS (August 31, 2011), available at <http://www.freakonomics.com/2011/08/31/the-music-industry-copyright-battle-when-is-owning-more-like-renting/>.

⁸⁹ *See infra* Part II.1.

⁹⁰ *See also* Raustiala & Sprigman, *supra* note 88.

⁹¹ “[T]he need to reassemble rights, held by many individuals, after termination.” *See* Rub, *supra* note 15, at 1.

⁹² Which is a relevant consideration within the utilitarian function of copyright law. The idea of incentivizing creative work is central to U.S. copyright theory, *see* PAUL GOLDSTEIN, *GOLDSTEIN ON COPYRIGHT*, 3rd edition, Aspen Publishers (2010), §1.14 (“Economic Foundations of Copyright”); NIMMER & NIMMER, *supra* note 56 at §1.03[A], p. 17-18; *see also* Justin Hughes, *Fair Use Across Time*, 50 UCLA L. REV. 775 (2003), p. 797; Joseph P. Liu, *Copyright and Time: A Proposal*, 101 MICH. L. REV. 409, (2002), p. 428. The U.S. Constitution enables copyright laws that grant “Authors [...] the exclusive Right to their [...] Writings” in order “to promote the progress of Science and useful Arts”, U.S. CONST. art. I, § 8, cl. 8. For more discussion of this *see also infra* Part III.

⁹³ *See, for example, infra* Part III for discussion of distribution effects.

The following Parts elaborate on the economic theory behind the above-mentioned issues and illustrate how they apply in the specific context of author termination rights.

1. Price Changes and Risk Allocation

Publishing industries, in other words markets for copyright grants, commonly comprise a large number of sellers (authors), and a far smaller number of buyers (publishers).⁹⁴ The buyers not only have access to the distribution channels necessary to disseminate and market the work, but also, importantly, they are in a better position to diversify risk. Markets for creative works are characterized by high uncertainty of future successes and failures.⁹⁵ With only a small portion of creations becoming popular and a great many not, making investments in a creative work carries significant risk. Publishers, by taking on a large number of projects, mitigate the all-over risk by distributing it over their entire pool of investments. Because authors, for the most part, are in no position to do the same,⁹⁶ they have an interest in signing the risk of success or failure over to publishers. Furthermore, as discussed in the preceding paper in this doctoral thesis, authors are often dependent on a source of immediate income, whereas the buyers generally are not.⁹⁷ Sellers are

⁹⁴ For examples of publisher concentration, see Allen J. Scott, *A New Map of Hollywood: The Production and Distribution of American Motion Pictures*, 36 REGIONAL STUD. 957 (2002); Michael Szenberg & Eric Youngkoo Lee, *The Structure of the American Book Publishing Industry*, 18 J. CULTURAL ECON. 313 (1994); Alan B. Albarran, *Media Economics*, in: THE SAGE HANDBOOK OF MEDIA STUDIES 291, John D.H. Downing, Denis McQuail, Philip Schlesinger, and Ellen A. Wartella eds. SAGE (2004), p. 296; Mike Jones, *Market Research*, in: CONTINUUM ENCYCLOPEDIA OF POPULAR MUSIC OF THE WORLD: VOL. 1: MEDIA, INDUSTRY AND SOCIETY, 554, John Shepherd et al. eds. Continuum International Publishing Group (2003), p. 555.

⁹⁵ See RICHARD E. CAVES, *CREATIVE INDUSTRIES: CONTRACTS BETWEEN ART AND COMMERCE*, Harvard University Press (2000), p. 2-3, 61; ALBERT N. GRECO, *THE BOOK PUBLISHING INDUSTRY*, 2nd edition, Lawrence Erlbaum Associates, Inc. (2005), p. 5-6; Sarah J. Skinner, *Estimating the Real Growth Effects of Blockbuster Art Exhibits: A Time Series Approach*, 30 J. OF CULTURAL ECON. 109 (2006); Jones, *supra* note 66, at 555-556.

⁹⁶ While it is conceivable that some authors may self-publish a large number of works, publishers commonly work with amounts that by far exceed that of an individual.

⁹⁷ See *Fred Fisher Music Co. v. M. Witmark & Sons*, 318 U.S. 643 (1943), p. 657; see also Kate Darling, *Contracting About the Future: Copyright and New Media*, 10 NW. J. TECH & INTELL. PROP. 485 (2012), p. 507-508.

therefore interested in exchanging the copyrights to their work for an upfront sum of money.

All of the above is reflected in the fact that pure royalty-rate contracts are relatively scarce in practice.⁹⁸ Publishers have an interest in purchasing the full transfer of copyright for an upfront fee. Royalties will often enter into contracts with an author once he or she has become established and successful, although even then, profit participation usually only makes up part of the remuneration.⁹⁹ While this circumstance could be attributed to bargaining disadvantages on the side of authors, it makes economic sense to have buy-out contracts for creative works. If buyers are willing and able to bear the (high) risks of success and failure, while sellers prefer to exchange this risk for immediate payment, royalty-rate contracts are not in either party's interest.¹⁰⁰ While for established authors the uncertainty of the work's success is reduced on both sides, new or less famous authors are a particularly high-risk investment.¹⁰¹ For example, a 2007 study by Martin Kretschmer and Philip Hardwick looks at earnings of authors from copyright, finding that royalty-based income is an extremely uncertain source.¹⁰² A small subset of authors will profit from royalty contracts, while the large part of authors will not.¹⁰³

⁹⁸ At least for not yet established artists, *see for example* ARTHUR DE VANY, *HOLLYWOOD ECONOMICS - HOW EXTREME UNCERTAINTY SHAPES THE FILM INDUSTRY*, Routledge (2004), p. 245; Menell & Nimmer (2009), *supra* note 14 at 802 (on record labels and the music industry); Darlene C. Chisholm, *Profit-Sharing Versus Fixed-Payment Contracts: Evidence From the Motion Pictures Industry*, 13 J. LAW ECON. ORGAN. 169 (1997); DONALD S. PASSMAN, *ALL YOU NEED TO KNOW ABOUT THE MUSIC BUSINESS*, 7th ed., Rosetta Books (2011), p. 68-88.

⁹⁹ *See id.*

¹⁰⁰ *See* Christoph Engel & Michael J. Kurschilgen, *Fairness Ex Ante and Ex Post: Experimentally Testing Ex Post Judicial Intervention into Blockbuster Deals*, 8 J. EMPIRICAL LEGAL STUD. 682 (2011), p. 683.

¹⁰¹ *See supra* notes 95 and 98.

¹⁰² MARTIN KRETSCHMER & PHILIP HARDWICK, *AUTHORS' EARNINGS FROM COPYRIGHT AND NON-COPYRIGHT SOURCES: A SURVEY OF 25,000 BRITISH AND GERMAN WRITERS*, Bournemouth: Centre for Intellectual Property Policy & Management (2007).

¹⁰³ *See also* Richard Watt, *Licensing and Royalty Contracts for Copyright*, 3 REV. ECON. RESEARCH COPYRIGHT ISSUES 1 (2006), p. 15. One way to look at royalty contracts is through the lens of a principal-agent relationship, *see* Ruth Towse, *Copyright and Economic Incentives: An Application to Performers' Rights in the Music Industry*, 52 KYKLOS 369 (1999), p. 369-390; *see also* (on musician revenue generally and the distribution of royalty-based vs. other income) Peter DiCola, *Money from Music: Survey*

In this setting, basic economic theory predicts that introducing a termination right for authors will have two relevant effects. First, it makes the initial assignment of a copyright less valuable to publishers, decreasing the price they are willing to pay to authors upfront. Second, this reallocates some of the risk of future success or failure back to the author.¹⁰⁴

Because publishers know that authors and their statutory successors can terminate, the contract for successful works is necessarily limited to 35 years. Reducing the term from the entire duration of the copyright (life of the author plus 70 years)¹⁰⁵ to a potential maximum of 35 years reduces the expected value of the copyright assignment that publishers are purchasing. In particular, publishers have to take into account that the works that turn out to be most profitable are the transfers that are most likely to be terminated. There is apparent imbalance in this contract situation: unlike the author, the publisher has no termination right, and therefore no opportunity to correct for a disproportionately high fee paid up front. The economically predicted reaction on the part of the publisher is to either reduce the price paid for the initial assignment,¹⁰⁶ or enter into fewer exploitation contracts with authors.¹⁰⁷

Of course, even if they receive less payment upfront, introducing a termination right gives authors the possibility of receiving more money at a future point in time. However, this will only offset the initial loss in price for a small subset of highly successful authors. Kal Raustialia and Christopher Sprigman have likened this to a regressive tax, because the

Evidence on Musicians' Revenue and Lessons About Copyright Incentives, ARIZ. L. REV. (forthcoming), available at <http://ssrn.com/abstract=2199058>.

¹⁰⁴ See, e.g., William M. Landes & Richard A. Posner, *An Economic Analysis of Copyright Law*, 18 J. LEGAL STUD. 325 (1989), p. 327.

¹⁰⁵ See for example 17 U.S.C. § 302(a).

¹⁰⁶ See Rub, *supra* note 15, at 34-35.

¹⁰⁷ Although this is theoretically empirically measurable, since the law came into effect in 1976 and publishers may have changed their behavior after knowledge of the change, the intricacies of legal reality may prevent measurable strong results for the time period between introduction of the law and now. The exact mechanics of the rules were (and are) quite obscure and difficult to understand in detail, let alone interpret. Some publishers may have optimistically assumed that their business comprised works made for hire (e.g. sound recordings), or that right-holders would not be able to navigate (or be able to afford to navigate) this complex legal terrain. They also may have relied on coming up with workarounds, such as pre-termination agreements etc., the validity of which have yet to be decided by courts.

net effect is to transfer wealth from the unsuccessful to the successful artists.¹⁰⁸ Furthermore, should publishers decide to reduce the number of contracts they invest in, fewer authors will receive any payment at all. Additionally, the work of those who lose out on initial contracts will not be distributed,¹⁰⁹ resulting in less visibility for the respective artists and fewer total artistic works in the market. Finally, this additional payment for the lucky few will not occur until at least thirty-five years after the transfer or license of copyright. As mentioned above, authors are generally the party in need of a more or less immediate source of income and are also far less able to diversify risk. The introduction of a termination right, in that it rewards only the most successful artists down the line, effectively reallocates some of the risk from the publisher back to the author.

Given that the reasoning behind termination rights appears to be to help authors as the disadvantaged party,¹¹⁰ this effect is unlikely what congress originally envisioned.¹¹¹ Discussion of legislative intent aside, however, there could be economic justification for the law. In theory, it could be that the ‘regressive tax’ outcome is desirable, for instance under the assumption that this high-risk lottery system will generate a ‘superstar effect’, inducing creators to strive for uncertain, but very high, payment.¹¹² This would incentivize the creation of artistic works by many, even though only a few individuals are rewarded.¹¹³ While this is not the given reason for introducing author termination rights,¹¹⁴ these author incentives deserve examination in light of the general incentive theory behind U.S.

¹⁰⁸ See Raustiala & Sprigman, *supra* note 88.

¹⁰⁹ At least not through the traditional channels that the publishers utilize in their function as gatekeepers.

¹¹⁰ See H.R. REP. NO. 94-1476, 94th Cong., 2d Sess. 124 (1976); see also *supra* Part I.1.

¹¹¹ See *id.* More on this see also *infra* Part III.

¹¹² See Sherwin Rosen, *The Economics of Superstars*, 71 AM. ECON. REV. 845 (1981); Diane L. Zimmerman, *Copyrights as Incentives: Did We Just Imagine That?* 12 THEORETICAL INQUIRIES L. 29 (2011), p. 41-42. For more on the ‘superstar effect’ in creative industries, see CAVES, *supra* note 95, at 73-76.

¹¹³ Some have also argued that risk allocation could incentivize the authors who are most likely to be successful, while weeding out those with lesser potential, see Henry Hansmann & Marina Santilli, *Royalties for Artists Versus Royalties for Authors and Composers*, 25 J. CULTURAL ECON. 259 (2001), p. 265. This argument is weaker to the extent that the success and failure of works is unpredictable, see *supra* note 95.

¹¹⁴ See *infra* Part III; *supra* Part I.

copyright law.¹¹⁵ Part II.4 explores the effect of author termination rights on creation motivation in more detail.

First, however, the following Part addresses another concern regarding the introduction of author termination rights, namely that risk-reallocation back to the author may have a negative effect on publisher incentives. Any positive effects on author incentives *ex ante* would have to be weighed against the costs of an (*ex-post*) effect on investment.¹¹⁶ Economically, a royalty-rate contract (which is comparable here in terms of introducing profit participation between author and publisher) will necessarily lessen a publisher's incentives to invest in the success of the work.¹¹⁷ Author termination rights not only decrease these incentives (similar to the case of royalty contracts) – they also raise further questions of rent-seeking behavior and hold-up situations. This is explored in the following.

2. Hold-Up and Publisher Investment Incentives

Apart from risk reallocation, economic theory predicts that the author termination right may affect the publisher's investment incentives. While copyrighted works may be the brainchild of the original creator, much of a work's value to society can come from later investments in quality, marketability, and of course from access to the work through its subsequent distribution.¹¹⁸ The reason that copyrights are so commonly transferred or licensed to another party is often because the original author is not in the best position to make his or her work widely

¹¹⁵ See *supra* note 92.

¹¹⁶ While this trade-off cannot, of course, be conclusively measured with data, this paper indicates that a positive incentive effect is likely to be smaller than the costs of termination right introduction, see *infra* Parts II.2, II.4, and III. See also DiCola, *supra* note 103, at fn. 8 (explaining that some indication is valuable in the context of copyright policy, which currently lacks sufficient data to conclusively measure trade-offs).

¹¹⁷ See Caves, *supra* note 95, at 56-57: „The author's royalty based on sales leaves the publisher with an underinducement to promote the [work] (the author, correspondingly, wants more promotion than would maximize author's and publisher's joint profits). The author's advance [payment], though, strengthens greatly the publisher's marginal incentive to promote – he gets roughly the full resulting gross profit [...], which increases the efficiency of the contract.”

¹¹⁸ See Shyamkrishna Balganesh, *Foreseeability and Copyright Incentives*, 122 HARV. L. REV. 1569 (2009), p. 1621-1623.

accessible to the public.¹¹⁹ In fact, the United States copyright system is based on the assumption that authors will enter into distribution contracts over their works,¹²⁰ and recognizes publishers as both necessary and desirable. Intermediary incentives are therefore a relevant concern for copyright policy.¹²¹ Publishers function as intermediaries that disseminate works to the public and generate value by assessing markets, making necessary alterations to the work, and attempting to ensure the maximum profitable distribution thereof.¹²² Their entire business model is basically to purchase copyrights and make them remunerative by investing in marketing, finding the right distribution channels, and exploring new media and exploitation methods. In the process, they will often make contributions to the quality of the work itself (think, for example, of record labels that professionally record and master songs, book publishers that are involved in everything from editing to design, etc.). Given the role of publisher investments in the quality and distribution of creative works, as well as the development of new, improved exploitation methods, it seems important to consider the effects of author termination rights on these investment incentives.

Allowing for a termination right, and thus a later renegotiation of contracts for (successful) works is comparable to a revenue-sharing contract *ex ante*. As mentioned above, this will reduce publishers' investment incentives in any case, because they lose part of the value they will be investing in creating.¹²³ Furthermore, however, both economic theory and intuition suggest a potential hold-up problem when authors have the right to withdraw their grant and force publishers into contract renegotiation.

¹¹⁹ See *id.*; see also Mark A. Lemley, *Ex Ante Versus Ex Post Justifications for Intellectual Property*, 71 U. CHI. L. REV. 129 (2004), p. 132–136.

¹²⁰ See Jessica Litman, *Real Copyright Reform*, 96, IOWA L. REV. 1 (2010), p. 10–12.

¹²¹ See, e.g., *Fox Film Corp. v. Doyal* 286 U.S. 123 (1932), p. 127: “The sole interest of the United States and the primary object in conferring the [copyright] monopoly lie in the general benefits derived by the public from the labor of authors”; see also DiCola, *supra* note 103, at 7, 10.

¹²² See also DiCola, *supra* note 103, at 7–8.

¹²³ See Landes & Posner, *supra* note 104, at 327; Caves, *supra* note 95, at 56–57; Rub *supra* note 15, at 43–44.

Contract theory predicts that relationship-specific investments can give rise to undesirable opportunistic behavior.¹²⁴ ‘Relationship-specific’ refers to any investment that is unique to a contractual agreement and has no (or lower) value outside of the particular relationship between the parties.¹²⁵ Once one of the parties has sunk costs in relationship-specific investments, these costs cannot be recouped when the relationship ends.¹²⁶

For copyright contracts, the investment problem arises because most of the above-mentioned investments that publishers make in improving, promoting, distributing, and sustaining the popularity and value of an artistic work are relationship-specific, meaning they are tied to a contract over a specific creation with a specific author. The publisher invests in the work because he or she is the holder and beneficiary of the copyright, and thus has an interest in increasing its value as much as possible. If the original author (or the original author’s statutory successors), however, can threaten to terminate the contract and initiate renegotiation of terms, the publisher risks losing the value from his or her investment. Assuming that the original author (or statutory successor), has full knowledge of the commercial success of his or her work, this will allow them to drive the price up and capture the entire bargaining surplus. Because the investment costs are sunk and all future profit is dependent on continuing the contractual relationship with the author, the publisher can be ‘held up’ - theoretically to the point at which nothing is gained from having made the investment in the first place.

Because publishers can foresee this situation, it may dissuade them from making investments when they could or should from a social welfare

¹²⁴ See Darlene C. Chisholm, *Asset Specificity and Long-Term Contracts: The Case of the Motion Pictures Industry*, 19 *EASTERN ECONOMIC JOURNAL* 143 (1993), p. 144.

¹²⁵ Salanié defines relationship-specific investment as “an investment that increases the productivity of the relationship under study, has a lower value outside of this relationship, [or] is costly for the party that makes it.” See BERNARD SALANIÉ, *THE ECONOMICS OF CONTRACTS: A PRIMER*, MIT Press (1997) (1994) (Fr.), p. 196; See also Benjamin Klein, Robert G. Crawford, and Armen A. Alchian, *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 *J. LAW ECON.* 297 (1978), p. 297-326; Vincent P. Crawford, *Relationship-Specific Investment*, 105 *Q. J. ECON.* 561 (1990), p. 561-574. PATRICK BOLTON & MATHIAS DEWATRIPONT, *CONTRACT THEORY*, MIT Press (2005), p. 490–491; Oliver Hart & John Moore, *Incomplete Contracts and Renegotiation*, 56 *ECONOMETRICA* 755 (1988), p. 755-785.

¹²⁶ See Chisholm, *supra* note 124, at 144.

perspective: Economic theory predicts that such hold-up situations will cause socially undesirable underinvestment.¹²⁷ Because the termination right can only be exercised during a specific point in time, it is also plausible that publishers will strategically manipulate their investments, such as by waiting to make large investments until the danger of being held up has passed. They may even attempt to sabotage the commercial success of a work during the time leading up to the window in which authors can consider to renegotiate.

Returning to the story of the rights to ‘Superman’, it is intuitively clear that Time Warner and any other involved publishers with stakes in the exploitation rights to the character have halted any major investments in new projects, and will continue to do so, at the very least until the current legal battle has been resolved.¹²⁸ In fact, the district court appears to have recognized this incentive problem in a follow-up decision, going so far as to essentially impose a duty on Time Warner to begin production of its movie sequel to the 2006 success “Superman Returns”.¹²⁹ It seems that the worry is indeed loss of value to the work due to underinvestment on the part of Time Warner.¹³⁰ In absence of this judicial pressure, fans would be kept waiting or entirely deprived of the sequel, and will perhaps turn their interest (and money) towards substitutes. Another example of distorted investment incentives is the speculation that Time Warner, facing this mandate, chose the director for the Superman movie based on how fast the movie could be released rather than on artistic merit.¹³¹

In terms of superheroes, the situation for many other popular characters is equally grim. Superman is far from being an exceptional case. For example, in the midst of a \$4 billion dollar acquisition,

¹²⁷ See SALANIÉ, *supra* note 125, at 195-200.

¹²⁸ See Michael Cieply, *Ruling Gives Heirs a Share of Superman Copyright*, THE NEW YORK TIMES (March 29, 2008); see also Matthew Jackson, *Why Siegel & Shuster’s Attorney Wants DC Superman Suit Thrown Out*, BLASTR (February 6, 2013) available at <http://www.blastr.com/2013-2-6/why-siegel-shusters-attorney-wants-dc-superman-suit-thrown-out>; Ethan Smith, *Studio Wins Superman Court Fight*, WALL ST. J. (January 11, 2013), U.S. edition, p. B7.

¹²⁹ See *Siegel v. Warner Bros. Entertainment Inc.*, No. CV 04-8400-SGL, 2009 WL 2014164 (C.D. Cal. Jul. 9, 2009), p. 28.

¹³⁰ See *Siegel v. Warner Bros. Entertainment Inc.*, No. CV 04-8400-SGL, 2009 WL 2014164 (C.D. Cal. Jul. 9, 2009), p. 25-28.

¹³¹ See Rub, *supra* note 15, at fn. 163, citing Chris Schrader, *Legal Wars Could Divide Superman Franchise in Two*, SCREENRANT (2011), available at <http://screenrant.com/superman-movie-legal-battle-siegel-shuster-schrad-117539/>.

statutory successors of Marvel superhero creator Jack Kirby have served 45 termination notices on figures from the “X-Men” and “Fantastic Four,” effective 2014.¹³² All of these characters now risk being tied up in litigation and withheld from the public for an unpredictable amount of time.¹³³ Again, the historical success of these characters and their value today cannot be attributed to their authors alone, as the publishers have been responsible not only for character development, but also for all of the advertising and merchandising related to the work.¹³⁴

This situation is not limited to comic book characters, stretching across all creative industries subject to copyright transfer terminations through authors and their statutory successors. Rub, for example, highlights investment decisions in the recording industry and how record companies can strategically underinvest in a work during the time period before the termination rights can be exercised, or release works like best-hits records right before termination rather than at the time most beneficial to the author and the public.¹³⁵

Again, the transfer of copyright to a publisher has the purpose of facilitating investments and securing distribution of popular works. This corresponds to the interests of all involved parties, including authors and the general public. A termination right will cut into this investment incentive, because the author (or the author’s statutory successors) can step in at a later time and capture value that the publisher has invested in. This can influence to what extent or how a publisher invests in a work *ex ante*.

There may also be hindrances to publisher investment *post* renegotiation of the contract. Even if publishers come to agreements with authors and statutory successors at the point of termination, ensuring that they can continue to exploit the copyrights, it is possible that the new agreement will be in the form of a revenue-sharing contract, for example

¹³² See *Marvel Worldwide, Inc. v. Kirby*, 777 F. Supp. 2d 720 (S.D.N.Y. 2011); Michael Cieply & Brooks Barnes, *Disney Faces Rights Issues Over Marvel*, THE NEW YORK TIMES (September 21, 2009), New York edition, p. B1.

¹³³ The case is ongoing, as it is facing appeal at the Second Circuit Court of Appeals; see also Murray, *supra* note 71, at 413-414; see also, e.g., Molinaro, *supra* note 72, on *Marvel Characters, Inc. v. Simon*, 310 F.3d 280 (2d Cir. 2002) over the rights to Captain America.

¹³⁴ For which most authors do not have the resources, see Murray, *supra* note 71, at 436.

¹³⁵ See Rub, *supra* note 15, at 44.

involving royalty-rates.¹³⁶ This is because the value of the work is more certain, making it potentially in the seller's interest to share future revenue, rather than be bought out. Buy-outs are more attractive to the seller when risk is involved. As mentioned above, profit participation contracts are in neither party's interest *ex ante*. *Ex-ante*, authors of a new work with uncertain success will prefer to burden the publisher with the risk of success or failure in return for an immediate paycheck.¹³⁷ *Ex post* (i.e. at the time of termination), however, the value of the work is more certain. Publishers can no longer make the offer to bear the risk of success or failure in exchange for a smaller buy-out price. Again, publishers will prefer to buy out the copyright so that they can fully reap the gains of their own investments in the work's success.¹³⁸ In the case of termination rights, however, only owners of successful works will initiate renegotiation. Because they already know that the work is profitable, they no longer have the same valuation and risk-allocation problem that they had when agreeing to the initial arrangement. Now able to use the work's value and the publisher's sunk investments as bargaining leverage, authors and their statutory successors may demand profit participation in uses of the work. Where this occurs, it will lessen the return on *ex post* publisher investments, potentially setting sub-optimal incentives.¹³⁹

Rub additionally explores the potential for a tragedy of the anticommons in a system with author termination rights.¹⁴⁰ The tragedy of the anticommons applies when a work is controlled by a multitude of right-owners, making it difficult to contract individually¹⁴¹ and, in the termination right context, raising the risk that assembled or collaborative works will be vetoed at some point in the future by one or more of the

¹³⁶ See *supra* notes 98 and 117 on royalty-rate contracts.

¹³⁷ For famous authors, or in instances where there is a higher probability of a work being successful on the market, profit participation contracts make more sense (and are more common, see *supra* note 98). In this instance, however, there is no need to introduce a termination right, since the author is more likely to have negotiated an appropriate remuneration up front. Furthermore, again, the deal is one-sided: in cases where works are not successful, the publisher has no option of getting money back.

¹³⁸ Whether this is *ex ante* or *ex post* does not matter to the publisher. See CAVES, *supra* note 95, at 56-57.

¹³⁹ See CAVES, *supra* note 95, at 56-57.

¹⁴⁰ See Rub, *supra* note 15, at 46-50.

¹⁴¹ See Michael A. Heller, *The Tragedy of the Anticommons: Property in the Transition from Marx to Markets*, 111 HARV. L. REV. 621 (1998); see also *supra* Chapter A, Part III.2.d of this thesis.

right-holders.¹⁴² While this is a legitimate concern in other legal systems,¹⁴³ the structure of author termination rights in United States copyright law is more likely to mitigate this problem. The work made for hire doctrine is designed (and used in practice) to cover most of the works with a multitude of creators, a major example being films.¹⁴⁴ Nevertheless, the risk of right termination through one of the authors could deter investment in collective projects that bring previously individual copyrighted works together, for example using new media formats.¹⁴⁵ This would exacerbate the hold-up problem illustrated above.

In general, all of the above may hamper socially desirable investments in quality and distribution of creative content. This cost also affects the authors, who generally have a strong interest in seeing their works brought to success, marketed, and widely shared. While it may still be the case that there are also benefits to allowing authors a contract renegotiation opportunity (for example, allowing authors to renegotiate payment for successful works at a later point in time could theoretically foster creation incentives through the prospect of being able to reap high future earnings),¹⁴⁶ this must be weighed against the costs of underinvestment due to hold-up.¹⁴⁷ Part II.4 will explore the author incentive side of the cost-benefit analysis in more detail. First, however, the following Part addresses one of the main criticisms that hold-up theory may face in this context: reputational concerns in scenarios with repeated interaction.

3. *Repeated Games*

One argument frequently made against strong hold-up effects in real-world contract situations is that parties are often interested in (or

¹⁴² See Rub, *supra* note 15, at 46.

¹⁴³ See *supra* Chapter A, Part III.2.f of this thesis.

¹⁴⁴ See 17 U.S.C. § 101, covering works “specially ordered or commissioned for use as a contribution to a collective work” and explicitly mentioning films. The music and software industries are also contractually structured to avoid collaborative copyright ownership between a large multitude of parties, e.g. sound mixers are unlikely to have authorship claims in recordings. Rub acknowledges this, see Rub, *supra* note 15, at 59 and fn. 168.

¹⁴⁵ See *supra* Chapter A of this thesis.

¹⁴⁶ But see *infra* Part II.4.

¹⁴⁷ For further discussion, see *infra* Part III.

dependent on) maintaining a good relationship with each other.¹⁴⁸ In the case of authors and publishers, it initially seems plausible that the author would have other contractual relations with the same publishing partner, or could want to retain the possibility of future interactions. While a one-shot game induces authors to make demands that capture the bargaining surplus, introducing a repeated game situation mitigates the hold-up problem, because authors will be unlikely to extort sums from their publishers that would endanger their relationship.

Publishers, on the other hand, may also be concerned about their reputation. While they are not in a position to hold up the author *ex post*, the general situation of the perceived disparity between initial copyright price and work value may entice favorable settlement gestures towards authors, particularly when public scrutiny is involved. As mentioned above,¹⁴⁹ Time Warner offered the Superman creators lifetime pensions and healthcare benefits when the story of their financial condition got attention in the press.¹⁵⁰

Theoretically, while the desire to maintain a good relationship with a publisher might lessen any hold-up concerns, it would also mean that authors would not gain as much leverage through termination rights as legislative intent assumes. From this perspective, one would need to question what purpose granting author termination rights serves at all. It seems that, in either case, it could be preferable to resort to alternative ways of reaching these policy goals, whether they are utilitarian or distributive.¹⁵¹ Even more realistically, however, it is questionable whether this repeated game scenario applies to most cases of author termination rights in practice at all. The shortest period of time that passes before an author is faced with the possibility of termination is thirty-five years. While some authors may still be dependent on continuing contractual relationships with a specific publisher at such a late point in time, many will not. For the most part, thirty-five years down the road, the situation

¹⁴⁸ See for example Joseph Farrell & Eric Maskin, *Renegotiation in Repeated Games*, 1 GAMES ECON. BEHAV. 327 (1989), p. 327, on the idea of sustainable subgame-perfect equilibria in repeated games.

¹⁴⁹ See *supra* note 3.

¹⁵⁰ See *Siegel v. Warner Bros. Entertainment Inc.*, 542 F. Supp. 2d 1098, (C.D. Cal. 2008). This was prior to having any legal obligation, e.g. through author termination right negotiations.

¹⁵¹ See *infra* Part III for discussion.

is likely to be different. Furthermore, many rights will have changed hands and gone to the authors' statutory successors. Unless the right successors are themselves authors and in a relationship with the same publisher, it seems unlikely that a repeated game scenario would occur, or lessen the statutory successors' ability to extract financial gains from the publisher through author termination rights.

One question left unaddressed by static hold-up theory is whether the renegotiation possibility could have a positive effect on *ex ante* author incentives, in other words on the investments made to create the work in the first place. This is explored in the following Part.

4. Uncertainty, Intertemporal Choice, and Author Incentives

One potential argument in favor of author termination rights resides within the utilitarian theory of U.S. copyright law.¹⁵² If authors can expect to reap high future earnings from the success of their works, they may have additional incentive to create, or to become authors in the first place. This would encourage the production of artistic work in general, furthering the "progress of art," which is the constitutionally defined aim of the U.S. copyright system.¹⁵³

As mentioned above,¹⁵⁴ introducing author termination rights creates a lottery-like effect, reducing prices for initial copyright assignments, but giving authors a high-risk, high-gain chance at earning profits much later on. This lottery, also called a 'superstar effect,' could entice more artistic creation *ex ante* through the prospect of potentially large reward.¹⁵⁵ The 'superstar effect' in creative industries has faced some criticism with regard to efficiency.¹⁵⁶ Rather than rehash the discussion over whether or

¹⁵² See *supra* note 92. For more discussion on the aims of the copyright system, see *infra* Part III

¹⁵³ See U.S. CONST. art. I, § 8, cl. 8.: "To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries." See also *supra* note 92 and discussion *infra* Part III.

¹⁵⁴ See *supra* Part II.1.

¹⁵⁵ See Rosen, *supra* note 112; Zimmerman, *supra* note 112, at 41-42.

¹⁵⁶ See, e.g., ROBERT H. FRANK & PHILIP J. COOK, THE WINNER-TAKE-ALL SOCIETY: HOW MORE AND MORE AMERICANS COMPETE FOR EVER FEWER AND BIGGER PRIZES, ENCOURAGING

not high-risk, high-reward systems function as efficient incentive mechanisms in creative markets in general,¹⁵⁷ this Part highlights some effects that apply specifically to the context of author termination rights and make the former discussion largely irrelevant. If the ‘superstar effect’ is to be generally functional as an author incentive mechanism, this relies on authors basing their decision-making on the future chance of high reward. Not only must authors factor in the future remuneration possibility at the point in time during which they are deciding whether to invest in creating the work, but this prospect must outweigh whatever losses they suffer through a termination right introduction.¹⁵⁸

The positive effect on creation incentives operates under the assumptions that [1] authors prefer the uncertain probability of high payment to the more certain probability of lower payment; [2] the uncertain payment possibility has sufficient value to the author despite occurring in the far future. These assumptions are examined in the following Parts.

a. Uncertainty and Risk Aversion

With regard to work creation incentives, the author’s situation involves a decision based on uncertain information. Copyright is granted (automatically) once the work has been fixed in a tangible medium of expression.¹⁵⁹ Its market success, however, remains highly speculative.¹⁶⁰ In absence of author termination rights, the author has the near-future possibility of monetizing his or her copyright by selling it to a publisher, and no far-future possibility to correct for undervaluing the work in the initial assignment. With the introduction of author termination rights, the author gains a far-future possibility of correction at the price of a lower compensation upfront.¹⁶¹ Compared to the near-future

ECONOMIC WASTE, INCOME INEQUALITY, AND AN IMPOVERISHED CULTURAL LIFE, Free Press (1995), p. 45, 110; *see also* DiCola, *supra* note 103, at 8.

¹⁵⁷ For more on this question, *see id.*

¹⁵⁸ *See supra* Part II.1.

¹⁵⁹ 17 U.S.C. § 102 (a).

¹⁶⁰ *See supra* note 95.

¹⁶¹ *See supra* Part II.1.

compensation, however, this far-future correction opportunity is highly uncertain.

Standard economic theory applies the concept of expected utility to decision-making under uncertain conditions. Actors will choose among different prospects, which are essentially collections of all of the possible outcomes of an action multiplied by their respective probabilities of occurring.¹⁶² Expected utility theory states that the value of a ‘prospect’ is the expected value of all of its outcomes.

To assess the expected value of the uncertain payment coming from exercising a termination right, the author will operate with the weighted average of potential values times the probabilities that they will occur. While this sounds highly complex and mathematical, it may not be so unrealistic in effect: With regard to the question of complete information, economic theory recognizes that real-world actors’ cognitive abilities are limited.¹⁶³ Predictive uncertainty, i.e. the inability to recognize or take into account all possible outcomes deriving from an action, is part of the rational actor model.¹⁶⁴ Most real-world situations that require decision-making involve some degree of uncertainty, meaning the actors do not have complete information to base their decisions on. Whenever the cost of acquiring the necessary information is too high,¹⁶⁵ actors will use their limited information to make choices.¹⁶⁶ Choices are then based on probabilities and anticipated likelihoods, and reflect this limitation of

¹⁶² See Philippe Mongin, *Expected Utility Theory*, in: THE HANDBOOK OF ECONOMIC METHODOLOGY 342, John B. Davis, D. Wade Hands, and Uskali Maki eds., Edward Elgar (1997), p. 342.

¹⁶³ See Oliver E. Williamson, *The New Institutional Economics: Taking Stock, Looking Ahead*, 38 J. ECON. LITERATURE 595 (2000), p. 600: “There is close to unanimity [...] on the idea of limited cognitive competence — often referred to as bounded rationality.” *But see infra* Part II.5 for more on a different definition of ‘bounded rationality’ as understood by behavioral economics.

¹⁶⁴ See for example Oliver Hart & John Moore, *Foundations of Incomplete Contracts*, 66 REV. ECON. STUD. 115 (1999); Eric Maskin & Jean Tirole, *Unforeseen Contingencies and Incomplete Contracts*, 66 REV. ECON. STUD. 83 (1999).

¹⁶⁵ For instance because it is difficult to predict future chances, see RICHARD R. NELSON & SIDNEY G. WINTER, *AN EVOLUTIONARY THEORY OF ECONOMIC CHANGE*, Harvard University Press (1982), p. 88.

¹⁶⁶ See for example OLIVER E. WILLIAMSON, *ANTITRUST ECONOMICS: MERGERS, CONTRACTING, AND STRATEGIC BEHAVIOR*, Blackwell Publishers (1987), p. 74–78; OLIVER E. WILLIAMSON, *MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS*, Free Press (1975), p. 21–26.

uncertainty. Even if authors have very limited information about their success chances, they will likely operate with some sort of probability value.

According to the substitution axiom, if all prospects have the same expected values, an actor will be indifferent in choosing between them.¹⁶⁷ Within this framework, if the (expected) value of the later payment is generally higher than the price authors expect to get for their work upfront pre-introduction, then the introduction of author termination rights would incentivize more creation. If it is not, for example, if the choice is between \$120 or a 1% chance of getting \$11,000, termination rights will not incentivize more creation. There are, however, further factors to consider. In particular, risk-averse actors will value the choices differently.

An actor is risk averse if he or she prefers a certain prospect to a risky prospect, despite them having the same expected value. Risk aversion is generally assumed for expected utility models, which is explained by the concept of decreasing marginal utility. This holds that more of something within a certain time frame will diminish the utility of additional units.¹⁶⁸ In other words, money earned when times are tough will have more value than the same amount of money earned when times are good and general income is high.¹⁶⁹

Applied to termination rights, a risk-averse author will value the certain payment more than the uncertain payment, even if the two expected values are equal. In general, individuals are assumed to be risk-averse, especially with regard to their basic income.¹⁷⁰ Furthermore, early in their careers, authors may be particularly likely to be risk averse regarding their work and to prefer the immediate certain payment.¹⁷¹ From this perspective, the prospects of a high-risk lottery may not necessarily have a positive effect on creation incentives. Authors may not value uncertain future payment highly enough to outweigh the loss they suffer in their more immediate payment. This effect, despite theoretical

¹⁶⁷ See Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision under Risk*, 47 *ECONOMETRICA* 263 (1979), p. 266.

¹⁶⁸ See Milton Friedman and L. J. Savage, *The Utility Analysis of Choices Involving Risk*, 56 *J. POL. ECON.* 279 (1948), p. 279-280.

¹⁶⁹ See PAUL KRUGMAN & ROBIN WELLS, *ECONOMICS*, Macmillan (2009), p. 545-549.

¹⁷⁰ See Friedmann & Savage, *supra* note 168, at 279-280; see also *id.*

¹⁷¹ See Hansmann & Santilli, *supra* note 113, at 262; see also Rub, *supra* note 15, at 36.

indication, cannot be measured conclusively.¹⁷² But even if a positive value remains within this framework, there are additional factors to consider. One such factor is the question of intertemporal decision-making, since the prospect of financial reward occurs so far in the future. This is explored in the following.

b. Discounting

Another issue is what value the potential future payment has for the author at the time of creation, especially given that it is in exchange for a present cost. The intuitively plausible notion that most authors might prefer immediate rather than later payment¹⁷³ has a solid basis in economic theory. One important aspect of far-future payment that could influence decision-making preferences (and in the author termination right context therefore creation incentives) is discounting.

Discounting pertains to the phenomenon of placing higher value on something received immediately than one does on the same thing received at a later point in time. While part of this is a simple reflection of the fact that goods or capital regularly lose value in the future because the general supply thereof increases, it is also recognized that people exhibit a strong personal preference for immediate payment.¹⁷⁴ The economic concept of discounting is based on early recognition of psychological factors involved in intertemporal decision-making.¹⁷⁵ In the 1930s,

¹⁷² Some have also argued that high-risk, high-reward intellectual property systems, similar to state-run lottery systems, could be based on individuals recognizing the respective size of gains vs. losses, but systematically overestimating their personal chances of success. See Dennis D. Crouch, *The Patent Lottery: Exploiting Behavioral Economics for the Common Good*, 16 GEO. MASON L. REV. 141 (2008). But see also *infra* Part II.4.b discussing intertemporal effects.

¹⁷³ See Rub, *supra* note 15, at 36: "One does not need to believe in the romantic view of the starving artists to assume that artists would prefer not to transfer income from their young poor self to the old, and probably very rich, self."

¹⁷⁴ See ARTHUR C. PIGOU, *THE ECONOMICS OF WELFARE*, Macmillan (1920), p. 24-25; ANDREAU MAS-COLLEL, MICHAEL WHINSTON & JERRY R. GREEN, *MICROECONOMIC THEORY*, Oxford University Press (1995), p. 734, rejecting the critical view that this assumption is but a "technical convenience."

¹⁷⁵ For example JOHN RAE, *THE SOCIOLOGICAL THEORY OF CAPITAL*, Macmillan (1834); EUGEN BÖHM-BAWERK, *CAPITAL AND INTEREST*, Libertarian Press (1889).

economists began to use a single parameter for these factors, called the discount rate.¹⁷⁶

Discounting is relevant in the context of author termination rights, because if the initial payment for the author's copyright is reduced through the introduction of a termination possibility, a high discount rate could actually reduce author investment incentives rather than raise them.¹⁷⁷ How much more an individual values the same thing now versus later is reflected in his or her personal time preferences. The higher the time preference rate, the more highly the individual will discount future values. While the extent of this is partly subjective, individuals are assumed to systematically discount future value.¹⁷⁸

Additionally, there is evidence that uncertain payoffs will further influence the extent of discounting. People tend to have much higher discount rates when rewards are certain.¹⁷⁹ Given that, in the termination right context, the first reward is far more certain than the second uncertain payout, it is plausible that authors may discount the future value even more highly.

In summary, because the author may not value far-future gains as much as immediate ones, this could influence his or her decision to create the work. Given that there is no exact knowledge of the reward values in relation to each other, nor the discount rates of individual authors,¹⁸⁰ it is

¹⁷⁶ The discounted utility model was introduced by Paul A. Samuelson, *A Note on Measurement of Utility*, 4 REV. ECON. STUD. 155 (1937); see also Shane Frederick, George Loewenstein, and Ted O'Donoghue, *Time Discounting and Time Preference: A Critical Review*, 40 J. ECON. LIT. 351 (2002).

¹⁷⁷ Similar to, and in fact in addition to, the effect of risk-aversion and uncertainty discussed above, *supra* Part II.4.a.

¹⁷⁸ Time preferences are recognized to be heterogeneous, see *infra* note 188. For evidence of heterogeneous time preference rates leading to distribution effects, see for example Lutz Hendricks, *How Important is Discount Rate Heterogeneity for Wealth Inequality?* 31 J. ECON. DYN. CONTROL 3042 (2007), p. 3042-3086.

¹⁷⁹ See, e.g., a seminal study by Gideon Keren & Peter Roelofsma, *Immediacy and Certainty in Intertemporal Choice*, 63 ORGAN. BEHAV. HUM. DEC. 287 (1995).

¹⁸⁰ In this context, another potentially relevant theory of interest is the behavioral economic concept of time inconsistency. In particular, empirical studies have shown that – contrary to traditional assumption – individuals' discount rates do not necessarily remain constant for all future time periods, but instead appear to grow smaller over time, see Richard Thaler, *Some Empirical Evidence on Dynamic Inconsistency*, 8 ECON. LETT. 201 (1981), p. 201-207; HAL R. VARIAN, *INTERMEDIATE MICROECONOMICS: A MODERN APPROACH*, 7th int. stud. ed., W.W. Norton & Company (2006), p. 556-557. This

not possible to determine that the effect of termination rights on author incentives is necessarily a negative one. What theory indicates, however, is that the positive effect may be smaller than assumed. Again, even if authors are positively motivated to create more work, this effect must be evaluated within a tradeoff. Any positive incentives must be weighed against the costs explored above, in particular the effects on publisher incentives and costs to the system as a whole.¹⁸¹

It may be that authors anticipate (at least part of) the possibility of far-future gains with the introduction of author termination rights. Even so, there are a few additional considerations as to their relevancy for work creation. These are highlighted in the following Part.

c. Further Considerations

There are two further factors that could play a role in authors' intertemporal decision-making process, thereby impacting their creation incentives. These have to do with the length of the time period before termination rights can be exercised, and with the statutory succession of the rights.

First of all, because thirty five years must elapse before the termination right can take effect, some authors will no longer be alive at this point. While copyright incentives may include the author's desire to accumulate wealth for his or her family and/or successors, the prospect of payment

observation, called hyperbolic discounting (see Ariel Rubenstein, "Economics and Psychology"? *The Case of Hyperbolic Discounting*, 44 INT. ECON. REV. 1207 (2003)) would weaken the result in so far that authors would not discount as much as initially assumed, since the expected profit is in the far, rather than immediate, future. However, while hyperbolic discounting has been manifestly demonstrated in cases with given (certain) time-frames and payoffs, the results of studies introducing uncertainty have been highly ambiguous, see Keren & Roelofsma, *supra* note 179, at 287-297; Martin Ahlbrecht & Martin Weber, *The Resolution of Uncertainty: An Experimental Study*, 152 J. INST. THEOR. ECON. 593 (1996), p. 593-607, both of which find that introducing uncertainty dramatically affects estimated discount rates. Because the question of future value of copyrighted works involves such considerable uncertainty, the concept of hyperbolic discounting cannot (yet) serve as a solid theoretical basis to evaluate the problem at hand.

¹⁸¹ Although neither side of the tradeoff can be exactly measured due to lack of numbers, we can try to get an idea of their respective weights in relation to each other.

post mortem may have a different value to some compared to wealth they can enjoy while they are alive.¹⁸²

The law specifies that author termination rights pass on to the right successors when the author is deceased.¹⁸³ Interestingly, the law assigns this interest to the statutorily designated successors, rather than permitting the author to determine whom he or she wishes to pass the right to. Ownership of termination rights follows the rules laid out in the Copyright Act, and therefore belongs first and foremost to the author's widow or widower, then to his or her children, and finally to the grandchildren.¹⁸⁴ Only if none of these statutorily designated successors are alive can the ownership be transferred according to the will of the author, or be owned by the author's executor, administrator, personal representative, or trustee.¹⁸⁵ This succession happens regardless and independent of what the author actually wants.¹⁸⁶

Therefore, when talking about creation incentives, it can be useful to remember that the author will in many cases not personally and directly profit from this far-future possibility of renegotiation. Additionally, the transfer of this option to the parties that will later profit may not even be in the author's interest.

Incentivizing the creation of a work is only the first step. As seen above, another incentive purpose is to facilitate the subsequent distribution of the work.¹⁸⁷ This relates to the contracting situation between author and publisher. While far-future gains may not impact the author's incentive to create, they could influence the slightly later transaction between the parties. In the contracting situation, both the

¹⁸² See, e.g., RAE, *supra* note 175, on the uncertainty of human life as a factor that reduces the motivation to defer gratification.

¹⁸³ 17 U.S.C. § 203 (a)(2) and § 304 (c)(2).

¹⁸⁴ 17 U.S.C. § 203 (a)(2)(A)-(C) and § 304 (c)(2)(A)-(C).

¹⁸⁵ 17 U.S.C. § 203 (a)(2)(D) and § 304 (c)(2)(D). Although if the author serves notice of termination before his or her death, the termination right will have vested in the author and become part of the estate. In this case, the author can determine through will to whom the right passes, see 17 U.S.C. § 203 (b)(2), § 304 (c)(6)(B), § 304 (d)(1).

¹⁸⁶ Some have criticized this, see Lee-ford Tritt, *Liberating Estates Law From the Constraints of Copyright*, 38 RUTGERS L.J. 109 (2006), p. 167-182; Desai criticizes the transfer of copyrights to heirs generally, pointing out undesirable rent-seeking behavior, see Deven R. Desai, *The Life and Death of Copyright*, 2011 WISC. LAW REV. 219 (2011), p. 209-272.

¹⁸⁷ See Balganes, *supra* note 118, at 1621; see also *supra* Part II.2.

authors' decisions and motivations as well as the publishers' decisions and motivations are relevant. For example, in the transaction, publishers could equally discount future gains or losses when deciding whether to purchase a copyright.¹⁸⁸ The parties' behavior in the contracting situation influences the price of the copyright assignment and the distribution of the work, both *ex ante* and *ex post* termination rights.

While so far this paper has indicated that the economic costs of risk-shifting and hold-up outweigh the potential benefits of incentivizing creation through author termination rights,¹⁸⁹ the next Part looks at some additional effects that are worth considering in the general tradeoff. There are some behavioral economic concepts that could potentially play a role in the context of author termination right contracts *ex ante* and *ex post*, in particular fairness preferences and opt-in effects.

¹⁸⁸ To the extent that publishers discount the future, this influences to what extent the prices for initial copyright assignments drop when author termination rights are introduced. For heavy discount rates, the price difference pre and post termination right introduction will be smaller. But: Much of the literature assumes time preferences to be heterogeneous, see Per Krusell & Anthony A. Smith, Jr., *Income and Wealth Heterogeneity in the Macroeconomy*, 106 J. POLIT. ECON. 867 (1998), p. 867-896; Andrew A. Samwick, *Discount Rate Heterogeneity and Social Security Reform*, 57 J. DEV. ECON. 117 (1998), p. 117-146; Emily C. Lawrance, *Poverty and the Rate of Time Preference: Evidence From Panel Data*, 99 J. POLIT. ECON. 54 (1991), p. 54-77; Robert B. Barsky, F. Thomas Juster, Miles S. Kimball, and Matthew D. Shapiro, *Preference Parameters and Behavioral Heterogeneity: An Experimental Approach in the Health and Retirement Study*, 112 Q. J. ECON. 537 (1997), p. 537-579; Erik Hurst, Ming Ching Luoh & Frank P. Stafford, *The Wealth Dynamics of American Families: 1984-1994*, 29 BROOKINGS PAP. ECO. AC. 267 (1998), p. 267-337; Kerwin Kofi Charles & Erik Hurst, *The Correlation of Wealth across Generations*, 111 J. POLIT. ECON. 1155 (2003), p. 1155-1182. The economic assumption that firms have lower discount rates than individuals is based on two factors. First, firms are likely less subject to the "impatience" of individuals, who may discount because they underestimate future needs due to shortsightedness or carelessness. See BÖHM-BAWERK, *supra* note 175, at 269; ARTHUR C. PIGOU, *THE ECONOMICS OF WELFARE*, Vol. 1, Cosimo, Inc. (2006), p. 24-25, speaking of a "cognitive illusion", see also Frederick, Loewenstein & O'Donoghue, *supra* note 176, at 354. Second, discounting is attributed to an internal risk premium that arises because the future enjoyment of capital is contingent on uncertain circumstances that are more prevalent in individuals (such as, for example, the probability of not dying beforehand), see GEORGE REISMAN, *CAPITALISM: A TREATISE ON ECONOMICS*, Jameson Books (1998), p. 55-56.

¹⁸⁹ Which this Part has indicated may be small to non-existent.

5. Behavioral Economics

So far, the above-predicted economic outcomes operate under the classic assumption of individuals as rational actors. While this simplification of reality is useful and sometimes necessary, some research over the last few decades has shown that people may be subject to systematic biases that can (and should) be considered in models of economic behavior.¹⁹⁰ These extensions to classic models are still far from perfectly mirroring the real world, but incorporating established human biases that more accurately reflect the behavior of individuals can change relevant outcomes and improve the power of classic economic theory as a predictive tool. Law and economics looks at the implications of legal rules through an economic approach to human behavior. According to Gary Becker, this behavior assumes that actors “[1] maximize their utility [2] from a stable set of preferences and [3] accumulate an optimal amount of information and other inputs in a variety of markets.”¹⁹¹ However, so long as people are deviating from the rational actor model in a systematic way, considering behavioral biases is consistent with economic modeling.¹⁹²

One bias that may more accurately reflect the choices humans make in some situations is the concept of bounded rationality.¹⁹³ Bounded rationality (in this context) means that actors deviate from Becker’s approach¹⁹⁴ and display non-optimizing behavior, but in a systematic,

¹⁹⁰ See Kenneth J. Arrow, *Rationality of Self and Others in an Economic System*, in RATIONAL CHOICE: THE CONTRAST BETWEEN ECONOMICS AND PSYCHOLOGY 201, Robin M. Hogarth & Melvin W. Reder eds., University of Chicago Press (1986), p. 202; Christine Jolls, Cass R. Sunstein, and Richard Thaler, *A Behavioral Approach to Law & Economics*, 50 STAN. L. REV. 1471 (1998), p. 1478; Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, 185 SCIENCE 1124 (1974).

¹⁹¹ GARY S. BECKER, THE ECONOMIC APPROACH TO HUMAN BEHAVIOR, University of Chicago Press (1976), p. 14.

¹⁹² See Arrow, *supra* note 190, at 202: „[T]here is no general principle that prevents the creation of an economic theory based on other hypotheses than that of rationality [...] [A]ny coherent theory of reactions to the stimuli appropriate in an economic context [...] could in principle lead to a theory of the economy.” See also Jolls, Sunstein & Thaler, *supra* note 190, at 1478; COLIN F. CAMERER, GEORGE LOEWENSTEIN, AND MATTHEW RABIN, ADVANCES IN BEHAVIORAL ECONOMICS, Princeton University Press (2011), p. 3.

¹⁹³ See Herbert A. Simon, *A Behavioral Model of Rational Choice*, 69 Q.J. ECON. 99 (1955).

¹⁹⁴ See BECKER, *supra* note 191, at 14.

measurable way. Behavioral economic studies have demonstrated a few effects that go beyond the classic recognition of limited cognitive capabilities,¹⁹⁵ some of which may be relevant in the context of author termination rights. The following Parts explore the behavioral economic concepts of fairness preferences and opt-in effects, and their potential implications for author termination rights. Fairness preferences may play a role for authors' *ex ante* creation incentives, as well as the terms and desirability of the initial assignment of copyright to a publisher. Opt-in effects could potentially lessen the *ex post* costs of hold-up and the negative effect on publisher investment incentives.

a. Fairness Preferences

As mentioned above, the prices of copyright assignments and the subsequent distribution of works depend on how the parties contract with each other. A potential effect of interest in this context is that of the parties' fairness preferences, because it may influence their contracting behavior. Fairness preferences may also play a role for creation incentives, especially if termination rights make the creator environment a more attractive one to be in from a fairness preference perspective.

Fairness preferences can be described as follows: The standard economic model assumes that all actions are motivated by self-interest.¹⁹⁶ Behavioral economic studies have shown, however, that people sometimes do not behave in accordance with the classic rational actor model when values are attached to their perception of 'fairness'.¹⁹⁷ There is evidence that people will systematically display behavior some would describe as "altruistic," or "spiteful," even when these actions involve a

¹⁹⁵ Unlike discussed above in Part II.4. on uncertainty.

¹⁹⁶ See George J. Stigler, *Economics or Ethics?* In: The TANNER LECTURES ON HUMAN VALUES 190, Sterling McMurrin ed., Cambridge University Press (1981): "[W]hen self-interest and ethical values with wide verbal allegiance are in conflict, much of the time, most of the time in fact, self-interest theory [...] will win."

¹⁹⁷ See Ernst Fehr & Simon Gächter, *Fairness and Retaliation: The Economics of Reciprocity*, 14 J. ECON. PERSPECT. 159 (2000); Elizabeth Hoffman, Kevin A. McCabe, and Vernon L. Smith, *Behavioral Foundations of Reciprocity: Experimental Economics and Evolutionary Psychology*, 36 ECON. INQ. 335 (1998); James Konow, *Fair Shares: Accountability and Cognitive Dissonance in Allocation Decisions*, 90 AM. ECON. REV. 1072 (2000); Daniel Kahneman, Jack L. Knetsch, and Richard H. Thaler, *Fairness and the Assumptions of Economics*, 59 J. BUS. 285 (1986).

cost to themselves.¹⁹⁸ While such behavior can theoretically also be categorized as ‘self-interested,’ because it fits into a more general model of utility, behavioral economics expands on the rational actor model to explicitly include costly actions that benefit others without *material* gain for oneself,¹⁹⁹ and costly actions that impose a cost on others with no corresponding *material* gain.

While fairness preferences are intuitively evident in real-world observations that do not fully align with the standard rational actor model,²⁰⁰ their existence and consistency are also based on a body of empirical evidence. Behavioral economic studies have explored fairness preferences in ultimatum bargaining games,²⁰¹ dictator games,²⁰² trust games,²⁰³ and public goods games,²⁰⁴ finding that people systematically deviate from what the rational actor model predicts. Behavioral economists have since developed models that incorporate fairness preferences, for example inequality aversion models.²⁰⁵ People display

¹⁹⁸ See NICK WILKINSON, *AN INTRODUCTION TO BEHAVIORAL ECONOMICS*, Palgrave MacMillan (2008), p. 328.

¹⁹⁹ But rather a psychological benefit from which the actor derives utility.

²⁰⁰ For example tipping in the service industry, voter participation, lost-and-found offices, punishing people who free ride on others’ investments (even when it is costly to do so), etc.

²⁰¹ Werner Güth, Rolf Schmittberger, and Bernd Schwarze, *An Experimental Analysis of Ultimatum Bargaining*, 3 J. ECON. BEHAV. ORGAN. 367 (1982); Elizabeth Hoffman, Kevin A. McCabe, and Vernon L. Smith, *On Expectations and Monetary Stakes in Ultimatum Games*, 25 INT. J. GAME THEORY 289 (1996); John List & Todd Cherry, *Learning to Accept in Ultimatum Games: Evidence from an Experimental Design that Generates Low Offers*, 3 J. EXP. ECON. 11 (2000).

²⁰² Robert Forsythe, Joel L. Horowitz, N. E. Savin, and Martin Sefton, *Fairness in Simple Bargaining Experiments*, 6 GAME. ECON. BEHAV. 347 (1994), Hoffman, McCabe, and Smith, *supra* note 201.

²⁰³ Joyce Berg, John Dickhaut, and Kevin McCabe, *Trust, Reciprocity, and Social History*, 10 GAME. ECON. BEHAV. 122 (1995).

²⁰⁴ John O. Ledyard, *Public Goods: A Survey of Experimental Research*, in: HANDBOOK OF EXPERIMENTAL ECONOMICS 111, John H. Kagel and Alvin E. Roth eds., Princeton University Press (1995); David Sally, *Conversation and Cooperation in Social Dilemmas: A Meta-Analysis of Experiments from 1958 to 1992*, 7 RATION. SOC. 58 (1995).

²⁰⁵ See Ernst Fehr & Klaus M. Schmidt, *A Theory of Fairness, Competition, and Cooperation*, 114 Q. J. ECON. 817 (1999); see also Gary E. Bolton & Axel Ockenfels, *ERC: A Theory of Equity, Reciprocity, and Competition*, 90 AM. ECON. REV. 166 (2000). Further models deal more with “reciprocity,” see Matthew Rabin, *Incorporating Fairness into Game Theory and Economics*, 83 AM. ECON. REV. 1281 (1993); Armin Falk & Urs Fischbacher, *A Theory of Reciprocity*, 54 GAME. ECON. BEHAV. 293 (2006).

inequality aversion when they care about the size of their payoffs in relation to other people's payoffs.²⁰⁶

Fairness preferences and inequality aversion could play a role in the context of author termination rights. For example, an experimental study by Christoph Engel and Michael Kurschilgen (2011) indicates that allowing for *ex-post* adjustment of copyright exploitation contracts could have positive effects, because people tend to deviate from the rational actor model in this context.²⁰⁷ In the study, participants bargain over the sale of a commodity, assuming that its future value is highly uncertain. In one version, there is no possibility to correct the bargained-for price after the deal is struck. In the other version, the parties have the opportunity to renegotiate the payment, and if that fails, a third party is asked to determine an 'appropriate purchase price'.²⁰⁸ Engel & Kurschilgen look at the changes in market prices, amount of agreements, and the differences in perceived fairness of the deals. They find that with introduction of a renegotiation possibility, lower prices are indeed paid for authors' copyrights *ex ante*.²⁰⁹ The experiment also finds, however, that more deals are struck, which benefits both parties and affects an improvement in social welfare because more trade takes place. The reason for this is assumed to be the parties' fairness preferences. Offers to purchase are rejected *ex ante* without the future possibility to correct for value. When questioned, the participants reported less perceived *ex-post* unfairness with the adjustment possibility.²¹⁰ This indicates that fairness preferences might create barriers to trade that can be mitigated by introducing the possibility of *ex post* contract adjustment.

²⁰⁶ See *id.*

²⁰⁷ See Engel & Kurschilgen, *supra* note 100.

²⁰⁸ The experiment is based on the 'Bestseller Paragraph' in German copyright law, which gives authors the right to a reasonable cut of profits in right transfers to works that turn out to be "bestsellers," i.e. if the profits and advantages from the use of the work are clearly disproportionate to what the author originally was paid. ["[D]ie vereinbarte Gegenleistung [...] in einem auffälligen Missverhältnis zu den Erträgen und Vorteilen aus der Nutzung des Werkes steht"], see Gesetz über Urheberrecht und verwandte Schutzrechte [Urheberrechtsgesetz] [Copyright Act], Sept. 9, 1965, BUNDESGESETZBLATT [BGBl.] I at 1273, § 32a (Ger.). While this law is slightly different from United States author termination rights, the experiment itself (as seen above) is simplified enough for the setting to be comparable and equally applicable.

²⁰⁹ As suggested above, *supra* Part II.1.

²¹⁰ Although interestingly their results show this for the buyers, i.e. the publishers, and not necessarily for the sellers, i.e. the authors, see Engel & Kurschilgen, *supra* note 100.

The overall implication of these findings is that the introduction of author termination rights may overcome existing barriers to trade resulting from the parties' fairness preferences, thus leading to more agreements. Even though the initial prices that copyrights trade for are lower, the finding that more deals are struck deviates from the outcome predicted by standard economic theory. The results of the experiment indicate that sellers (authors) and buyers (publishers) do indeed have and act on fairness preferences.

The implications of fairness preferences would affect the cost-benefit tradeoff of author termination rights. As discussed above, standard economic theory assumes the introduction of a termination right to have negative *ex ante* economic implications.²¹¹ The existence of fairness preferences could lessen the negative impact and be worth considering in the general tradeoff.

b. Opt-In Effects

Behavioral effects could also come into play at the point in time when the termination rights are exercisable. The termination right allows the author to threaten the publisher with copyright withdrawal, thereby initiating a renegotiation over the terms of the grant. Assuming rational actors, this threat will be made whenever the value of the granted rights is (or has become) larger than what was agreed to in the original contract. The parties will then always renegotiate and come to new terms reflecting the change in value. However, assuming boundedly rational actors may lead to a different outcome. One possible relevant behavioral bias could be opt-in effects, in other words, the stickiness of default rules. Studies have shown that systems requiring individuals to take a specific, even non-costly, action in order to achieve an outcome that corresponds to their preferences can lead to a far lower amount of individuals opting for this outcome than would in absence of the need to take action.

This goes further than simply being a matter of transaction costs.²¹² For example, Johnson & Goldstein (2003) look at people's choices as to

²¹¹ E.g. lower initial prices, a shift of risk from the publisher to the author, and ambiguous effects on creation incentives.

²¹² I.e. the costs of the action outweighing the potential gains from taking it.

whether or not to donate their organs.²¹³ They compare countries with an opt-out default (meaning that in these countries people's consent to donating their organs is presumed unless they register otherwise), to countries with an opt-in default (meaning that people must explicitly consent to donating their organs). Standard economic theory would predict that, in this situation, people's willingness to donate or not donate will correspond to their (pre-held) preference, since it is not overly costly to express. In fact, however, countries with an opt-out default are shown to have a far higher donation rate, even when controlled for social and other factors.²¹⁴ Furthermore, countries with low donation rates were found to have similarly high approval rates of organ donation in the population when surveyed for sentiment, despite the fact that the numbers of people who had actually signed a donor card were far lower.²¹⁵

Similarly, studies have revealed that changing defaults for employee 401(k) (or other) saving plans from opt-in to opt-out considerably increases enrollment.²¹⁶ Here, too, even though only few employees had previously chosen the contribution rate that later became the default, most chose to stay with the default once it was in place.²¹⁷

There are various hypotheses as to why these default rules are sticky. If preferences are constructed,²¹⁸ in other words not already formulated like standard economic theory assumes, actors may decide based on thinking that the default is a recommendation from the entity that set it,²¹⁹ or they

²¹³ See Eric J. Johnson, & Daniel G. Goldstein, *Do Defaults Save Lives?* 302 SCIENCE 1338 (2003).

²¹⁴ See *id.*, at 1338.

²¹⁵ See *id.*, citing a 1993 poll that shows that while 85% of Americans approve of organ donation, only 28% had opted to do so, see THE GALLUP ORGANIZATION, THE AMERICAN PUBLIC'S ATTITUDE TOWARD ORGAN DONATION AND TRANSPLANTATION, Gallup Organization (1993).

²¹⁶ Brigitte C. Madrian & Dennis Shea, *The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior*, 116 Q. J. ECON. 1149 (2001); James J. Choi, David Laibson, Brigitte C. Madrian, and Andrew Metrick, *Defined Contribution Pensions: Plan Rules, Participant Decisions, and the Path of Least Resistance*, in: TAX POLICY AND THE ECONOMY 67, Vol. 16, James M. Poterba ed., MIT Press (2002).

²¹⁷ See Madrian & Shea, *supra* note 216, at 1150.

²¹⁸ John W. Payne, James R. Bettman, and Eric J. Johnson, *Behavioral Decision Research: A Constructive Processing Perspective*, 43 ANNU. REV. PSYCHOL. 87 (1992); Paul Slovic, *The Construction of Preference*, 50 AM. PSYCHOL. 364 (1995); DANIEL KAHNEMAN & AMOS TVERSKY (eds.), CHOICES, VALUES, AND FRAMES, Cambridge University Press (2000).

²¹⁹ See, e.g., Madrian & Shea, *supra* note 216, at 1150.

may be avoiding making an active decision because it requires psychological (or other) effort,²²⁰ or they may be reluctant to change the status quo due to loss aversion.²²¹ Regardless of whether due to framing effects, starting points, or other factors, most opt-in and opt-out regimes tend to display dramatic differences.²²²

Although some of the above hypotheses might not necessarily apply in the context of termination rights, the fact that action is required on the part of authors to make use of their rights could nevertheless be an issue. If actors are indeed generally hindered by more than just transaction costs in taking specific actions that would otherwise be in their interest, then authors may make less use of termination rights than intended. Furthermore, the execution of termination rights is considerably complicated.²²³ According to the observations of the district court in *Siegel v. Warner Bros. Entertainment*, “[t]he termination provisions contained in the Copyright Act of 1976 have aptly been characterized as formalistic and complex, such that authors, or their heirs, successfully terminating the grant to the copyright in their original work of authorship is a feat accomplished “against all odds.”²²⁴ The court further notes: “It is difficult to overstate the intricacies of these provisions, the result of which is that they are barely used, no doubt the result desired by lobbyists for assignees.”²²⁵ It is further the author’s responsibility to keep track of the exact dates and initiate the termination. The publisher has no notification or information duties. In practice, this is likely to result in a certain percentage of authors (or their statutory successors) forgetting, not being

²²⁰ See Johnson & Goldstein, *supra* note 213, at 1338.

²²¹ For more on loss aversion, see Amos Tversky & Daniel Kahneman, *Loss Aversion in Riskless Choice: A Reference-Dependent Model*, 106 Q. J. ECON. 1039 (1991).

²²² See Cass R. Sunstein, & Richard H. Thaler, *Libertarian Paternalism is Not an Oxymoron*, 70 U. CHI. L. REV. 1159 (2003), p. 1159-1160.

²²³ See 17 U.S.C. § 304 (c) and § 203, as well as further regulations issued by the Copyright Office, 37 C.F.R. § 210.10 (2009); see also Loren (2010), *supra* note 14, at 1335; William Patry, *Choice of Law and International Copyright*, 48 AM. J. COMP. L. 383 (2000), p. 447.

²²⁴ *Siegel v. Warner Bros. Entertainment Inc.*, 542 F. Supp. 2d 1098 (C.D. Cal. 2008), p. 1098, citing PATRY, *supra* note 12, at 7:52.

²²⁵ *Siegel v. Warner Bros. Entertainment Inc.*, 542 F. Supp. 2d 1098 (C.D. Cal. 2008), p. 1117; see also *Burroughs v. Metro-Goldwyn-Mayer, Inc.*, 683 F.2d 610 (2nd Cir. 1982), p. 621, commenting that the steps necessary to make a termination effective oftentimes create “difficult, technical questions”.

aware of, not going through the trouble for, or otherwise relinquishing their termination possibilities.

This effect would mitigate at least part of the negative effects described above. It can be noted, however, that instating a complicated legal rule for authors' benefit that authors then neglect to make use of for behavioral reasons would be both strange and unnecessary. It would be more efficient in the interest of policy makers and all involved parties to find a better-suited solution.

The next and final Part of this paper will recap the discussed costs and benefits and explore their relevance for copyright policy.

III. IMPLICATIONS

This paper has looked at the economics surrounding the introduction of author termination rights. This Part will explore the implications of the discussed effects. The first Part will do so within the standard incentive theory framework.²²⁶ The second Part will also look at author termination

²²⁶ This is not the only conceivable framework: Literature on the theories and philosophies of intellectual property often brings up the concept of copyright as a moral right inherent to the author, see Justin Hughes, *The Philosophy of Intellectual Property*, 77 GEO. L.J. 287 (1988); Barbara Friedman, *From Deontology to Dialogue: The Cultural Consequences of Copyright*, 13 CARDOZO ARTS & ENT. L. J. 157 (1994). This theory, the historical basis for copyright law in some other countries (see for example JOHANN CASPAR BLUNTSCHLI & FELIX DAHN, DEUTSCHES PRIVATRECHT [GERMAN PRIVATE LAW], 3d ed., Cotta (1864) (Ger.), p. 113; 1 OTTO GIERKE, DEUTSCHES PRIVATRECHT [GERMAN PRIVATE LAW] Duncker & Humblot (1895) (Ger.), p. 762–766; EUGEN ULMER, URHEBER- UND VERLAGSRECHT [COPYRIGHT LAW AND PUBLISHING], 3d ed. Springer (1980) (Ger.), p. 109–110; PIERRE RECHT, LE DROIT D'AUTEUR, UNE NOUVELLE FORME DE PROPRIÉTÉ: HISTOIRE ET THÉORIE [COPYRIGHT, A NEW FORM OF PROPERTY: HISTORY AND THEORY], Librairie générale de droit et de jurisprudence (1969) (Fr.), p. 61-89; CLAUDE COLOMBET, PROPRIÉTÉ LITTÉRAIRE ET ARTISTIQUE ET DROITS VOISINS [COPYRIGHT AND NEIGHBORING RIGHTS], 8th ed., Dalloz (1997) (Fr.), p. 13-14; see also Neil Netanel, *Alienability Restrictions and the Enhancement of Author Autonomy in United States and Continental Copyright Law*, 12 CARDOZO ARTS & ENT. L. J. 1 (1994); Jane C. Ginsburg, *A Tale of Two Copyrights: Literary Property in Revolutionary France and America*, 64 Tulane L. Rev. 991 (1990), p. 991-1031; see also *supra* Chapter A Part II of this thesis), has never been given a strong stance in United States copyright policy, where copyright is regarded (and generally treated) as an incentive mechanism. Authors are granted exclusionary rights in order “to promote the

rights from the perspective of the officially given policy goals. The reasoning behind author termination rights is largely distributive and has been central to the discourse surrounding the U.S. Copyright Act of 1976. It should therefore not go unaddressed.

1. Utilitarian Goals

Given the utilitarian function of copyright law in aiming to incentivize the creation of artistic works,²²⁷ the theory behind author termination rights could be that the opportunity to renegotiate rights later on and additionally profit from the success of the work leads to more creation *ex ante*. The anticipation of future profits will entice more authors to create in the first place, thus furthering the progress of the arts, as is the proclaimed goal of the system.²²⁸ While this is not the given rationale for introducing termination rights,²²⁹ it makes sense to first evaluate them within this framework.

Because authors are given a chance to reap some of the benefits later on if what they create is successful, this could motivate their work. From the economic perspective of our policy in practice thus far, which is based on a very simple concept, this adds up. Copyright theory, as it is commonly understood in practice, assumes linearity of author incentives.²³⁰ The more future gains an author is promised, the more artistic creation this will incentivize.

It can be questioned, however, what happens to authors' incentives when a highly uncertain, far-future remuneration possibility is introduced at the cost of what authors can sell their rights for up front. It could be that the increased risk of the introduced lottery simply amplifies the

Progress of [...] the Arts." (see U.S. CONST. art. I, § 8, cl. 8) As such, this paper has chosen this framework for its central analysis. See also *supra* Part II.

²²⁷ See *supra* note 92.

²²⁸ U.S. CONST. art. I, § 8, cl. 8.: "To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries."

²²⁹ See *supra* Part I; see also *infra* Part III.2.

²³⁰ See Jessica Litman, *War Stories*, 20 CARDOZO ARTS & ENT. L. J. 337 (2002), p. 344; Sara K. Stadler, *Incentive and Expectation in Copyright*, 58 HASTINGS L. J. 433 (2007), p. 435.

‘superstar effect,’²³¹ with a positive effect on creation incentives. As discussed above, this necessarily assumes that authors value the chance probability of later payment more than what they lose in certain immediate payment, since introducing termination rights will lead to lower prices and/or less initial contracts.

The payment possibility through termination rights is [1] highly uncertain, and [2] more than²³² thirty-five years in the future. Exploring the concepts of decision-making under risk, and discounting future value, this paper has questioned whether the far-future payment has sufficient value to authors *ex ante* to be preferable to a higher buy-out price, and thus have a positive influence on their work. It is plausible that authors will discount this uncertain, far-future payment chance at the point in time of work creation, placing higher value on more immediate, certain payment.²³³ Additionally, since many authors will never see any of the money personally, even if their work is successful,²³⁴ it could also be that the introduction of author termination rights reduces, rather than increases, *ex ante* incentives.

This is not the first criticism of the policy assumption in copyright that author incentives are linear. For example, drawing on economic theories of predictive uncertainty, Shyamkrishna Balganesh (2009) argues that there are natural limits to what behavior the law can expect to incentivize through copyrights.²³⁵ Laws that attempt to correct for unanticipated value *ex post* assume that this value was foreseeable, and thus would be factored in by a rational actor and taken into account when deciding whether to invest in creating a work. But this foreseeability could be limited.²³⁶

²³¹ See *supra* Part II.1 and note 112.

²³² The chance of later profiting from future financial success of their works must be factored into their decision-making process before the work exists, in other words, well over 35 years in advance. The term for termination rights does not begin until the rights are transferred to another party, which is after the decision-making process to create the work occurs, and usually after the work itself has been created.

²³³ See *supra* Part II.4.

²³⁴ Because over thirty-five years down the road it could be just their rights successors who profit. While some authors may value this equally, some may not. In particular since the statutory right successors are not necessarily who the author would prefer to bequeath his or her wealth to, see *supra* Part II.4.

²³⁵ See Balganesh, *supra* note 118.

²³⁶ See *id.* at 1592.

Based on the incentive purpose of copyright law, it has also frequently been argued that unanticipated windfalls²³⁷ should not be allocated to the author, because they are unlikely to have influenced the decision to create the work.²³⁸ Because of limited cognitive capability or the above-discussed factors, some gains are unlikely to be factored into authors' decision-making, and it is questionable that these should automatically go to creators.²³⁹ The argument is that copyright law, like other areas of the law,²⁴⁰ should reflect what actually influences decision-making, rather than simply assuming that more gains equals more creation. To the extent that far-future gains are not relevant to the creation of artistic work, copyright policy should reconsider whether they are properly allocated or even necessary.

While the argument is sometimes that the expectation is unlikely to influence an author's incentive to create a work because of its highly uncertain nature,²⁴¹ this paper recognizes that actors may factor in the probability of future gains, no matter their uncertainty. In other words, the uncertainty does not necessarily influence the assumption that the chance of high future earnings factors into a decision-making process at the outset of creating. Indeed, the theory of the 'superstar effect' takes this into account. But because the introduction of termination rights increases risk at a price to the author, it becomes less effective when authors are risk averse. Risk-averse actors will prefer certain to uncertain payment.

²³⁷ A windfall is an unanticipated financial gain that comes about independent of work, planning, or any other socially desirable activity on the creator's part. See Eric Kades, *Windfalls*, 108 YALE L.J. 1489 (1999), p. 1491.

²³⁸ See for example *Rey v. Lafferty*, 990 F.2d 1379 (1st Cir. 1993), p. 1388; *Cohen v. Paramount Pictures Corp.*, 845 F.2d 851 (9th Cir. 1988), p. 854; *ABKCO Music, Inc. v. Westminster Music, Ltd.*, 838 F. Supp. 153 (S.D.N.Y. 1993), p. 156; *Platinum Record Co. v. Lucasfilm, Ltd.*, 566 F. Supp. 226 (D.N.J. 1983), p. 227; *Kirke La Shelle Co. v. Paul Armstrong Co.*, 188 N.E. 163 (N.Y. 1933), p. 165-166.

²³⁹ See, e.g., Baganesh, *supra* note 118, at 1590 on allocating windfalls: "In practical terms, copyright windfalls allow creators to engage in monopolistic pricing in new markets that are unlikely to have formed a crucial part of their incentives in creating the work. In addition, in relation to new uses and later-developed technologies, these windfalls give creators control over markets that they clearly are not best positioned to develop."

²⁴⁰ For example tort law.

²⁴¹ See Baganesh, *supra* note 118, at 1615 on predictability: "[A] creator's belief that her work will come to be used in association with some wholly unforeseeable medium, merely because such unforeseeable media emerged in the past, represents an expectation that is not necessarily grounded in anything other than a bald prediction that a historical contingency is likely to repeat itself."

This paper draws attention to the fact that actors in creative markets may be risk-averse, and may furthermore additionally discount values in the far future. An incentive effect that is based on the predictive uncertainty of author termination rights thirty-five years down the road may be less strong than an incentive provided by anticipated immediate and more certain payment, even when such payment is smaller than the expected future remuneration.

Even if author termination rights have a slightly positive effect on incentives, this must be weighed against other factors. This paper also looked at the potential for hold-up situations and their effect on investment incentives. Hold-up, which is plausible in the termination right context, can reduce quality and distribution of artistic works, as well as hinder the development of new exploitation methods and technologies. This would neither be in authors' nor in the public's best interest. Again, the utilitarian goal of the copyright system is to trade off exclusive rights in return for not just creation incentives, but also distribution of, and access to, artistic works.²⁴²

While the law specifically intends to give authors the type of bargaining advantage seen in the hold-up scenario,²⁴³ consideration of the effects on publisher investment seems to be lacking. The arguments of large publishing corporations in court are often not viewed particularly kindly by the general public, because it appears to be (and is) the case that they are trying everything they possibly can to protect their own financial interests. The argument of investment incentives, however, does line up with economic theory and should be weighted in policy decision-making.²⁴⁴ This incentive structure essentially affects not just the financial gains of publishers, but also the interests of authors, and that of the general public. Intermediaries perform an essential role in both generating additional value of the work, and fostering public access. As mentioned above, the incentive system is primarily designed for this

²⁴² See *supra* Part II.2.; see also Ashok Chandra, *Crisis of Indefinite Consequence: How the Derivative Works Exception and the Lanham Act Undercut the Remunerative Value of Termination Transfers*, 16 *FORDHAM INTELL. PROP. MEDIA & ENT. L.J.* 241 (2005), p. 250, citing *United States v. Paramount Pictures, Inc.*, 334 U.S. 131 (1948), p. 158: “[R]eward to the author or artist serves to induce release to the public of the products of his creative genius.”

²⁴³ See discussion of this in Part III.2 below.

²⁴⁴ See *supra* Part II.2.

purpose, and not simply to remunerate authors.²⁴⁵ Quality, distribution, and investment in new media formats are things that benefit both authors and public interest.²⁴⁶ If copyright is intended to foster distribution and public access to artistic works, hold-up situations will be at odds with these goals. This cost must thus be weighed against whatever benefits that author termination rights confer.

Additionally, this paper looked at some behavioral economic factors that could come into play in the termination right context. One discussed effect that could impact distribution contracts is fairness preferences. If authors feel that a prospect of future compensation correction is more 'fair' than a system without termination possibility, then more deals may be struck, even if these deals are at lower prices.²⁴⁷ *Ex post*, the fact that making use of the right to terminate requires an action, not to mention some effort, on the part of the authors or right successors could mean that the barrier to exercising author termination rights is higher than assumed.²⁴⁸ Both of these effects could mitigate some of the costs inherent to a termination rights system.

Again, it is useful to remember that copyright laws are a tradeoff. Exclusive rights, and the possibility to capitalize on artistic works, are granted in order to correct for a market failure.²⁴⁹ This correction does not come without economic costs. Copyrights reduce the distribution and accessibility of works.²⁵⁰ Author termination rights, just like the copyrights they apply to, create economic inefficiencies, induce rent-

²⁴⁵ See *supra* Part II.2; see also Murray, *supra* note 71, at 415.

²⁴⁶ See DiCola, *supra* note 103, at 10: "[O]ne cannot lose sight of the intermediaries' function within the system. To fully understand copyright incentives, one must measure the financial rewards the intermediaries receive, the services they offer in terms of developing and disseminating works to the public, and how changes in the financial rewards to intermediaries are affecting the public's access to creative works."

²⁴⁷ See *supra* Part II.5.a.

²⁴⁸ See *supra* Part II.5.b.

²⁴⁹ See GOLDSTEIN, *supra* note 92, at §1.14; NIMMER & NIMMER, *supra* note 56 at §1.03[A], p. 17-18. Copyright enables creators of artistic works to recoup production costs by creating exclusive rights on content so they can monetize it. Without this mechanism, the theory goes, content will be too easily replicated, eroding the creator's profits and reducing the incentive to invest in creating content, resulting in market failure, see Landes & Posner, *supra* note 104, at 326.

²⁵⁰ See Landes & Posner, *supra* note 104, at 326, GOLDSTEIN, *supra* note 92, at § 1.14.

seeking behavior, and come with transaction costs.²⁵¹ Furthermore, this paper draws attention to the fact that termination rights induce price- and risk shifting that is not necessarily efficient and may add to this cost. It also demonstrates that hold-up situations could have negative effects on distribution and access to copyrighted works. While it is difficult to measure the costs and benefits conclusively,²⁵² this paper indicates that the relative weight of the costs is probably larger than the benefits. Author termination rights are likely to have a much smaller positive *ex ante* effect on creation incentives²⁵³ than the negative effects they introduce.

However, investment incentives, while prevalent in U.S. copyright theory, are not everything. Another possible effect that copyright policy could be interested in fostering, even at the cost of some inefficiency, is wealth redistribution to authors. This is discussed in the following.

2. Distributive Goals

Another reason to grant author termination rights within copyright law serves distributive purposes. Policy makers may not care about incentives and instead be looking to achieve wealth redistribution.²⁵⁴ In many countries outside of the United States, the copyright system's history and purpose is seen not as an incentive mechanism for the public benefit, but rather as a direct compensation mechanism for authors.²⁵⁵ Because

²⁵¹ Transaction costs are the costs incurred in performing market exchanges, frequently subcategorized as search and information costs, bargaining costs, and enforcement costs, see Carl J. Dahlman, *The Problem of Externality*, 22 J. LAW & ECON. 141 (1979), p. 148, expanding on the original theory in Ronald H. Coase, *The Problem of Social Cost*, 3 J. LAW & ECON. 1 (1960), p. 15.

²⁵² See also David McGowan, *Copyright Nonconsequentialism*, 69 MO. L. REV. 1 (2004), p. 9, on the fact that copyright discourse is (necessarily) based on indication rather than empirical data.

²⁵³ If any at all, see *supra* Part II.4.

²⁵⁴ See, e.g., Molly Shaffer Van Houweling, *Distributive Values in Copyright*, 83 TEX. LAW REV. 1535 (2005), p. 1539-1542.

²⁵⁵ See for example in Germany: Schulbuch, Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court] July 7, 1971, 31 ENTSCHEIDUNGEN DES BUNDESVERFASSUNGSGERICHTS [BVERFGE] 229 (240) (Ger.); see also CATHARINA MARACKE, DIE ENTSTEHUNG DES URHEBERRECHTSGESETZES VON 1965 [THE FORMATION OF THE COPYRIGHT ACT OF 1965], Duncker & Humblot (2003) (Ger.), p. 729; see also Murray, *supra* note 71, at

authors have created something, the compensation falls first to them, as the originators of the work. Introducing author termination rights could potentially serve such distributive purposes, rather than utilitarian purposes.

Indeed, looking at the documented debate and case law on the U.S. Copyright Act of 1976, there are two main reasons given for the introduction of author termination rights. One argument is that authors are at a bargaining disadvantage with dealing with publishers.²⁵⁶ Allowing them a chance to terminate unremunerative agreements later on endeavors to give them “a second bite of the apple” and reduce some of the publishers’ bargaining leverage.²⁵⁷ The other reason is the high uncertainty surrounding the success and failure of creative works.²⁵⁸ Because neither party is sufficiently able to foresee the future value of the copyright at the time of the agreement, the termination right serves to correct any imbalance caused by inaccurate predictions.

Some prior literature, in answering the question of how the details of author termination rights are to be interpreted as the law comes into full effect over the next few years, bases its answer on either of these reasonings.²⁵⁹ Both of them are essentially distributive, because they intend to reallocate wealth to authors as the deserving or disadvantaged party. Based on the analysis in this paper, however, it seems that both the valuation problem and the issue of bargaining leverage are unfittingly addressed by termination rights.

As seen above, the uncertain future value of artistic works makes it in the author’s interest to allocate the risk of success or failure to the publisher. It is one of the reasons why publishers exist in the first place.

416, citing F. Willem Grosheide, *Paradigms in Copyright Law*, in: OF AUTHORS AND ORIGINS: ESSAYS ON COPYRIGHT LAW 205, Brad Sherman and Alan Strowel eds., Clarendon Press (1994), p. 207; *see also supra* note 266.

²⁵⁶ *See* H.R. REP. NO. 94-1476 (1976), p. 124; *Mills Music, Inc. v. Snyder*, 496 U.S. 153 (1985), p. 172, 173; STUDIES PREPARED FOR THE SUBCOMM. ON PATENTS, TRADEMARKS, AND COPYRIGHTS OF THE COMM. ON THE JUDICIARY, 86TH CONG., 31 RENEWAL OF COPYRIGHT 125 (Comm. Print 1961), claiming that “the author [...] is necessarily in a poor bargaining position.”; *Marvel Characters, Inc. v. Simon*, 310 F.3d 280 (2d Cir. 2002), p. 292; *see also Loren* (2010), *supra* note 14, at 1345-1346.

²⁵⁷ *See id.*

²⁵⁸ *See Loren* (2010), *supra* note 14, at 1346.

²⁵⁹ *See Menell & Nimmer* (2009), *supra* note 14; *Loren* (2010), *supra* note 14; *Menell & Nimmer* (2010), *supra* note 15.

Allowing authors a termination right will reallocate part of the risk back to the party least benefited by bearing it. Publishers will reduce what they are willing to pay for copyright grants, because the expected value is necessarily lower: they have no option to recoup money from the author when the work turns out to be unsuccessful, yet are subject to a shorter exploitation period when the value of the work turns out to be high. In the latter case, a small subset of highly successful authors (or their statutory successors) will get paid well the second time, but the majority will receive less *ex ante*. While this could theoretically fit into a utilitarian justification for termination rights, as discussed above, it is unlikely what Congress envisioned in their focus on the disadvantaged creator. Authors are essentially giving up part of their initial payment in return for a highly uncertain chance of reward thirty-five years down the road.²⁶⁰ If the intent behind the law is to correct the ‘imbalance’ that results from the difficulty of predicting a work’s success, it is questionable whether this is actually achieved by giving only (successful) authors and statutory successors the possibility to negotiate for more money *ex post*.

This brings us to the other argument of bargaining leverage. It could be plausible that authors are generally at a bargaining disadvantage in dealing with publishers in practice.²⁶¹ For example, a limited number of publishers in a market will create imbalances in negotiating with a far larger number of authors.²⁶² Large numbers of actors in a market can band together to increase their leverage, and authors’ guilds are to a certain extent effectual in some industries.²⁶³ Yet the stories of bought-out authors are persistent²⁶⁴ and it thinkable that allowing these particular authors a termination right will give them more leverage in a

²⁶⁰ And quite possibly not until after their death.

²⁶¹ See Darling, *supra* note 97, at 506-515 for an extensive analysis; see also *supra* note 256. But see also Rub, *supra* note 15, at 27-31, rejecting the notion of authors as the weaker party in some, but not all, creative industries.

²⁶² Both bargaining theory and experimental evidence indicate that competition plays a role in price negotiation, see for example Brit Grosskopf, *Reinforcement and Directional Learning in the Ultimatum Game with Responder Competition*, 6 EXPERIMENTAL ECONOMICS 141 (2003), see also *supra* note 94.

²⁶³ The legislature acknowledges this in STAFF OF H.R. COMM. ON THE JUDICIARY, 87TH CONG., REGISTER’S REPORT ON THE GENERAL REVISION OF THE U.S. COPYRIGHT LAW (Comm. Print 1961), p. 93.

²⁶⁴ See *id.*

second negotiation.²⁶⁵ The above-discussed effects indicate, however, that this will only benefit a small subset of highly successful authors and come at the expense of the rest. In many cases, this will not even be the original author, but rather the statutory successors. If it turns out that authors as a group lose bargaining power and part of their income in the initial copyright assignments,²⁶⁶ the argument that termination rights generally give authors more leverage needs to be relativized.

In essence, no matter which of these two justifications one chooses, if the effect of this law is to reduce the initial prices that authors can sell their copyrights for, as well as shift the burden of risk back to them, then this outcome poses the question whether the rule is performing its distributive function as intended.

3. Outlook

This paper indicates that the introduction of author termination rights is neither in the interest of distributive-oriented nor utilitarian-oriented copyright policy. The normative implication of this result would be to eliminate author termination rights in United States copyright law and look for alternative ways to achieve the goals of the legislature, should such goals still be preferred. Because a legislative solution is difficult to bring about,²⁶⁷ this Part turns to ways in which the negative effects of termination rights could be reduced within the given legislative framework. As seen above, termination rights will be subject to considerable judicial interpretation in the near-term future. There is some leeway with regard to the strictness of their application, essentially allowing courts to influence some of the costs of author termination rights.

Returning to the open legal questions addressed in the first Part of this paper, courts will soon be asked to decide on issues like the boundaries of works made for hire and inalienability. Assuming we stay within the given

²⁶⁵ Particularly in the case of relationship-specific investments on the part of the publisher, *see supra* Part II.2.

²⁶⁶ Due to economic price changes and risk allocation, *see supra* Part II.1.

²⁶⁷ *See also infra* note 268.

framework of the law,²⁶⁸ this paper indicates that a narrow interpretation of author termination rights may be in the interest of both utilitarian and distributive-based policies. Rather than deciding based on anecdotes of disadvantaged artists at the mercy of publishing conglomerates,²⁶⁹ courts can take economic factors into account in their decision-making. This would mean interpreting the inalienability of termination rights narrowly, declaring rescissions and copyright re-grants valid in certain cases.²⁷⁰ It would also mean not hesitating to apply the work made for hire doctrine where it makes economic sense to do so.²⁷¹ Judicial interpretation can establish the boundaries of the rights, setting legal precedence for times to come. In the context of author termination rights, courts thus have some space to influence the above-discussed costs and benefits of the law.

CONCLUSION

This paper contributes to the ongoing debate surrounding author termination rights by providing further economic insight. U.S. law grants authors a contract termination right thirty-five years after the license or transfer of their copyrights. This paper argues that, from an economic perspective, author termination rights are likely not desirable for authors, publishers, or the general public. Price changes, risk shifting, hold-up problems, and skewed incentive structures raise questions about the distributive policy argument of author termination rights, and put them at odds with the utilitarian purpose of U.S. copyright law.

²⁶⁸ Others have made suggestions to change the legislation, e.g. Rub argues for shortening the time period before termination of transfer can be exercised and restructuring the copyright post termination as a liability v. a property rule, *see* Rub, *supra* note 15, at 58. The insights from this paper support these suggestions. However, its policy recommendations (to the extent that they are made) remain focused on the given framework and what immediate changes are possible and realistic (i.e. common-law judicial interpretation in the many cases on the immediate horizon that will set precedents).

²⁶⁹ *See* Murray, *supra* note 71, at 424 on courts' observable tendency to be influenced by such concerns; *see also* McGilvray, *supra* note 82, at 333-336.

²⁷⁰ *See* Rub, *supra* note 15, at 61-65.

²⁷¹ *See for example* Marvel Worldwide, Inc. v. Kirby, 777 F. Supp. 2d 720 (S.D.N.Y. 2011).

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Copyright Withdrawal

[2014

LOW-IP INDUSTRIES

LITERATURE REVIEW

There is a growing body of interdisciplinary research that puts the traditional economic assumptions behind intellectual property law to the test. Through a fine-grained approach of empirical industry studies, this literature aims to collect a better picture of the relationship between intellectual property and innovation in practice, especially within information markets that appear to be sustained despite reduced - or even without - intellectual property protection (often called "IP without IP" – Information Production without Intellectual Property). The law and policy surrounding intellectual property is frequently based on abstract economic theory. Gathering reliable images of what effects these laws have in practice may ultimately lead to a more realistic general model and provide the necessary tools for industry-specific differentiations. These studies are therefore a first critical step in striving towards the optimization of intellectual property law in particular, and innovation/competition policy in general. So far, this research has explored numerous industries where intellectual property rights do not play the role predicted by traditional theory. This paper provides an overview of these studies and theoretically grounds the current research into the general literature on self-regulation and social norms.

C. Low-IP Industries: Literature Review

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INTRODUCTION

The traditional economic assumption behind intellectual property rights concerns the problem of information appropriability. The creation and widespread dissemination of information is a driving factor of technological progress and generally regarded as socially desirable. When ideas and creative works are easily copied, the incentive to invest in their creation decreases, leading to underinvestment and market failure.¹

¹ See ROBERT COOTER & THOMAS ULEN, *LAW AND ECONOMICS*, international ed., Addison-Wesley (2008), p. 123; WILLIAM M. LANDES & RICHARD A. POSNER, *THE ECONOMIC STRUCTURE OF INTELLECTUAL PROPERTY LAW*, Harvard University Press (2009), p. 332;

Intellectual property aims to correct this problem by rewarding innovators and creators for their investment with a temporary exclusion right. With this right to exclude others from the use of their work, inventors and authors can appropriate the returns to their investments, which increases the incentives to innovate.² However, the grant of an exclusion right, even temporarily, constitutes a trade-off to society in that it decreases dissemination. Economic theory predicts that the rents extracted by the intellectual property holder will result in higher prices, leading to underuse of the information.³ This deadweight loss is justified under the assumption that intellectual property law is a necessary requirement in upholding a functioning market for information.⁴

An increasingly large body of literature has begun to question this assumption. One of the major drawbacks of the traditional theoretical approach is that it lacks the necessary knowledge and tools to distinguish on an industry-specific level. For this reason, a new area of empirical research endeavors to examine the role of intellectual property in individual industries. Through a bottom-up approach, this scholarship explores the actual use and effects of intellectual property laws in practice, aiming to eventually gather enough individual studies to reach more general conclusions. The ultimate goal of this field of research is more efficient innovation policy. Understanding the actual role of intellectual property in practice, finding other driving forces behind innovation, and recognizing industry-specific conditions for investment incentives are important steps towards optimizing the behavior-governing legal regime.

The most relevant observation for theory is that some markets for information goods may be able to function despite partial or full absence of state-enforced intellectual property protection. A number of industry studies have uncovered areas where an information market is sustainable with modified - or even without - intellectual property laws. Often, specific characteristics allow for the development and sustenance of

Kenneth W. Dam, *The Economic Underpinnings of Patent Law*, 23 J. LEGAL STUD. 247 (1994), p. 247.

² See COOTER & ULEN, *supra* note 1 at 120.

³ Kenneth J. Arrow, *Economic Welfare and the Allocation of Resources for Invention*, in: THE RATE AND DIRECTION OF INVENTIVE ACTIVITY: ECONOMIC AND SOCIAL FACTORS, Richard R. Nelson ed., Princeton University Press (1962), p. 173.

⁴ There are a few alternatives that also fit into the economic theory of correcting the information market failure (such as state subvention through prizes, etc.). See for example SUZANNE SCOTCHMER, *INNOVATION AND INCENTIVES*, MIT Press (2004), p. 31-61.

alternative mechanisms that assume the function of intellectual property, sometimes arguably more efficiently. These mechanisms either enforce a certain level or type of information appropriation or certain market characteristics provide alternative incentives to create information in the first place. While it is difficult to claim with certainty that the level or type of content production found in these markets is economically optimal,⁵ the factors that contribute to sustaining it challenge previously held assumptions. Once the body of studies is large enough to establish a solid foundation of systematic factors, this may help to design policies that better support innovators and improve the balance we currently attempt to achieve through intellectual property laws.⁶

This paper provides an overview of the current research on "IP without IP",⁷ or 'low-IP' industries,⁸ and grounds it in the general literature on self-regulation and social norms. This body of literature explores the phenomenon of "order without law" and the sustainability of enforcement mechanisms that function outside of the legal system.⁹ A large part of the 'low-IP' industry literature integrates nicely into this framework.

This literature review is structured as follows: Part I provides an overview of the current literature on 'low-IP' industries. This research is situated within the broader law and economic literature on law and norms in Part II. Part III describes and addresses some points of criticism that 'low-IP' industry literature faces. Part IV highlights the relevance of the literature to theory and policy.

⁵ See Rochelle C. Dreyfuss, *Does IP Need IP? Accommodating Intellectual Production Outside the Intellectual Property Paradigm*, 31 CARDOZO L. REV. 1437 (2010), p. 1460-1462.

⁶ But see limitations *infra* Part III.

⁷ See also overviews of the literature by Dreyfuss (2010), *supra* note 5; Elizabeth L. Rosenblatt, *A Theory of IP's Negative Space*, 34 COLUM. J. L. ARTS 317 (2010).

⁸ For the purposes of this literature review, the latter term is preferred, as intellectual property is not entirely absent in many of the studies industries, but rather assumes a lesser or different role than elsewhere.

⁹ See *infra* Part II.

I. REVIEW OF EXISTING 'LOW-IP' INDUSTRY LITERATURE

In the field of law and economics, scholars have increasingly begun to examine production in creative or innovative industries with limited or no reliance on intellectual property. Mainly through empirical methodologies, many of these studies find that information goods are produced despite the absence of formal intellectual property protection, challenging a basic assumption of our current theory and policy. This Part provides an overview of this body of research and the various areas of information good production it has studied so far.

1. *University Research*

The basic idea that information production incentives can and do exist outside of formal intellectual property structures is not new. In the 1940s, for example, Robert Merton (1942)¹⁰ explored the norms governing academic communities, finding their systems of informal principles and motivations essential to producing science. Interest in the direct relationship between these norms and intellectual property, however, largely came about around the turn of the century in the context of university patenting.¹¹ With a take on academic norms similar to Merton, Arti Rai (1999)¹² compares the traditional, norm-based university research setting to one with an increased focus on formal intellectual property. Based on her seminal study of biomedical research, Rai argues that scientific progress in the university context is better regulated through a system of academic norms than through the patent system. She

¹⁰ Robert K. Merton, *Science and Technology in a Democratic Order*, 1 J. LEGAL & POL. SOC. 115 (1942); see also Robert K. Merton, *The Reward Structure of Science*, in: THE SOCIOLOGY OF SCIENCE: THEORETICAL AND EMPIRICAL INVESTIGATIONS, Norman W. Storer ed., University of Chicago Press (1973), p. 279-285.

¹¹ The passage of the Bayh-Dole Act in 1980 introduced the possibility of obtaining intellectual property protection for government-funded research (as opposed to previously assigning ownership to the government), allowing universities to patent their inventions. See 35 U.S.C. §§ 200-212.

¹² Arti Kaur Rai, *Regulating Scientific Research: Intellectual Property Rights and the Norms of Science*, 94 NW. U. L. REV. 115 (1999).

demonstrates that researchers' incentives are more efficiently aligned within the existing system of information-sharing norms, which essentially achieve the same instrumental goals as formal intellectual property rights.

Others have also questioned the necessity, value, and harm of formal intellectual property rights for innovation in university research settings. Katherine Strandburg (2005)¹³ has surveyed scientists' preferences, finding that research is often driven by curiosity and the motivation of directly gaining knowledge. Scientists will share resources and information with each other to further the state of research for personal motivation, rather than wanting to benefit from exclusionary rights.

Not only do alternative motivations appear to exist in scientific research, scholars also find that introducing formal intellectual property regimes could be counter-productive and harmful to information production and sharing. Fiona Murray et al. (2009)¹⁴ examine the effect of intellectual property rules on the use of genetically engineered mice in the 1990s. Comparing the research done under a strict intellectual property regime with a regime where intellectual property restrictions were officially circumscribed, they find a significantly higher amount of follow-on research in the latter, as well as an increase in exploration and diversity.¹⁵

This first combined body of research on university settings demonstrates that the incentives provided through intellectual property systems are indeed a trade-off in practice. Patent rights are granted to incentivize innovation, and to incentivize the sharing of information. Many university researchers, however, have alternative motivations to

¹³ Katherine J. Strandburg, *Curiosity-Driven Research and University Technology Transfer*, in: UNIVERSITY ENTREPRENEURSHIP AND TECHNOLOGY TRANSFER: PROCESS, DESIGN, AND INTELLECTUAL PROPERTY (ADVANCES IN THE STUDY OF ENTREPRENEURSHIP, INNOVATION AND ECONOMIC GROWTH), Vol. 16, Gary D. Libecap ed., JAI Press (2005) 93.

¹⁴ Fiona Murray, Phillippe Aghion, Mathias Dewatripont, Julian Kolev, and Scott Stern, *Of Mice and Academics: Examining the Effect of Openness on Innovation*, National Bureau of Economic Research, No. w14819 (2009), available at <http://www.nber.org/papers/w14819>; see also Fiona Murray & Scott Stern, *Do Formal Intellectual Property Rights Hinder the Free Flow of Knowledge?* 63 J. ECON. BEHAV. ORG. 648 (2007); Fiona Murray, *The Oncomouse that Roared: Hybrid Exchange Strategies as a Source of Distinction at the Boundary of Overlapping Institutions*, 116 AM. J. SOC. 341 (2010).

¹⁵ See Murray et al. (2009), *supra* note 14.

innovate and do not require the additional incentive. These studies find that there is also ample motivation to share information and tools¹⁶ among research communities in absence of exclusive rights. These findings caution that intellectual property protection in such settings does not increase innovation and sharing of information. Rather, introducing it may even decrease the desired effects due to the exclusionary nature of patenting.

University research is but one setting where the relationship between intellectual property incentives and innovation is not as simple as predicted by traditional intellectual property theory. The existence of social norms and alternative motivations in academia could be attributed to the fact that it is an exceptional environment: the structure of academia is based on historical tradition and university research is often funded through the government. Yet scholars have also found similar norms and incentive mechanisms in other, more commercially oriented fields. The following describes industry studies in open-source software development.

2. *Software Development*

A more commercially driven area that has sparked considerable economic interest is computer software. Around the turn of the century, the growing phenomenon of voluntary participation in open-source and software development inspired scholars to more closely examine proprietary motivations in information production.

Josh Lerner & Jean Tirole (2002¹⁷ and 2005)¹⁸ and Jeffrey Roberts et al. (2006)¹⁹ have done research on the open source software movement,

¹⁶ See, e.g., also John P. Walsh, Ashish Arora, and Wesley M. Cohen, *Research Tool Patenting and Licensing and Biomedical Innovation*, in: PATENTS IN THE KNOWLEDGE-BASED ECONOMY, Stephen A. Merrill ed., National Academies Press (2003), 285, p. 315-316 (lamenting the costs and difficulties associated with sharing research tools when intellectual property protection is involved).

¹⁷ Josh Lerner & Jean Tirole, *Some Simple Economics of Open Source*, 50 J. INDUS. ECON. 197 (2002).

finding it able to sustain innovation incentives without patents or other intellectual property through special social structures and non-monetary (or indirectly monetary) motivational factors.

In their seminal article on developer motivations, Lerner & Tirole explore four case studies of open source software projects.²⁰ They demonstrate that the behavior of individual developers, and also that of commercially motivated firms, can largely be explained through labor economics and industrial organization theory. Rather than soliciting participation through direct monetary incentives, open-source software projects tap into alternative motivations, for example career concerns. The authors expand on this in a later article, showing that while much of the participation is unpaid, it is driven by indirect benefits and a desire for peer recognition – similar in some ways to the motivations in academic communities.²¹

Roberts et al. develop a theory of the various (intrinsic and extrinsic) motivations of open source software developers, their interrelation, and how they affect participation and performance. They compare their theoretical model to a longitudinal field study of the Apache projects,²² establishing a complex interplay of monetary, status, use-value, and intrinsic motivations.

The body of studies on open-source software development and academic research communities establishes that innovation can be driven by factors outside of (or only tangentially related to) intellectual property incentives. Participation in these areas is partially attributed to intrinsic motivation, but may also rely heavily on a structure of indirect monetary factors, such as status and career concerns. The following explores literature that addresses the question whether other structures exist that can sustain similar innovation in research & development.

¹⁸ Josh Lerner & Jean Tirole, *The Economics of Technology Sharing: Open Source and Beyond*, 19 J. ECON. PERSP. 99 (2005).

¹⁹ Jeffrey A. Roberts, Il-Horn Hann, and Sandra A. Slaughter, *Understanding the Motivations, Participation, and Performance of Open Source Software Developers: A Longitudinal Study of the Apache Projects*, 52 MGMT. SCI. 984 (2006).

²⁰ Apache, Linux, Perl, and Sendmail, see Lerner & Tirole (2002), *supra* note 17.

²¹ See *supra* Part I.1. Although Lerner & Tirole also distinguish these motivations to a certain extent, see Lerner & Tirole (2005), *supra* note 18, at 116-118.

²² The Apache HTTP Server is a popular open-source, community-developed web server software program, monitored by the Apache Software Foundation.

3. Commons-Based Peer Production and User-Innovation

Using the study of open-source software development as an example, scholars have expanded the core organizational and motivational concepts to other areas. Instead of relying solely on indirect monetary incentives, as one could insinuate for academia and software, these scholars argue that some structures tap into and are sustained largely through intrinsic motivations.²³ Yochai Benkler (2002)²⁴ suggests based on observations of numerous Internet-related projects²⁵ that “commons-based peer production” could be a new, efficient model of incentivizing innovation.²⁶ He looks at systems that can coordinate a large number of people and combine their individual efforts, allowing for self-selection into tasks, showing that this form of organization can sometimes be superior to markets and firms.²⁷ This is partially based on the reduced cost of building and maintaining networks on the Internet, but it is also based on the potential to capture individuals’ diverse desires to generate information, recognizing that proprietary monetary incentives do not paint a complete picture of human motivation.²⁸ Benkler also argues that intellectual property regimes may hinder rather than help commons-based peer production. Strong patent and copyrights may prevent or limit access to information, creating costs and inefficiencies for peer production.²⁹

²³ This is usually in combination with the low cost of sharing innovation with others, for example, in networked environments or user communities.

²⁴ Yochai Benkler, *Coase’s Penguin, or, Linux and The Nature of the Firm*, 112 YALE L.J. 369 (2002).

²⁵ Linux and open-source software generally, but also looking at the phenomenon of Wikipedia and other examples of crowd-sourced information production, *see id.*

²⁶ *See also* YOCHAI BENKLER, *THE WEALTH OF NETWORKS: HOW SOCIAL PRODUCTION TRANSFORMS MARKETS AND FREEDOM*, Yale University Press (2006).

²⁷ Benkler (2002), *supra* note 24, at 400-404.

²⁸ *Id.* at 426-436.

²⁹ *Id.* at 445-446.

Sonali Shah (2005)³⁰ also examines “community-based” production models that are based on collaborative, voluntary participation through “users.”³¹ Extending her analysis beyond open source software to a variety of different fields,³² she establishes three factors that define and sustain successful community-based information production: [1] A difference in the type of innovation produced through manufacturers and users; [2] a norm of sharing information and building upon innovation amongst users; and [3] that the innovation generated through user communities ends up being the basis for commercial products. She suggests that intellectual property policy neglects to consider that users have both the ability and the incentive to modify and improve existing products. Similar to the reasoning behind the General Public License for software,³³ proprietary rights are argued to sometimes actively hinder desirable use, modification, and distribution.³⁴

Delving further into systems of information production through users and user communities, Eric von Hippel et al. (2000,³⁵ 2005,³⁶ 2009,³⁷ etc.)³⁸ have analyzed user innovation in a number of different fields. For example, together with Pamela Morrison and John Roberts, von Hippel looks at development through users of online public access catalogue (OPAC) information search systems in Australia, finding that people freely share their innovations amongst themselves. The authors note that

³⁰ Sonali K. Shah, *Open Beyond Software*, in: OPEN SOURCES 2.0: THE CONTINUING EVOLUTION 339, Chris DiBona et al.eds., O'Reilly Media, Inc. (2005), p. 339-360.

³¹ “[A] term that describes enthusiasts, tinkerers, amateurs, everyday people, and even firms who derive benefit from a product of service by using it.” *See id.* at 339.

³² For example user innovation surrounding recreational sport equipment.

³³ *See* Richard Stallman, *Why Software Should Be Free*, in: INTELLECTUAL PROPERTY: MORAL, LEGAL, AND INTERNATIONAL DILEMMAS 283, Adam Moore ed., Rowman & Littlefield (1997), p. 283.

³⁴ Shah, *supra* note 30, at 357.

³⁵ Pamela D. Morrison, John H. Roberts, and Eric von Hippel, *Determinants of User Innovation and Innovation Sharing in a Local Market*, 46 MGMT. SCI. 1513 (2000).

³⁶ ERIC VON HIPPEL, *DEMOCRATIZING INNOVATION*, MIT Press (2005).

³⁷ Jeroen P.J. de Jong & Eric von Hippel, *Transfers of User Process Innovations to Process Equipment Producers: A Study of Dutch High-Tech Firms*, 38 RES. POLY 1181 (2009).

³⁸ Fred Gault & Eric von Hippel, *The Prevalence of User Innovation and Free Innovation Transfers: Implications for Statistical Indicators and Innovation Policy*, MIT Sloan Research Paper No. 4722-09 (2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1337232.

because of the norm of information sharing, this system is more efficient than other models of information production.³⁹

Von Hippel takes the investigation of user-driven innovation further, demonstrating how it complements commercial innovation and potentially lowers production costs in a variety of different fields.⁴⁰ User-innovation is not just driven through individual hobbyists, but also created through firms.⁴¹ While the earlier studies of library information sharing acknowledged that users might be sharing information because they are not in direct competition within their community, the studies on firms demonstrate that such behavior is also found in competitive market environments.⁴² This work raises the question of patent law reevaluation, suggesting that alternative incentives and free sharing of innovation are not taken into account by government policies, despite being prevalent in practice.⁴³

The collection of peer-production and user-innovation studies has expanded the literature from university research and software to other innovative fields. Spanning intrinsically motivated users and commercially oriented environments, this research begins to raise more generalizable questions about innovation policy.⁴⁴ While many of the policy implications in the above-described research have dealt with patent-oriented settings involving tools, technology, and inventions,⁴⁵ user creation in other areas involves copyright norms and incentives for

³⁹ Morrison, Roberts, and von Hippel, *supra* note 35. The authors acknowledge, however, that the users in this library market are not competing with each other, as could be the case in other settings. This could impact actors' willingness to freely share information.

⁴⁰ See, e.g., VON HIPPEL (2005), *supra* note 36.

⁴¹ De Jong & von Hippel, *supra* note 37 (on user innovation and sharing among high-tech firms in the Netherlands); Gault & von Hippel, *supra* note 38 (on Canadian manufacturing plants).

⁴² See also Robert C. Allen, *Collective Invention*, 4 J. ECON. BEHAV. & ORG. 1 (1983), on collective invention within the nineteenth century iron industry in England, where firms chose to share innovations with their competitors, thereby advancing the industry as a whole. See also Dreyfuss (2010), *supra* note 5, at 1444.

⁴³ See e.g. Gault & von Hippel, *supra* note 38, at 23-24.

⁴⁴ See also BENKLER, *supra* note 26.

⁴⁵ Although software can arguably fall into the category of patent or copyright policy, and some of the case studies described in this Part cover copyrightable works (e.g. Wikipedia).

artistic works. Rebecca Tushnet (1997)⁴⁶ and Casey Fiesler (2008)⁴⁷ explore fan fiction communities; in particular their norms around, and their relationship to, copyright law. Debora Halbert (2009)⁴⁸ also looks at fan fiction,⁴⁹ but examines online social networking and user-generated content more generally, as well, largely using the example of YouTube video culture. These scholars find that fan cultures have strong informal norms governing copying and noncommercial exchange. Halbert points out that actors in these markets not only create works without the financial incentive that would be provided through formal copyright protection, but that they also invest in creating derivative works despite the cost of potentially infringing on original content rights.⁵⁰ In the area of fan fiction and YouTube videos, one might be quick to dismiss the relevance of the insights for copyright policy based on the non-commercial, hobby-like nature of the creative work in question. Yet scholars have also explored highly commercially oriented markets for artistic and creative works, finding sustainability in low-copyright environments. These are described in the following Part.

4. *Creative Design and Performance Industries*

While the above-described ‘low-IP industry’ research largely focuses on the realm of inventions and patent policy,⁵¹ scholars have also studied other intellectual property environments. There is an increasing body of

⁴⁶ Rebecca Tushnet, *Legal Fictions: Copyright, Fan Fiction, and a New Common Law*, 17 LOY. L.A. ENT. L. REV. 651 (1997).

⁴⁷ Casey Fiesler, Note, *Everything I Need to Know I Learned from Fandom: How Existing Social Norms Can Help Shape the Next Generation of User-Generated Content*, 10 VAND. J. ENT. & TECH. L. 729 (2008).

⁴⁸ Debora Halbert, *Mass Culture and the Culture of the Masses: A Manifesto for User-Generated Rights*, 11 VAND. J. ENT. & TECH. L. 921 (2009).

⁴⁹ *Id.* at 945-948.

⁵⁰ *Id.* at 960.

⁵¹ *But see supra* notes 45, 46, 47, and 48.

work on creative industries that explores the intersections of patent, copyright, and trademark law,⁵² and the space between.

Scholars like Jonathan Barnett (2005),⁵³ Kal Raustiala & Christopher Sprigman (2006),⁵⁴ and Scott Hemphill & Jeannie Suk (2009)⁵⁵ have all done interesting work on information protection and production incentives in the fashion industry. Fashion design in the United States is covered only by trademark and trade dress protection, both of which are argued to be largely ineffective in preventing copying of information goods.⁵⁶ These studies examine the role and meaning of intellectual property protection in an industry with special characteristics, such as short product cycles and reliance on certain kinds of ‘copying’ to drive trends.

Barnett focuses on counterfeiting, demonstrating that (imperfect, but nevertheless) copies in the fashion industry are likely to increase rather than decrease innovators’ profits due to perceived status.⁵⁷ He argues that intellectual property theory and policy has failed to take into account potential relationships between goods in markets of trend- and status-based consumption.⁵⁸ Hemphill & Suk also recognize the impacting circumstance of product cycles in fashion, showing that while protection for close copies may be economically desirable, a certain amount of shared participation in similar designs is essential to innovation and production.⁵⁹ Finally, Raustiala & Sprigman argue extensively that the fashion industry operates in an equilibrium where copying drives

⁵² While few studies so far have dealt with purely low-trademark industries (*but see* Fagundes, *infra* note 81; *see also* Barnett, *infra* note 53, at 1393-1394 on trademark enforcement problems in fashion), trademarks often intersect with a lack of patent and/or copyright protection, to some extent replacing their function, *see, e.g.*, Hemphill & Suk, *infra* note 55; Dreyfuss (2010), *supra* note 5, at 1449-1450. *See also infra* Part III.

⁵³ Jonathan Barnett, *Shopping for Gucci on Canal Street: Reflections on Status Consumption, Intellectual Property, and the Incentive Thesis*, 91 VA. L. REV. 1381 (2005), p. 1381-1423.

⁵⁴ Kal Raustiala & Christopher Sprigman, *The Piracy Paradox: Innovation and Intellectual Property in Fashion Design*, 92 VA. L. REV. 1687 (2006).

⁵⁵ C. Scott Hemphill & Jeannie Suk, *The Law, Culture, and Economics of Fashion*, 61 STAN. L. REV. 1147 (2009), p. 1147-1200.

⁵⁶ *See* Barnett, *supra* note 53, at 1393-1394.

⁵⁷ Barnett, *supra* note 53, at 1419-1422.

⁵⁸ *Id.*

⁵⁹ Hemphill & Suk, *supra* note 55, at 1196.

innovation, rather than deterring it. They call this the “piracy paradox,”⁶⁰ and begin to explore whether this industry-specific insight could extend to other areas, raising more fundamental questions about exclusive rights for designs. Coining the term of intellectual property’s “negative space,”⁶¹ they propose that other design industries like furniture, tattoos,⁶² hairstyles, and perfume may function similarly.⁶³

Following the work on fashion and design, scholars have begun to extend this analysis to a number of creative industries for which formal copyright protection is not, or only limitedly, available. In the form of empirical studies, they research what characteristics drive information production in the absence of such protection, often finding that investment incentives are sustained through systems of social norms or strategic innovation.

Part of this literature delves into other design-based industries, such as food, body art, and typefaces. For example, Christopher Buccafusco (2007)⁶⁴ has posed the question whether chefs’ recipes should be protected by copyright,⁶⁵ concluding that they should be according to accurate interpretation of the letter of the law. He argues, however, that extending a copyright monopoly to recipes would not increase innovation. Formally protecting the work of chefs would limit the possibilities of experimenting with other chefs’ creations, a practice that his research shows to be socially acceptable and encouraged within the community, so long as certain norms are respected.⁶⁶ The chef community also makes use of social enforcement mechanisms that render intellectual property enforcement through the legal system unnecessary and costly.⁶⁷ Emmanuelle Fauchart & Eric von Hippel (2008)⁶⁸ confirm the existence of strong norms and social enforcement mechanisms within chefs’

⁶⁰ Raustiala & Sprigman (2006), *supra* note 54, at 1717.

⁶¹ *Id.* at 1762; *see also* Dreyfuss (2010), *supra* note 5, at 1445.

⁶² *See also* Perzanowski, *infra* note 71.

⁶³ Raustiala & Sprigman (2006), *supra* note 54, at 1769-1775.

⁶⁴ Christopher J. Buccafusco, *On the Legal Consequences of Sauces: Should Thomas Keller’s Recipes Be Per Se Copyrightable?* 24 CARDOZO ARTS & ENT. L.J. 1121 (2007).

⁶⁵ Which they currently are not, *see, e.g.*, U.S. Copyright Office, *Recipes*, available at <http://www.copyright.gov/fls/fl122.html>; *see also id.*, at 1124-1125.

⁶⁶ The most prominent of these norms is attribution.

⁶⁷ Buccafusco, *supra* note 64, at 1151-1155.

⁶⁸ Emmanuelle Fauchart & Eric A. von Hippel, *Norms-Based Intellectual Property Systems: The Case of French Chefs*, 19 ORG. SCI. 187 (2008).

communities in a more extensive empirical study (both qualitative and quantitative) of French chefs. They find that innovation in the creative food industry is protected and driven by three social norms: [1] no exact one-to-one copying of recipes (iterations are encouraged); [2] being respectful of “confidential” information when declared as such; and [3] that creators of significant works must be attributed.⁶⁹ The authors call this a “norms-based intellectual property system,” which they argue can and should be considered as a complement to, or substitute for, law-based systems.⁷⁰

Aaron Perzanowski (2013)⁷¹ has studied norms in the tattoo industry and their relationship to intellectual property, finding that tattoo artists do not make use of formal law. Rather, the industry governs appropriability, attribution, and infringement through a culture of social norms.⁷²

Jaqueline Litman (2009)⁷³ and Blake Fry (2009)⁷⁴ have both looked at norms and innovation in the typeface industry.⁷⁵ Litman examines industry norms on copying that have historically protected investments in typefaces, and argues that there could be a loss of such norms in the digital age with increased market size and more anonymous actors.⁷⁶ Fry’s research, on the other hand, indicates that the typeface industry can continue to proliferate online. He demonstrates that industry norms are

⁶⁹ *Id.*

⁷⁰ *Id.* at 196-199.

⁷¹ Aaron Perzanowski, *Tattoos & IP Norms*, 98 MINN. LAW REV. (forthcoming), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2145048.

⁷² Previously on complications within the relationship of body art to intellectual property: Thomas F. Cotter & Angela M. Mirabole, *Written on the Body: Intellectual Property Rights in Tattoos, Makeup, and Other Body Art*, 10 UCLA ENT. L. REV. 97 (2003), p. 97-138.

⁷³ Jaqueline D. Litman, *To © or Not to ©? Copyright and Innovation in the Digital Typeface Industry*, 43 UC DAVIS L. REV. 143 (2009), p. 143-192.

⁷⁴ Blake Fry, *Why Typefaces Proliferate Without Copyright Protection*, 8 J. TELECOMM. & HIGH TECH L. 425 (2010).

⁷⁵ Typefaces are generally not protected by copyright in the United States, see Terrence J. Carroll, Comment, *Protection for Typeface Designs: A Copyright Proposal*, 10 SANTA CLARA COMPUTER & HIGH TECH. L.J. 139 (1994), p. 141-142; see also *id.* at 11-13.

⁷⁶ See Litman, *supra* note 73, at 189-191.

but one part of the picture, and that technological factors and short, fashion-like production and trend cycles drive innovation, as well.⁷⁷

This literature extends beyond design-based industries, also covering creative areas like performance art. A seminal study by Dotan Oliar & Christopher Sprigman (2008)⁷⁸ follows stand-up comedy throughout the past decades, researching how stand-up comedians protect their investments in joke creation. Like in other studies of norm-based intellectual property systems, they find strong social enforcement mechanisms. They also find, however, that as norms and enforcement possibilities have changed over time, so has the type of investment that creators will engage in. Most interestingly, this effect need not be a negative one. The authors argue that, contrary to popular economic wisdom in intellectual property theory, the shift they observe in stand-up comedy (of investment in content versus investment in performance) cannot be easily evaluated in terms of what outcome is more socially desirable.⁷⁹

Norm enforcement is observable in other stage performance communities, as well. Jacob Loshin (2010)⁸⁰ studies the ways that magicians protect their magic tricks, which are ill-suited for formal intellectual property protection, from being appropriated. Community norms are also found in sports, for example in David Fagundes' (2012)⁸¹ work on how roller derby players protect their pseudonyms instead of relying on trademark law.

Music performance and music composition have sometimes also thrived when formal intellectual property protection has been inadequate, replaced, or opted out of. Scholars have studied the history of the blues,⁸²

⁷⁷ Fry, *supra* note 74.

⁷⁸ Dotan Oliar & Christopher Sprigman, *There's No Free Laugh (Anymore): The Emergence of Intellectual Property Norms and the Transformation of Stand-Up Comedy*, 94 VA. L. REV. 1787 (2008).

⁷⁹ *Id.* at 1857.

⁸⁰ Jacob Loshin, *Secrets Revealed: Protecting Magicians' Intellectual Property Without Law*, in: LAW AND MAGIC: A COLLECTION OF ESSAYS, 123, Christine A. Corcos ed., Carolina Academic Press (2010).

⁸¹ David Fagundes, *Talk Derby to Me: Intellectual Property Norms Governing Roller Derby Pseudonyms*, 90 TEXAS L. REV. 1093 (2012), p. 1093-1152.

⁸² See, e.g., Keith Aoki, *Distributive and Syncretic Motives in Intellectual Property Law (with Special Reference to Coercion, Agency, and Development)*, 40 U.C. DAVIS L. REV. 717 (2007), p. 759-761.

the law and culture of digital sampling and mixtapes,⁸³ and community norms around the work of jam bands,⁸⁴ finding social enforcement systems, norms that deviate from those imposed by law, and also alternative motivations that drive innovation despite the absence of formal protection.⁸⁵

5. Outlook and Summary

In their recent book, Kal Raustiala and Christopher Sprigman (2012)⁸⁶ summarize and elaborate on a large part of the above-described scholarship. They further suggest that plays in American football,⁸⁷ investment tools and strategies in the financial industry,⁸⁸ and computer databases⁸⁹ are other 'low-IP' fields with sustainable innovation. Others have also summarized the existing research, further establishing connections and legitimizing its collection.⁹⁰

Thus far, the 'low-IP' industry literature has looked at the relationship between intellectual property and creation in both commercial and non-commercial environments. Innovation is driven by a myriad of factors: sometimes it is sustained through social norms and indirect monetary incentives or intrinsic motivation, as shown for academia,⁹¹ software development,⁹² peer production, and user-innovation.⁹³ Sometimes it is sustained through social norms and strategic innovation, like in the

⁸³ See PETER DiCOLA & KEMBREW McLEOD, *CREATIVE LICENSE: THE LAW AND CULTURE OF DIGITAL SAMPLING*, Duke University Press (2011); Horace J. Anderson, Jr., "Criminal Minded": *Mixtape DJs, the Piracy Paradox, and Lessons for the Recording Industry*, 76 TENN. L. REV. 111 (2008) (on mixtape culture and copyright).

⁸⁴ Mark F. Schultz, *Fear and Norms and Rock & Roll: What Jambands Can Teach Us About Persuading People to Obey Copyright Law*, 21 BERKELEY TECH. L.J. 651 (2006).

⁸⁵ See, e.g., Aoki, *supra* note 82, at 759-761.

⁸⁶ KAL RAUSTIALA & CHRISTOPHER SPRIGMAN, *THE KNOCKOFF ECONOMY – HOW IMITATION SPARKS INNOVATION*, Oxford University Press (2012).

⁸⁷ See *id.* at 126-136.

⁸⁸ See *id.* at 155-161.

⁸⁹ See *id.* at 161-166.

⁹⁰ See Rosenblatt, *supra* note 7; Dreyfuss (2010), *supra* note 5.

⁹¹ See *supra* Part I.1.

⁹² See *supra* Part I.2.

⁹³ See *supra* Part I.3.

performance and close-knit design-based industries.⁹⁴ Sometimes special market characteristics create alternate production incentives, like in the fashion industry.⁹⁵ One of the recurring factors in many (if not quite all)⁹⁶ of these information markets is the existence of social norm mechanisms. For this reason, much of the ‘low-IP’ industry research has its foundation in a prior body of literature on law and social norms. This is explored in the following Part.

II. SITUATION WITHIN LAW AND NORMS LITERATURE

Many of the above-described studies on ‘low-IP’ industries discover social enforcement mechanisms that perform a function similar to formal intellectual property protection within a market. Oftentimes, these studies will be situated more broadly within the economics and legal literature on law and social norms.⁹⁷ This is a prior body of research on social enforcement mechanisms that deals with the phenomenon of “order without law”. It examines the sustainability of norm mechanisms that function independently of state law enforcement. The main stream of literature can be traced to seminal contributions around the beginning of the nineties⁹⁸ by Robert Ellickson (1986⁹⁹ and 1991),¹⁰⁰ Avner Greif

⁹⁴ See *supra* Part I.4.

⁹⁵ See *supra* Part I.4.

⁹⁶ The fashion industry, for example, seems to rely more on specific market characteristics than social enforcement mechanisms or community norms, see *supra* Part I.4.

⁹⁷ See, e.g., Rai, *supra* note 12, at 81-115 (fittingly applying insights from “order without law” literature to the academic community, which traditionally comprises a strong, informal system of norms and motivations); see, e.g., also Fauchart & von Hippel, *supra* note 68, at 188-191; Fagundes, *supra* note 81, at 1131-1134; Aoki, *supra* note 82, at 768; Perzanowski, *supra* note 71, at 56-61; see also Rosenblatt, *supra* note 7, at 322-323, 338-340.

⁹⁸ Although there is some prior research that arguably fits within this collection, see, e.g., Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55 (1963) (on how businessmen frequently disregard contract law in their transactions and relationships).

⁹⁹ Robert C. Ellickson, *Of Coase and Cattle: Dispute Resolution Among Neighbors in Shasta County*, 38 STAN. L. REV. 623 (1986).

(1993¹⁰¹ and 1997),¹⁰² and Paul Milgrom et al. (1990).¹⁰³ Ellickson, for example, looks at how neighboring ranchers in rural areas disregard the legal system and govern disputes around property boundaries and fencing costs through their own implicit norms.¹⁰⁴ Elinor Ostrom (1990)¹⁰⁵ has done extensive work on community-enforced norm systems that allow for sharing of resources in commons.¹⁰⁶

This research has since been extended to numerous further industries and markets that do not (or cannot) rely on state legal enforcement and instead have developed systems of self-regulation.¹⁰⁷ Lisa Bernstein (1992,¹⁰⁸ 1996,¹⁰⁹ and 2000),¹¹⁰ for example, has done work on the use of informal rules and norms in the diamond industry, in merchant law, and

¹⁰⁰ ROBERT C. ELICKSON, *ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES*, Harvard University Press (1991).

¹⁰¹ Avner Greif, *Contract Enforceability and Economic Institutions in Early Trade: The Maghribi Traders' Coalition*, 83 AM. ECON. REV. 525 (1993) (examining how trader coalitions used social structures and norms, e.g. reputation mechanisms, to overcome commitment problems in their trading relationships); see also Avner Greif, Paul R. Milgrom, and Barry R. Weingast, *Coordination, Commitment, and Enforcement: The Case of the Merchant Guild*, 102 J. POLIT. ECON. 745 (1992).

¹⁰² Avner Greif, *Contracting, Enforcement, and Efficiency: Economics Beyond the Law*, in: PROCEEDINGS OF THE WORLD BANK ANNUAL CONFERENCE ON DEVELOPMENT ECONOMICS, Michael Bruno & Boris Pleskovic, eds., The World Bank (1997), p. 239-266.

¹⁰³ Paul R. Milgrom, Douglas C. North, and Barry R. Weingast, *The Role of Institutions in the Revival of Trade: The Law Merchant, Private Judges, and the Champagne Fairs*, 2 ECON. & POL. 1 (1990).

¹⁰⁴ See Ellickson (1986), *supra* note 99; ELICKSON (1991), *supra* note 100.

¹⁰⁵ ELINOR OSTROM, *GOVERNING THE COMMONS: THE EVOLUTION OF INSTITUTIONS FOR COLLECTIVE ACTION*, Cambridge University Press (1990).

¹⁰⁶ For example on how commons around fisheries, forests, and oil fields prevent the overuse and collapse of their ecosystems, see *id.*

¹⁰⁷ For a brief overview of literature, see also John McMillan, & Christopher Woodruff, *Private Order Under Dysfunctional Public Order*, 98 MICH. LAW REV. 2421 (2000), p. 2443-2444; see also Symposium, *Social Norms, Social Meaning, and the Economic Analysis of Law*, 27 J. LEGAL STUD. 537 (1998); Symposium, *Law, Economics, and Norms*, 144 U. PA. L. REV. 1643 (1996).

¹⁰⁸ Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115 (1992).

¹⁰⁹ Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Codes Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765 (1996).

¹¹⁰ Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions*, 99 MICH. L. REV. 1724 (2000).

the cotton industry, indicating that self-enforcement systems outside of formal law are a common occurrence.¹¹¹

The most relevant insight that this literature offers is that formal law is not the only way to structure behavior in a market, and that it can be displaced by other incentive mechanisms. Sometimes, norms can function as a substitute for law.¹¹² Applied to the 'low-IP' literature, this is seen, for example, in the way that chefs, stand-up comedians, and magicians use social mechanisms to maintain norms of copying and attribution in a community that lacks standard intellectual property protection for its creative work.¹¹³ This is similar to Ostrom's commons problem:¹¹⁴ because formal law is not available to combat the market failure inherent to information good production, social norms emerge to fulfill this function. Generally, these norms are comparable to formal intellectual property law, were it to cover the respective creations.¹¹⁵ But interestingly, either because norms are not sufficiently equipped to enforce financial transactions or because they are better tailored towards actual creator preferences, scholars have observed a comparatively strong emphasis on creator attribution in many of these communities (rather than exclusivity or financial compensation).¹¹⁶ Iterations on works by others are also treated with more lenience.¹¹⁷

In other cases, the relationship between law and norms is more complex: they can work together, or also diverge and undermine each other.¹¹⁸ Ellickson, for example, discovers relevant differences between formal property laws and community-enforced norms, raising doubts as to whether formal law enforcement would be efficient as a supplement or even a substitute.¹¹⁹ With regard to 'low-IP' industries, in some cases

¹¹¹ See also J. Mark Ramseyer, *Product Liability Through Private Ordering: Notes on a Japanese Experiment*, 144 U. PA. L. REV. 1823 (1996).

¹¹² See, e.g., Ellickson (1986), *supra* note 99.

¹¹³ See *supra* Part I.4.

¹¹⁴ See OSTROM, *supra* note 105.

¹¹⁵ Deterring unauthorized copying, punishing those who do not adhere.

¹¹⁶ See Rosenblatt, *supra* note 7, at 359-360.

¹¹⁷ See *id.* at 360-361.

¹¹⁸ See Eric A. Posner, *Symbols, Signals, and Social Norms in Politics and the Law*, 27, J. LEGAL STUD. 765 (1998), p. 778-789; Rai, *supra* note 12, at 83-84; see also, e.g., Ben Depoorter, Sven Vanneste, and Alain Van Hiel, *Copyright Backlash*, 84 SOUTHERN CALIF. LAW R. 1251 (2011).

¹¹⁹ See ELLICKSON (1991), *supra* note 100, at 167.

where markets are governed by norms it is not clear whether the effect of introducing formal intellectual property protection would be desirable. First of all, to the extent that law and norms are complementary, formal law may add stability,¹²⁰ but it would also add different costs of enforcement, as well as the costs associated with exclusive rights that go beyond existing norms.¹²¹ Secondly, in systems where social rules encourage information sharing, formal intellectual property may not be complementary and could work against existing norms. For example, Rai argues that the displacement of university research norms through the introduction of formal patent law is detrimental.¹²² Gault and von Hippel demonstrate that user-driven innovation is often freely transferred, leading to an increase in social welfare compared to exclusive intellectual property rights. They argue that in such cases, the law restricts rather than encourages innovation.¹²³ Schultz shows how norms amongst music fans diverge from formal law, and recommends that copyright law be amended rather than enforced to increase compliance.¹²⁴ Much of fan-fiction and social media content creation would not be possible in its current forms if participants adhered to copyright law rather than existing community norms.¹²⁵

From this perspective, many of the studies described in this literature review on innovation policy and the relationship between law and incentives fit nicely within the law and norms framework, in that they deal with some similar questions. The law and norms literature also offers some prior thought on common mechanisms that drive these alternative systems and contribute to their sustainability. Identifying industry-specific factors and recognizing overarching themes is essential to improving our understanding of innovation policy. For example, as mentioned above, one norm that is found to be pervasive in many socially enforced, “norm-based” intellectual property systems is that of

¹²⁰ For criticism of norm stability, see *infra* Part III.

¹²¹ See SCOTCHMER, *supra* note 4, at 34-39; see also, e.g., Gault & von Hippel, *supra* note 38, at 22; RAUSTIALA & SPRIGMAN (2012), *supra* note 86, at 168-169.

¹²² At least without tailoring them towards the existing norms, see Rai, *supra* note 12, at 137-144.

¹²³ See Gault & von Hippel, *supra* note 38, at 21-24.

¹²⁴ See Schultz, *supra* note 84; see also Depoorter et al., *supra* note 118.

¹²⁵ See Tushnet, *supra* note 46; see Halbert *supra* note 48, at 960.

attribution.¹²⁶ To the extent that this is a reflection of creator preferences, it is plausible that in some environments innovation could be better driven through a strong focus on attribution rights rather than on protection of exclusivity.

As explored above, the existence and importance of social norms varies in the studies on 'low IP' industries.¹²⁷ A variety of factors are found to play a role for innovation in these markets alongside, and occasionally without, social norms. Creation is often not solely driven by the circumstance that formal intellectual property protection is replaced by norms that allow for appropriation. Intrinsic motivation, extrinsic non-monetary or indirectly monetary interests, and special market characteristics also provide incentives for market participants. Given the frequent importance of social mechanisms in these studies, however, the law and norms literature undoubtedly constitutes part of the foundation for this body of research. It has also inspired some of the criticism and concerns around 'low-IP' industry studies, which are explored in the following Part.

III. CRITICISM

The literature on 'low-IP' industries has faced some criticism regarding its relevance for innovation policy.

One concern wonders whether some of the studied markets may actually have more reliance on formal intellectual property than initially meets the eye. The respective markets for open-source software, recipes, fashion, and many others, may rely not directly but indirectly on

¹²⁶ See, e.g., Buccafusco, *supra* note 64; Fauchart & von Hippel, *supra* note 68; Oliar & Sprigman, *supra* note 78; and others; see also Catherine L. Fisk, *Credit Where It's Due: The Law and Norms of Attribution*, 95 GEO. L.J. 49 (2006) (on the importance of attribution in academia, etc.); see also Rosenblatt, *supra* note 7, at 359-360.

¹²⁷ See *supra* Part I.

proprietary protection (for example, in the form of trademark protection, or though the sale of *copyrighted* cookbooks, etc.).¹²⁸

Another quite substantial point of criticism concerns the generalizability, as well as the efficiency, stability, and sustainability of informal incentives and norm enforcement systems.¹²⁹ There is question as to whether the industry-specific characteristics that many studies on 'low-IP' industries highlight might remain strictly industry-specific, rather than translating to anything more general that would be helpful for overarching innovation policy. For example, Rochelle Dreyfuss worries that studying the fashion industry may provide little useful insight beyond establishing that this market functions largely thanks to its short product cycles and consumer trends.¹³⁰ She argues that this says nothing about other creative or innovative industries, which do not operate under the same circumstances. Similarly, David Opderbeck worries that commons-based peer production is difficult to apply to other fields, finding that an open-source-software-development-type model is unlikely to work in biotechnology.¹³¹

Norms and communities sometimes face organizational difficulties.¹³² Furthermore, they are fragile and susceptible to change. Technological advances and industry maturity may pose challenges to previously stable norm systems. New technologies that facilitate copying,¹³³ or increase the market size or the number and anonymity of participants can disrupt a low-IP equilibrium that relies on social enforcement. Finally, as Dreyfuss points out, "any system that depends on norms is vulnerable to their breakdown."¹³⁴

¹²⁸ See Dreyfuss (2010), *supra* note 5, at 1449-1450; see also Ronald J. Mann, *Commercializing Open Source Software: Do Property Rights Still Matter?* 20 HARV. J. L. TECH. 1 (2006), p. 11-13 (on the success of combinations of open-source and proprietary software systems).

¹²⁹ See Rochelle C. Dreyfuss, *Fragile Equilibria*, VA. L. REV. IN BRIEF (2007), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=964242; see also Dreyfuss (2010), *supra* note 5, at 1452-1460.

¹³⁰ Dreyfuss (2010), *supra* note 5, at 1452.

¹³¹ See David W. Opderbeck, *The Penguin's Genome, or Coase and Open Source Biotechnology*, 18 HARV. J.L. TECH. 167 (2004), p. 182-184.

¹³² See Dreyfuss (2010), *supra* note 5, at 1453-1455.

¹³³ For example with digitization making designs like typefaces or fashion easier to replicate.

¹³⁴ Dreyfuss (2010), *supra* note 5, at 1458-1460.

This is legitimate criticism. As Arti Rai demonstrates, however, one helpful contribution that norm systems studies can make is to determine where it could make sense to stabilize and formalize such norm systems (for example through state enforcement)¹³⁵ rather than focusing on enforcing the laws in place. When norm systems deviate from what is intended by the law, it is sometimes because actor incentives or preferences deviate from what is assumed by classic intellectual property theory. Changing the focus of intervention to take these newly found insights into account can help restructure and optimize innovation policy. Few scholars argue that the existence of alternative innovation systems means that formal intellectual property or other state-enforced innovation policy systems should simply be abolished.¹³⁶ Rather, this research can indicate shortcomings or draw attention to previously unconsidered factors, which may allow existing systems to be improved or better ones constructed.

Returning to the general body of ‘low-IP’ industry research, it appears that community norm enforcement systems are but one of the mechanisms that sustain functioning markets for innovation without intellectual property protection.¹³⁷ As discussed above, “norm-based IP systems” will often function as a replacement for formal intellectual property, serving a similar function.¹³⁸ However, other discovered mechanisms for driving creation include alternative incentives¹³⁹ and strategic innovation.¹⁴⁰

The following paper in this doctoral thesis intends to make a contribution to the ‘low-IP’ industry literature that addresses some of the above-described concerns.¹⁴¹ This paper is a study of content production incentives in the online adult entertainment industry. Because copyright

¹³⁵ See Rai, *supra* note 12, at 152.

¹³⁶ But see MICHELE BOLDRIN & DAVID LEVINE, *AGAINST INTELLECTUAL MONOPOLY*, Cambridge University Press (2008), p. 40-42.

¹³⁷ See *supra* Part II.

¹³⁸ See, e.g., Fauchart & von Hippel, *supra* note 68, at 191.

¹³⁹ For example, in the cases of open-source software, user-generated innovation, etc. See *supra* Parts I.2 and I.3.

¹⁴⁰ For example, in the cases of stand-up comedy (which relies not only on a system social norms, but also experiences changes in content driven by differences in the ‘IP-like’ regimes), fashion, recipes, tattoos, etc. See *supra* Part I.4; see also *infra* Chapter D of this thesis.

¹⁴¹ See *infra* Chapter D of this thesis.

protection has been considerably weakened in their current online environment, content producers have effectively not been able to rely on the economic incentives that copyright intends to provide. An interview study with industry specialists and producers confirms that copyright enforcement is ineffective. As a result, many producers have developed alternative, cost-recouping strategies. These findings include strategic innovation toward experience-based goods as well as methods of continuing traditional content production. The analysis of this market distances itself from the criticism regarding norm-based intellectual property enforcement. The online adult entertainment industry is a highly competitive market that does not rely on fragile norms or a close-knit community to replace the function of intellectual property. Instead, the findings indicate that production is mostly sustained through strategic innovation and other factors.¹⁴² Although this partly relies on industry-specific characteristics, this project nevertheless addresses part of the above-described concerns regarding ‘low-IP’ industry research.¹⁴³ It also supports the notion, however, that low copyright systems may sometimes rely on other forms of intellectual property protection, in this case trademark law, to assist their sustainability.¹⁴⁴ Such insights may be helpful for future policy debate. The general relevance of low-IP industry research is described in the following Part.

IV. RELEVANCE TO POLICY DEBATE

Copyright law is commonly based on the utilitarian theory of incentivizing artistic production.¹⁴⁵ Because this choice of incentive

¹⁴² See *infra* Chapter D of this thesis.

¹⁴³ While displaying a few potentially specific characteristics, the online adult entertainment industry is arguably closer to the entertainment industries at the heart of current copyright policy debates (film, music) than previous industry studies in this body of literature. Some of the gathered insights may therefore be more generalizable.

¹⁴⁴ See *infra* Chapter D of this thesis; see Dreyfuss (2010), *supra* note 5, at 1448-1452 (on the oftentimes functional dependence of “open systems” on formal intellectual property protection).

¹⁴⁵ See PAUL GOLDSTEIN, GOLDSTEIN ON COPYRIGHT, 3rd edition, Aspen Publishers (2010), §1.14 (“Economic Foundations of Copyright”); MELVILLE NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT, rev. ed., Matthew Bender (2009), Vol. 1, §1.03[A], p. 17-18. The U.S. Constitution enables copyright laws that grant “Authors [...] the exclusive Right to

method comes with costs, it is helpful to have the most accurate possible information regarding the balance and relationship between exclusive right systems and innovation in practice. Striving towards a better understanding of the way that intellectual property laws interact with innovation in individual industries may prove useful and important. This growing area of study could ultimately help refine innovation policy and develop better solutions for supporting and protecting the investments of creators, as well as ensuring that market demand for creative works can be met in the best possible way.

While some of the insights remain industry-specific, determining and collecting the factors that sustain individual innovative markets in the absence of intellectual property may in time lead to more general knowledge of the conditions under which intellectual property is efficient or inefficient as a driver of innovation. This would allow a more optimal structuring of the laws that aim to encourage artistic creation and technological progress. Some have tentatively begun to collect commonalities within — and make policy recommendations on the basis of — the above-described industry studies,¹⁴⁶ but there is further work to be done. The bottom-up approach necessitates a more substantial body of studies in order to establish systematic common factors.

The findings of existing studies on ‘low-IP’ markets display a few common threads. One general insight from the literature is that individual industries differ very widely in what role intellectual property plays in terms of incentivizing innovation. Not all creative or innovative industries rely on intellectual property protection. Some rely on informal norm enforcement mechanisms; others rely on alternative incentives, strategic innovation, special characteristics like trend cycles, or other factors that drive creation outside of intellectual property.¹⁴⁷ These mechanisms are all shown to help prevent the ‘market failure’ inherent to information good production — the traditional economic justification for intellectual property.

their [...] Writings" in order "to promote the progress of Science", U.S. CONST. art. I, § 8, cl. 8. *But see also* Dan L. Burk, *Law and Economics of Intellectual Property: In Search of First Principles*, 8 ANNU REV. L. SOC. SCI. 397 (2012), p. 397-414.

¹⁴⁶ See Dreyfuss (2010), *supra* note 5; Rosenblatt, *supra* note 7.

¹⁴⁷ See Rosenblatt, *supra* note 7, at 321, 337-340.

Another common finding is that creators and innovators across a variety of fields are frequently motivated by factors independent of intellectual property protection.¹⁴⁸ While this is a fairly intuitive insight for non-economists, it deserves to be highlighted wherever it is discovered, because it challenges the current trade-off inherent to intellectual property theory and policy. Enforcing exclusive rights in domains where alternative incentives exist may impose more costs than necessary to achieve a desirable outcome. In fact, many of the above-described studies demonstrate empirically that overprotection can have negative effects on information production.¹⁴⁹

In summary, this paper has provided a systematic overview of the growing body of research on 'low-IP' industries, situating it within the existing literature on law and social norms. The next paper in this doctoral thesis will follow with its own contribution to the literature on 'low-IP' industries.

¹⁴⁸ For example recognition, community, indirect monetary incentives like career concerns, etc., *see id.* at 336, *see also, e.g.*, Benkler (2002), *supra* note 24, at 426-436. Also, where the function of intellectual property is replaced by norm systems, there is often a stronger emphasis on attribution than on compensation. If this is a more general value, it raises questions as to the optimal structure of intellectual property law, which currently deals more closely with exclusivity (for primarily financial reasons) than attribution rights.

¹⁴⁹ *See, e.g.*, Rai, *supra* note 12; Murray et al. (2009), *supra* note 14; Rosenblatt, *supra* note 7, at 361-363.

WHAT DRIVES IP WITHOUT IP?*

A STUDY OF THE ONLINE ADULT ENTERTAINMENT INDUSTRY**

Existing copyright policy is based largely on the utilitarian theory of incentivizing creative works. This study looks at content production incentives in the online adult entertainment industry. A recent trend of industry-specific studies tries to better understand the relationship between intellectual property (IP) and creation incentives in practice. This study makes a contribution to the literature by analyzing a major entertainment content industry where copyright protection has been considerably weakened in recent years. Because copyright infringement is widespread and prohibitively difficult to prevent, producers have been effectively unable to rely on the economic benefits that copyright is intended to provide.

Qualitative interviews with industry specialists and content producers support the hypothesis that copyright enforcement is not cost effective. As a result, many producers have developed alternative strategies to recoup their investment costs. Similar to the findings of other scholarly work on low-IP industries, this research finds a shift toward the production of experience goods. It also finds that some incentives to produce traditional content remain. The sustainability of providing convenience and experience goods while continuing content production relies partially on general, but also on industry-specific factors, such as consumer privacy preferences, consumption habits, low production costs, and high demand. While not all of these attributes translate to other industries, determining such factors and their limits brings us toward a better understanding of innovation mechanisms.

· Internet Pornography without Intellectual Property (conventionally: Intellectual Production without Intellectual Property).

** A revised version of this paper is forthcoming in 17 STAN. TECH. L. REV. (2014).

D. What Drives IP Without IP? A Study of the Online Adult Entertainment Industry

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INTRODUCTION

“The Internet is for porn.”

- U.S. House Congressional Hearing on the Stop Online Piracy Act¹

The magnitude and prevalence of adult entertainment as a business is undeniable. For decades, even centuries, the industry has flourished despite considerable social and legal obstacles. It has often been on the forefront of new media adoption,² from paperback books³ to photography,⁴ cable television,⁵ and home cinema formats.⁶ Adult entertainment companies have pioneered innovations like secure online payment systems and high-definition streaming video.⁷ Market demand for adult entertainment products is asserted to be the main driver behind

¹ Markup of H.R. 3261: *Stop Online Piracy Act*: Hearing before the U.S. House of Representatives, Committee on the Judiciary, 112th Cong., 1st sess. Washington D.C. (December 15, 2011), p. 312, available at <http://judiciary.house.gov/hearings/pdf/transcript12152011.pdf>, quoting Robert Lopez & Jeff Marx (Comps.), *The Internet Is for Porn*, Avenue Q The Musical, RCA Victor Broadway (2003).

² See Benjamin Edelman, *Red Light States: Who Buys Online Adult Entertainment?* 23 J. ECON. PERSP. 209 (2009), p. 210.

³ See Peter Johnson, *Pornography Drives Technology: Why Not To Censor The Internet*, 49 FED. COMM. L.J. 217 (1996), p. 220-221.

⁴ See Piet Bakker & Saara Taalas, *The Irresistible Rise of Porn: The Untold Story of a Global Industry*, 1 OBSERVATORIO 99 (2007), p. 103.

⁵ See Johnson, *supra* note 3, at 221-222.

⁶ See David Slayden, *Debbie Does Dallas Again and Again: Pornography, Technology, and Market Innovation*, in: PORN.COM: MAKING SENSE OF ONLINE PORNOGRAPHY 54, Feona Attwood ed., Peter Lang (2010), p. 57; Lucas Mearian, *Porn Industry May Decide Battle between Blu-Ray, HD-DVD*, COMPUTERWORLD (May 2006), available at http://www.computerworld.com/s/article/111087/Porn_industry_may_decide_battle_between_Blu_ray_HD_DVD_.

⁷ See Kayte Van Scoy, *Sex Sells, So Learn a Thing or Two From It*, 13 PC COMPUTING 1 (January 2000), p. 64.

the success or failure of new technologies.⁸ At the same time, technology has helped proliferate adult content.⁹ When the World Wide Web launched in the 1990s, there were about ninety adult magazine publications in the United States.¹⁰ By 1997 there were an estimated nine hundred adult websites on the Internet.¹¹ Today, there are millions.¹² The largest of these dwarf comparable mainstream media websites, hosting over 100 terabytes of content and clocking over 100 million page views per day.¹³ Although no reliable data exist on the exact value of the online market,¹⁴ it is not far-fetched to claim that the online adult entertainment industry carries considerable economic weight.

⁸ PATCHEN BARSS, *THE EROTIC ENGINE: HOW PORNOGRAPHY HAS POWERED MASS COMMUNICATION, FROM GUTENBERG TO GOOGLE*, Random House Digital, Inc. (2011); JOHANNES GRENZFURTHNER, GUNTHER FRIESINGER & DANIEL FABRY (eds.), *PRONNOVATION: PORNOGRAPHY AND TECHNOLOGICAL INNOVATION*, ReSearch Publications (2008); Johnson, *supra* note 3, at 217-226.

⁹ See Catherine MacKinnon, *Vindication and Resistance: A Response to the Carnegie Mellon Study of Pornography in Cyberspace*, 83 GEO L.J. 1959 (1995), p. 1959.

¹⁰ See OGI OGAS & SAI GADDAM, *A BILLION WICKED THOUGHTS: WHAT THE WORLD'S LARGEST EXPERIMENT REVEALS ABOUT HUMAN DESIRE*, Penguin (2011), p. 6.

¹¹ See *id.* at 6-7.

¹² According to the commonly cited Internet Pornography Statistics from Top Ten Reviews (see Jerry Ropelato, *Internet Pornography Statistics*, TOP TEN REVIEWS (2006), available at <http://internet-filter-review.toptenreviews.com/internet-pornography-statistics.html>), the number of adult websites in 2006 was 4.2 million. Unfortunately, while this number is difficult to trace, some of their other, traceable numbers turn out to be a circle of sources all citing each other, with no discernable original source of credibility. OGAS & GADDAM, *supra* note 10, at 7, posit that in 2011, filtering programs were blocking around 2.5 million adult-rated sites. Regardless of exact numbers, "millions" is a fairly well-educated guess.

¹³ Xvideos, one of the largest adult websites, is credited 4.4 billion page views per month and is three times larger than CNN or ESPN. The most popular adult video streaming sites are many times larger than Hulu. See Sebastian Anthony, *Just How Big Are Porn Sites?* EXTREMETECH (April 4, 2012), available at <http://www.extremetech.com/computing/123929-just-how-big-are-porn-sites>.

¹⁴ While the United States online adult entertainment industry is generally estimated to be worth billions of dollars, exact numbers are difficult to determine, as most companies are privately held. Furthermore, adult content is difficult to define and many firms engage in a variety of activities that may not fall under the definition of pornography. Estimates from the past decade range from four to ten billion in the United States (for an overview see Sam Spencer, *How Big Is The Pornography Industry in The United States?* COVENANT EYES: BREAKING FREE BLOG (June 1, 2012), available at <http://www.covenanteyes.com/2012/06/01/how-big-is-the-pornography-industry-in-the-united-states/>). The most recent data from a poll conducted by one of the industry's main news sources estimates industry revenues exceeding 5 billion dollars, see Dan Miller, *Porn*

The Internet has created a new world of business for adult entertainment. For the traditional model of producing and selling content, however, it has proven to be a double-edged sword. On the one hand, increased privacy and convenience for consumers have arguably given adult content distributors even greater opportunities to capitalize than their mainstream counterparts in film and music. On the other hand, an Internet-architecture specifically designed for copying and sharing digital files has ushered in an era of unprecedented content piracy. From individual unauthorized use, to file-sharing systems, to content aggregation websites, copyright infringement has become increasingly widespread and difficult to prevent. Content ownership, while protected in theory through the legal system, can often no longer be enforced in a cost-effective way.¹⁵

For any industry that deals in easily replicated goods, the problem is evident and reflected in the economic theory behind copyright law. Copyright enables content producers to recoup production costs by letting them sell their product exclusively. Economics tells us that without this mechanism, there will be a lack of incentive to produce content, resulting in market failure.¹⁶ What this theory implies for adult entertainment production is supported by recent reports in the news media, which tell the stories of struggling companies and forecast the death of the industry.¹⁷ Undoubtedly, these anecdotes are true and some adult content

Revenues Exceed \$5 Billion According to Industry Survey, XBIZ NEWSWIRE (July 2012), available at <http://newswire.xbiz.com/view.php?id=151751>.

¹⁵ See *infra* Part III.3.

¹⁶ See for example PAUL GOLDSTEIN, *GOLDSTEIN ON COPYRIGHT*, 3rd edition, Aspen Publishers (2010), §1.14 (“Economic Foundations of Copyright”); MELVILLE NIMMER & DAVID NIMMER, *NIMMER ON COPYRIGHT*, rev. ed., Matthew Bender (2009), Vol. 1, §1.03[A], p. 17-18.

¹⁷ See for example Louis Theroux, *How The Internet Killed Porn*, THE GUARDIAN (June 6, 2012), Guardian Features Pages; Ben Fritz, *Tough Times in the Porn Industry*, LOS ANGELES TIMES (August 10, 2009), LA Times Local Section; Chris Morris, *Is The Porn Industry Imperiled?* CNBC (January 2012) available at http://www.cnbc.com/id/45989346/Is_the_Porn_Industry_Imperiled; Michael Stabile, *End of the Porn Golden Age*, SALON (March 3, 2012), available at http://www.salon.com/2012/03/03/life_after_the_golden_age_of_porn/; David Futrelle, *Sex on the Internet: Sizing Up the Online Smut Economy*, TIME MAGAZINE (April 2012), Time Business & Money, United States edition; Joe Garofoli, *Economic Woes Hit Porn Industry*, THE SAN FRANCISCO CHRONICLE (March 2, 2009), online version, available at <http://www.sfgate.com/>

producers have taken a substantial financial hit due to the difficulties of online copyright enforcement, but is the industry really dying? To this day, content production persists, and a number of companies remain in business.

If there is no effective copyright protection for the traditional content of the industry, why is it still being produced? How can adult entertainment businesses continue to survive in the face of these difficulties? What drives production, and how is it financed? And finally, can we learn anything for general IP theory and innovation policy? These are questions that fit into a broader stream of literature. A growing body of scholarly work on information production without intellectual property (“IP without IP”) analyzes the relationship between exclusive rights and innovation in practice, trying to better understand the mechanisms that influence production.¹⁸ While it recognizes that markets for information goods may suffer economically under the absence or removal of IP, some insights about the ways that information is produced challenge the basic theory underlying our laws and innovation policies.

This study addresses two questions.¹⁹ First, it investigates the hypothesis that copyright enforcement in the online adult entertainment industry is prohibitively difficult. Second, it explores whether and how adult content producers are recouping their investments, as well as to what extent the contributing factors are industry-specific. Based on qualitative interviews with content producers and industry specialists, it concludes that copyright enforcement, while still engaged,²⁰ is generally not an effective method of recouping costs. It also concludes that there has been a shift in the industry towards new types of goods and services.

entertainment/article/Economic-woes-hit-porn-industry-3170051.php; The Economist, *The Trouble With Pornography: Hard Times*, THE ECONOMIST (September 12, 2009), United States print edition.

¹⁸ See Rochelle Dreyfuss, *Does IP Need IP? Accommodating Intellectual Production Outside the Intellectual Property Paradigm*, 31 CARDOZO L. REV. 1437 (2010), p. 1437–1473; see also *infra* Part I.

¹⁹ This Article recognizes, but does not engage in, the discussion of social issues surrounding adult content. While this discussion is undoubtedly important, it is orthogonal to the research objective of this project, which is to better understand the market mechanisms of the United States adult entertainment production industry.

²⁰ Either in specific areas where it is still effective or as part of a more complex strategy, see *infra* Part III.3.

Rather than focusing only on selling content,²¹ the industry is increasingly moving into convenience and experience goods, which are inherently difficult to pirate.²² The production of traditional content continues, both as a basis for services and experiences, as well as for marketing purposes.²³

By trying to better understand the struggles and survival methods of this innovative market for entertainment goods, this study attempts to make a significant contribution to the literature on low-IP industries. The unique characteristics²⁴ and the historical flexibility of the adult entertainment industry make it an interesting market to study in general, but in this context also its similarities to the entertainment industries at the heart of our copyright law debates. Given that our current innovation policies are based on abstract theory,²⁵ looking at this unique, yet parallel industry may provide some valuable insights for the discussion.

Part I briefly refers to the underlying body of literature and the concept of low-IP industry research that is described in the preceding paper of this doctoral thesis. Part II outlines the research methodology. Part III looks at copyright in the online adult entertainment industry, including the copyrightability of adult content, the history and various types of online

²¹ This is, to a certain extent, still a successful business model in certain areas and for specific reasons, such as niche markets that cater to very specific consumer preferences (*see infra* Part IV.1).

²² Such as live camera, and more, *see infra* Part IV.

²³ This study does not suggest, however, that adult entertainment production functions at an economically optimal level without copyright protection. While some scholars have argued that removing copyright from the industry has no negative effect, *see* MICHELE BOLDRIN & DAVID LEVINE, *AGAINST INTELLECTUAL MONOPOLY*, Cambridge University Press (2008), p. 40-42, this study does not support the argument that economic market failure is absent simply because an industry can survive through alternate strategies. Both the quantity and quality of information goods may be unable to meet economic demand without intervention. For more on this, *see infra* Part V.

²⁴ Such as high consumer privacy preferences, comparatively low production costs, short product cycles, fast adaptability, and comparatively high demand. There is also indication that demand is more inelastic than in comparable mainstream entertainment industries.

²⁵ The theory of hypothetical market failure, *see* William M. Landes & Richard A. Posner, *An Economic Analysis of Copyright Law*, 18 J. LEGAL STUD. 325 (1989), p. 326. Furthermore, our system of copyrights was designed in a time prior to digital files and the architecture of the Internet.

infringement, and the difficulties involved in copyright enforcement. It concludes that the industry faces considerable barriers to enforcing exclusive content ownership. Part IV explores the qualitative data in more detail, detecting a shift in the industry toward convenience and experience goods, and describing current changes in market structure and what they imply for traditional content production; Part V looks at general implications for innovation policy.

I. CONTRIBUTION TO LOW-IP INDUSTRIES

The preceding paper in this doctoral thesis explores literature on low-IP industries.²⁶ As seen above, prior work in this field looks at markets for replicable goods that do not rely on formal IP protection. Many of these studies find that information goods are produced despite the absence of formal IP protection.

This study aims to extend this body of literature. Given the difficulties in enforcing copyrights, the adult industry has effectively been operating without, or at least with low reliance on copyright protection. The conventional theory behind copyright law predicts that content production is not sustainable in this environment. In tune with this prognosis, recent reports in the media have repeatedly predicted the death of the adult industry, supported by the fact that many content producers have found themselves in considerable financial difficulty and previously stable businesses have failed.²⁷ That the industry cannot continue with business models based entirely on the protection of copyrights seems fairly obvious. Also, even if it can somehow survive this exogenous shock, this is not likely to happen without structural changes. The stories of struggling entities are undoubtedly very real: many have disappeared, and most that remain have seen their business severely impacted by copyright infringement, not to mention the crash of the economy in 2008.²⁸ However, some insights gathered from prior studies

²⁶ See *supra* Chapter C of this thesis.

²⁷ See *supra* note 17.

²⁸ See Stabile, *supra* note 17.

on low-IP markets,²⁹ as well as some characteristics of this particular industry indicate that adult content production may be able to survive in some form, despite the difficulties involved in formal copyright protection.

Studying the adult entertainment industry is a particularly important extension to the previous studies of low-IP markets. While the insights gathered from markets with norm systems have been greatly valuable, the main criticism that prior work in this area faces is that it is focused on close-knit communities that are not comparable to larger industries. This is the first contribution to the low-IP literature that analyzes a billion dollar market for entertainment goods³⁰ with strong parallels to the industries at the center of the copyright debate.

II. RESEARCH METHODOLOGY

1. *Aims and Objectives*

The aim of this study is to explore how the adult entertainment industry in the United States has been affected by online copyright infringement and how it has dealt with enforcement difficulties. Specifically, it looks at producer reliance on copyright protection as a business model and alternative methods that content producers are using to recoup costs.³¹ The first hypothesis is that producers are unable to rely on the copyright system in the way that it is intended to function, that is, as an effective method of recouping production and investment costs through exclusive rights to their content. Following from the conclusions, the second hypothesis is that content production can be sustained,

²⁹ Previous literature on low-IP industries has shown shifts within markets, indicating that changes in IP-regimes can sometimes affect type of production rather than quantity, *see infra* Parts IV.2 and V.

³⁰ *See supra* note 14. For more on the lack of research on the adult entertainment industry, see Georgina Voss, *‘Treating it as a Normal Business’: Researching the Pornography Industry*, 15 *SEXUALITIES* 391 (2012), p. 391-410.

³¹ “Producers” are chosen as the subject of study based on the assumption that these actors are most likely to be the copyright holders of adult content, or at least be making relevant investments in content production.

partially through user-generated content,³² and partially through alternative financing methods (in particular through selling different types of goods).

2. *Research Design*

This study primarily comprises a sample of in-depth, qualitative interviews, supplemented by a variety of information sources. Information was gathered in three phases over a period of two years, from September 2010 to September 2012.

The first phase was the collection of general, potentially relevant information from industry news sources,³³ the trade association,³⁴ industry message boards,³⁵ and legal cases involving copyright infringement of adult material.³⁶ This preliminary research set the objectives for the study as described above and helped to identify industry contacts and interview subjects.

The second phase was a series of highly explorative interviews and conversations with industry specialists, including lawyers, journalists, and people who have worked in or with adult entertainment companies in the United States within the past decade. The subjects were selected using snowball sampling.³⁷ They were asked in conversation to supplement the researched information and to further elaborate on the workings of the

³² This part of the hypothesis was rejected during the second phase of the study, because user-generated content is a less common occurrence in the United States than originally presumed. The reason for this is apparently strict legal requirements surrounding record keeping for content providers and content hosts. Most of the 'amateur' content distributed in the United States is in fact professionally produced and only made to look like it is user-generated. *See infra* Part IV.3.

³³ Industry trade journals XBIZ NEWSWIRE and AVN.

³⁴ The Free Speech Coalition.

³⁵ The GFY Webmaster Board and the XBIZ.com message boards.

³⁶ Either through individual users (through file-sharing or other means) or by intermediaries (such as video content aggregation sites, file-sharing sites, and file-lockers).

³⁷ In which the first participants were selected opportunistically and then asked to recommend further participants, *see* NIGEL KING AND CHRISTINE HORROCKS, *INTERVIEWS IN QUALITATIVE RESEARCH*, SAGE (2012), p. 34.

industry. They were also questioned about various hypotheses formed during the first phase of the study.³⁸

Based on the information gathered during the first and second phases, the third phase of the study was a series of semi-structured, qualitative interviews with content producers. In order to be mindful of ethical responsibilities in conducting research with participants, the Institutional Review Board was consulted prior to this phase of the study. Because the interviews were targeted at individuals representing their firms in a business context, the two most important ethical considerations for the procedure were *informed consent* and *confidentiality*.

All participants were consulted and given information about their participation in the study prior to the data collection. After data collection, participants were debriefed about the research questions and goals and have been ensured access to drafts and publications of the resulting work. There was no deception involved in the data collection, and participants remained free to withdraw their participation at any time. Confidentiality of the participants' personal information was explicitly promised and respected. Given this last requirement, the consulted member of the Institutional Review Board confirmed that the Board would not need to specially review the study prior to data collection. Because this research was partially funded through a grant from the Center for the Analysis of Property Rights and Innovation (CAPRI) at the University of Texas at Dallas, the grant director and administration were also consulted to confirm that there would be no additional IRB requirements from their university related to the support.

The sample consisted of 21 producers. In order to ensure the most industry-representative possible sample, this included large,³⁹ medium, and small companies,⁴⁰ producing material either for (predominantly)

³⁸ See for example *supra* note 32.

³⁹ The larger companies included Larry Flynt Publications (Hustler); Vivid Entertainment Group; Pink Visual; Digital Playground Inc. (prior to being acquired by Manwin); Corbin Fisher.

⁴⁰ Note: the medium and small company names are withheld for privacy reasons and only available for auditing purposes. All interviewees were assured anonymity, given the delicate nature of the content and the potential confidentiality of the information sought.

heterosexual or homosexual audiences.⁴¹ For reason of access and location, the interviewees were selected through convenience sampling.⁴² Using the attendee lists for three heavily attended industry networking conferences in L.A. and Las Vegas (XBIZ LA, InterNEXT Expo, and the AVN B2B tradeshow), a random selection of producers was made in alphabetical order from the above-described categories. These producers were subsequently contacted via email or in person at the conferences to ask for their participation.

All producers were U.S. based.⁴³ A regional bias in interviewing producers from only one country rather than worldwide is acknowledged, and the conclusions of this work therefore only apply to the United States industry. While there is production in many other countries, the U.S.-based industry was chosen for its international prominence in the media, as well as because of a high variance in legal constraints across borders.⁴⁴ Furthermore, the United States industry is comparatively concentrated in terms of location,⁴⁵ and networking opportunities,⁴⁶ allowing for easy access to a large part of the industry at once.

⁴¹ Conversations with industry specialists during the first phase of this project indicated that there may be differences relevant to copyright enforcement. In particular, privacy preferences were alleged to be higher for consumers of homosexual adult material. This was suggested to play a role for copyright enforcement, because extracting settlements in file-sharing lawsuits is potentially easier if information about alleged personal sexual preferences in this area is threatened to become public (*see infra* Part III.3.b) The study therefore included multiple producers from both areas, although no notably significant differences were found (*see infra* notes 107 and 123; *but see infra* notes 71 and 86).

⁴² *See e.g.* BONITA KOLB, *MARKETING RESEARCH, A PRACTICAL APPROACH*, SAGE (2008), p. 110.

⁴³ The interviews included one UK-based and one Canada-based producer, which, although their answers did not differ significantly, are omitted from the sample based on the reasons of legal differences mentioned above.

⁴⁴ *See for example* 18 U.S.C. § 2257 on United States record keeping requirements. Germany has strict rules governing access to online content, *see for example* court decision of the Bundesgerichtshof [BGH] [Federal Court of Justice] Oct. 18, 2007, MEDIEN INTERNET UND RECHT [MIR] 125, 2008 (Ger.). on age verification systems for content distribution.

⁴⁵ Many production companies are based in the districts of Los Angeles, California.

⁴⁶ The industry holds multiple B2B conferences and trade shows a year, some of which attract fairly comprehensive attendance of industry members from all over the country, *see also supra* note 42 *and infra* note 52.

Nearly all interviewees were company CEOs, the remaining were people in high operational positions with sufficient knowledge and overview of company strategy to answer the questions with competence.⁴⁷ Of the company leaders actively sought to interview for the study, only one request remained unmet. This helped to largely mitigate a potential selection bias in the study, as discussed below.

The qualitative interviews all took place between January and April of 2012. Their duration was between 20 and 45 minutes⁴⁸ and their nature was explorative. The explorative style was chosen in order to give the interviewees sufficient space to elaborate, offer anecdotes along with their own assessments and interpretations, and bring up additional, unanticipated points.⁴⁹ While the interviews were not based on a strict set of pre-defined questions, the covered topics as follows: The producers were asked (1) how they had experienced the history, development, and impact of copyright infringement in the online adult industry since the mid-2000s; (2) what measures they and others had and were taking in terms of copyright enforcement (e.g. technological measures, take-down notices, litigation); (3) what strategies they and other producers were using to recoup costs; and what they saw in terms of future developments (4) for their own business, as well as (5) for the industry in general.

All interviews were conducted face-to-face, with the exception of one phone interview.⁵⁰ The face-to-face interviews were recorded and transcribed personally, in order to eliminate unintentional interpretive difficulties and to become as familiar as possible with the data. The one phone interview was recorded through note taking, thereby generating a less complete data sample for one participant. This potential limitation was countered by making every effort to note as much as possible during

⁴⁷ As identified by the respective companies.

⁴⁸ A minimum of 30 minutes was scheduled per interviewee. The actual length of the interviews was subject to people's availability and the general flow of the conversation.

⁴⁹ See C. R. KOTHARI, *RESEARCH METHODOLOGY: METHODS AND TECHNIQUES*, New Age International (2009), p. 98.

⁵⁰ The reason for this was to better establish a trust relationship with the interviewees, as well as maintain spontaneity and exploration while being able to communicate using and interpreting visual cues. On the limitations of telephone interviews, see also KING & HORROCKS, *supra* note 37, at 79-83.

the conversation and being actively aware of potential selectivity and bias in the choice of what parts of conversation were written down. All of the collected data were coded by hand, using a highlighter and notes to identify and label the interviewees' answers to the five main questions listed above. The direct quotations in the text of this thesis chapter are all taken from the content producer interviews in this third, data collecting phase of the study (unless otherwise marked).⁵¹

Additionally, information was gathered at four business-to-business industry conferences through casual conversation, and by observing workshops and industry-only panel discussions on piracy and general market developments.⁵²

3. Choice of Methodology and Limitations

The goal of this study is to provide a first-of-its-kind overview and analysis of the situation through information gathered directly from industry sources and members.

In using other methods of data collection, it would have proven difficult to gather representative information on the adult entertainment industry with regard to the research objectives. Because most companies are privately held, there is not sufficient public data to explore that would supply relevant and accurate information. Furthermore, a series of qualitative interviews was preferred over a quantitative survey. Preliminary discussion with senior researchers had raised concerns that the potentially secretive climate (due to the nature of the business) could make it difficult to get survey responses from a representative sample size of U.S. industry members, even when granted anonymity. In choosing a qualitative interview approach, subjects could be approached directly and

⁵¹ To ensure the privacy of the interview subjects, attribution is available for auditing purposes.

⁵² The January 2012 XBIZ show in Los Angeles, California, the January 2012 InterNEXT Expo and AVN Adult Entertainment Expo B2B Show in Las Vegas, Nevada, and the March 2012 Phoenix Forum in Tempe, Arizona. According to sources from the first phase of the study, these are the largest and most comprehensively attended adult industry conferences in the United States.

in a trustworthy way. The topic was thus explored with a smaller subject sample but with greater flexibility and in more depth.

As with any research method, the findings are subject to limitations. Noteworthy limitations to a qualitative interview study are the smaller sample size of qualitative interviews compared to data from a larger quantitative survey, including the possibility of skewed representativeness for the industry as a whole. Given the time constraints for the project, the sample for this specific study was made as large as possible. It is unknown how many companies exist in the industry, but a sample of 21 participants was deemed sufficiently large to robustly establish the initial findings of this work, particularly because such care was taken to counter the issue of selection bias. The set of chosen firms was made as diverse as possible and snowball sampling was specifically avoided in the third part of the study. Fortunately, the participation requests were all met positively with only one exception, largely eliminating the selection bias concern. Furthermore, as mentioned above, the interviews were supplemented by gathering of information from a variety of sources.

Another limitation is the possibility that the interviewees were unduly influenced by the research questions and perception of a desired outcome. This danger was another reason for choosing explorative, conversational interviews, rather than fixed question sets. Every effort was made to bring up general themes instead of indicating a specific direction or answer.

Lastly, the optimism of the interviewees with regard to the success of their business models must be viewed against the backdrop of their positions and goals. As CEOs and high-level strategy decisionmakers, it is part of their job to be optimistic. This was countered by consulting outside information sources and experts to indicate any severe differences in general optimism and prognoses. While all of the above limitations are legitimate concerns for the chosen research methodology, they should not impact this study's ability to provide a sufficiently robust overview of the situation.

III. COPYRIGHT IN THE ONLINE ADULT ENTERTAINMENT INDUSTRY

Copyright law protects adult-themed content that is original and fixed in a tangible medium. Because much of today's material is in digital file format, it is easily copied and shared on the Internet. The law, while protecting such works from unauthorized reproduction in theory, has proven difficult to enforce in an online environment. Peer-to-peer file sharing and user-uploaded video content aggregators have undermined content owners' ability to cost-effectively prevent copyright infringement. This Part outlines the general copyrightability of adult material, chronicles the relevant types of online infringement, and finally describes why copyrights on adult content are currently difficult to enforce through the legal system.

1. *Copyrightability of Adult Content*

Defining adult content is no simple matter.⁵³ For the purposes of this Article, adult content refers to the depiction of sexual acts or sexual subject matter through writing or visuals (such as photography, film, and other media) that is specifically designed to arouse sexual interest.⁵⁴

Adult content that fulfills the conditions of being original work and fixed in a tangible medium of expression is protected under the United States Copyright Act.⁵⁵ While some have argued that certain types of adult

⁵³ See for example James Lindgren, *Defining Pornography*, 141 U PENN LAW REV 1153 (1993), p. 1153-1275; JOSEPH SLADE, *PORNOGRAPHY IN AMERICA: A REFERENCE HANDBOOK*, ABC-CLIO (2000), p. 3-5. The Merriam Webster definition of pornography is vague: "the depiction of erotic behavior intended to cause sexual excitement." (see "Pornography" Merriam-Webster Online Dictionary (2012), available at <http://www.merriam-webster.com/dictionary/pornography>).

⁵⁴ A similar definition can be found in *City of Youngstown v. DeLoreto*, 19 Ohio App. 2d 267 (U.S. 1969), p. 274-275.

⁵⁵ See Sections 101 and 102 of the Copyright Act, 17 U.S.C.

entertainment should not be granted copyright protection because they do not promote “‘progress’ or ‘useful arts,’”⁵⁶ United States courts have repeatedly determined that copyright law does not discriminate according to the nature of the content.⁵⁷ So long as a work meets the standard of originality set forth in the copyright act, it is granted the same protection as any other type of copyrightable expression. Copyright is even granted to works depicting criminal acts.⁵⁸ For example, courts have repeatedly rejected an obscenity defense to copyright infringement,⁵⁹ holding that “[t]here is not even a hint in the language [of the Copyright Act] that the obscene nature of a work renders it any less a copyrightable ‘writing’”⁶⁰ and that “acceptance of an obscenity defense would fragment copyright enforcement” due to different community standards.⁶¹ The United States Copyright Office maintains that it will not ordinarily “examine a work to determine whether it contains material that might be considered obscene or pornographic.”⁶² In a recent decision concerning adult material, Judge

⁵⁶ See for example Ann Bartow, *Copyright Law and the Commoditization of Sex*, working paper, available at <http://ssrn.com/abstract=1825946>; see also plaintiff’s first amended complaint in *Liuxia Wong v. Hard Drive Productions, Inc.*, 5:12-00469-HRL, N.D. Cal (2012), p. 10-11. See also *Liberty Media Holdings, LLC v. Swarm Sharing Hash File et al.*, No. 11-10802, 2011 WL 5161453 (D. Mass. Oct. 31, 2011) at fn. 2, claiming it is “unsettled in many circuits whether pornography is in fact entitled to protection against copyright infringement.”

⁵⁷ See for example *Bleistein v. Donaldson Lithographing Company*, 188 U.S. 239 (1903); See also *Mitchell Bros. Film Group v. Cinema Adult Theater*, 604 F.2d 852 (5th Cir. Tex. 1979): “[w]e conclude that the protection of all writings, without regard to their content, is a constitutionally permissible means of promoting science and the useful arts.” Furthermore, that “it is inappropriate for a court, in the absence of some guidance or authorization from the legislature, to interpose its moral views between an author and his willing audience.” See also *Jartech, Inc. v. Clancy*, 666 F.2d 403 (9th Cir. 1982), rejecting the idea that obscenity is a bar to copyright protection.

⁵⁸ The California Supreme Court prominently held in *The People v. Harold Freeman*, 46 Cal. 3d 419 (1988) that adult content production is not prohibited per se, placing most of the material discussed in this Article in the legal realm, but there are of course limits set by the law, for instance to producing/distributing “obscene” content.

⁵⁹ See *Mitchell Bros. Film Group v. Cinema Adult Theater and Jartech, Inc. v. Clancy*, *supra* note 57. See also Marc Randazza, *Challenging the Copyrightability of Porn*, XBIZ NEWSWIRE (April 19, 2012, site NSFW), available at <http://www.xbiz.com/articles/legal/147189>.

⁶⁰ See *Mitchell Bros. Film Group v. Cinema Adult Theater*, *supra* note 57, at 854.

⁶¹ See *Jartech, Inc. v. Clancy*, *supra* note 57, at 406.

⁶² U.S. Copyright Office, *Compendium of Office Practices II*, Section 108.10 (“Obscene or pornographic works”), available at <http://www.copyrightcompendium.com/#108.10>.

Posner held that “even illegality is not a bar to copyrightability,”⁶³ again confirming that copyright does not discriminate according to community standards, social value, or even criminally sanctioned works.

The question, therefore, of whether or not a specific work ‘promotes the progress of science and useful arts’, or even whether or not it is legal to produce or distribute is a separate question from whether or not it is copyrightable. While this is partially due to strong First Amendment rights in the United States, there is another reason within the economic justification of copyright law. Regardless of a country’s emphasis on the right to free speech, the copyright system enables policy makers to set aside the controversy involved in making value judgments. Instead of selecting which works to support based on ambivalent and subjective factors like social or artistic merit, copyright law sets a low ‘originality’ bar⁶⁴ and leaves it to the market to assess whether a work is of any value to society. This allows creators to directly capitalize on works that are successful, at no cost to those that are not. Since other areas of law already fully cover the question of legality, raising the copyright bar to include social value judgments seems to be unnecessary given copyright’s role, not to mention a slippery slope.⁶⁵ Despite its social stigma, adult-themed content is therefore generally protected by copyright, both in the United States and abroad.⁶⁶

The question as to what specific parts of a work enjoy protection is slightly more complicated. Many types of adult film and photography, while copyrightable as a whole, include elements that may be perceived as generic and thus freely replicable by others. Does copyright cover particularly original positions or acts, perhaps in analogy to decisions on

⁶³ *FlavaWorks, Inc. v. Gunter et al.*, Case No. 11-3190, 2012 WL 3124826 at *2, ___ F.3d ___ (7th Cir. Aug. 2, 2012).

⁶⁴ *See for example* *Feist Publications, Inc. v. Rural Telefon Service Co., Inc.*, 499 U.S. 340 (1991); *United States v. Hamilton*, 583 F.2d 448 (9th Cir. 1978). For Germany *see for example* THOMAS DREIER & GERNOT SCHULZE, *URheberRECHTSGESETZ, URheberRECHTSWAHRNEHMUNGSGESETZ, KUNSTURheberGESETZ: KOMMENTAR*, 4th ed., Beck (2013) (Ger.) at §2 note 25.

⁶⁵ *See* Dan Schneider, *Authority of the Register of Copyrights to Deny Registration of a Claim to Copyright on the Ground of Obscenity*, 51 CHI.-KENT L. REV. 691 (1975), p. 718-721.

⁶⁶ *See for example* court decisions in Germany: Oberlandesgericht [OLG] [Higher Regional Court] Hamburg May 10, 1984 Az.: 3 U 28/84 (Ger.); OLG Köln, March 25, 2011 Az.: 6 U 87/10 (Ger.).

choreography and dance moves?⁶⁷ What parts of a standard adult movie plot are protected from being used by other filmmakers without permission? While these are interesting questions, this Article sets them aside due to their lack of practical relevance. To date, all cases of copyright infringement in the adult industry have revolved around “literal copying.”⁶⁸ A literal copy is an exact replica of the original work. The issue that content producers therefore face is not that others are creating similar works, but rather that they are reproducing and distributing exact copies of the original without authorization.

Since adult content is legally protected from unauthorized literal copying, this should allow creators of successful content to recoup their production costs through the ability to sell it exclusively. But what happens when this protection fails? The following Part looks at unauthorized uses of adult content online.

2. Infringement in the Digital Age

When adult entertainment businesses first began to distribute content online, they had the advantage of greatly increased privacy and convenience for consumers. Despite its historic prevalence, adult entertainment has traditionally struggled with social acceptance. Making content available online meant that consumers could purchase adult entertainment within the four walls of their homes, without having to be associated with their consumption in public or deal with physical objects such as magazines or video cassettes and DVDs. It also meant circumventing local resistance to retailer locations, while at the same time making content accessible to far more people and even offering it on an international scale. Given the privacy enhancement and new opportunities to meet the massive demand for material, the adult business was arguably in an even better position to capitalize than its mainstream counterparts when content first began to move online.⁶⁹

⁶⁷ See Bartow, *supra* note 56, at 7.

⁶⁸ See Bartow, *supra* note 56, at 11.

⁶⁹ It should be pointed out, however, that a number of adult companies went out of business during that time. While many were able to successfully capture online markets, some resisted adapting to the change, increasingly finding themselves unable to make ends meet through the old business model of selling physical home video formats in mail

The downside to the distribution possibilities of the Internet is that they greatly facilitate unauthorized use of content. Digital files are easily copied and shared, allowing for an unprecedented magnitude of copyright infringement. While many industries have grappled with this problem in the online domain, the adult industry was apparently able to thrive for quite some time before running into difficulties. In the beginning, online copyright infringement took the form of individual users capturing content (through scanning, downloading, encoding, or other measures) and making it available to other users on their personal websites. Industry specialists claim that this type of unauthorized use, while widespread, did not generally have a negative impact on business. Some companies were even able to use content ‘piracy’ to their advantage.⁷⁰

When asked to describe what forms copyright infringement has taken and how it has impacted the industry in recent years, only one of the producers mentioned that individual unauthorized use of their content on personal websites was a problem.⁷¹ Eleven of the twenty one producers identified (later-developed) peer-to-peer file-sharing technologies as cutting into their sales by allowing for much wider-spread copying of their content.⁷² Every single one of the twenty one interviewees, however, purported that the relevant source of copyright infringement for the industry in general was the development of user-uploaded video content aggregators, the so-called “tube sites”. These sites are based on a similar model to YouTube,⁷³ and allow users to freely share videos. These two distribution methods are described in the following.

catalogues or retail outlets. DVD sales have increasingly declined, especially as broadband speed and video technology have improved.

⁷⁰ See *infra* Part IV.3.

⁷¹ Although some industry specialists and producers noted a comparatively strong sense of “community” among consumers of gay adult material, leading to a culture of collecting and sharing found or purchased material with others or over publicly accessible social networks and blogs (like Tumblr), regardless of associated rights.

⁷² In particular as broadband access has become more common and connection speeds have increased. The other half did not believe that file sharing had a significant impact on sales, either because it expanded the consumer base (attracting new, paying customers at the same time as forfeiting others), or because the file-sharers were believed to have never belonged to the paying customer base.

⁷³ YouTube is a prominent video-sharing website that was created in 2005 and acquired by Google Inc. in 2006.

a. Peer-to-Peer File Sharing

The architecture of the Internet allows computers to build networks that share digital files. In peer-to-peer file-sharing networks, users can connect to a network via software, which then allows them to search for and transfer data from other users.⁷⁴ With increasing broadband access, peer-to-peer file sharing has become an efficient and popular way to share and distribute digital content. Content is often copied and shared without authorization of the rights holder. In 2008, over 150 million people were using peer-to-peer networks and an estimated 35% of downloads were adult-related material.⁷⁵ The current standard peer-to-peer file sharing protocol is *BitTorrent*, which is used to transfer large files at increasingly high average speeds.

b. User-Uploaded Content Aggregation Websites

As mentioned above, while about half of the content producers felt that file sharing is relevant, they unanimously claimed that user-uploaded content aggregators have posed the larger problem to the industry, in particular the adult content tube sites.⁷⁶ Companies were allegedly successful in capturing online markets prior to this development and industry specialists and producers place the crux of the copyright infringement problems between 2006-2008 as these sites gained popularity. Tube sites are very widespread today.⁷⁷ Just like their originating platform, *YouTube*, users can view and upload videos directly on the site. In most cases, unregistered users can access and watch the videos, while only registered users can upload content. Registration is commonly anonymous and uploads are unlimited. These sites offer advantages to consumers of adult entertainment over file-sharing networks because no files are downloaded and they allow for easy

⁷⁴ See Felix Oberholzer-Gee & Kohleman Strumpf, *File Sharing and Copyright*, in: INNOVATION POLICY AND THE ECONOMY, Vol. 10, Josh Lerner & Scott Stern eds., University of Chicago Press (2010), p. 24.

⁷⁵ See Jerry Ropelato, *P2P Networking – Kids Know! Do Mom & Dad?* TOP TEN REVIEWS (2008), available at <http://internet-filter-review.toptenreviews.com/peer-to-peer-file-sharing.html>.

⁷⁶ But also other social networks or content sharing sites, such as 4chan, Tumblr, etc.

⁷⁷ In July 2012, a Google search for the words “porn tube” returned about 146,000,000 results.

previewing and switching between videos.⁷⁸ Downloading files through peer-to-peer networks is generally more time-consuming, less easy to browse and preview, and also carries the risk of corrupted files.⁷⁹

Some producers postulated that consumers of adult entertainment may be unique in that their browsing experience is a significant part of the consumption. Unlike a consumer who visits an online music store to purchase a specific album, consumers of adult material will often prefer to look through a less-specific variety of different content. Furthermore, they can be driven by comparatively stronger impatience,⁸⁰ preferring to purchase or use immediately. These factors, plus the anonymity, and finally the legality of watching user-uploaded and remotely hosted videos⁸¹ make the tube sites an attractive choice over peer-to-peer file sharing for consumers looking for free content.

Because there is little to prevent anonymous users from uploading content without authorization from the rights holder, the tube sites have been recognized as the main source of video copyright infringement for the adult industry. Additional contributing factors are described next.

c. Contributing factors

File-sharing and content aggregators coincided with a few other circumstances that contributed to the magnitude of online copyright infringement in the adult industry. In what two interviewees described as “the perfect storm”, an increasing erosion of consumer trust (due to the spread of scams), the popularity of the tube sites, and the economic crash

⁷⁸ See also *infra* Part III.2.c.

⁷⁹ As one producer described, “if you’ve ever tried to download anything from BitTorrent, it’s like hit and miss. [...] Sometimes it takes a long time. Sometimes it’s fast, but the files are corrupted [...] So you’ll sit there and be like, ‘oh, I’m getting this thing’, but unless you have a lot of time on your hands...”

⁸⁰ See also remark on impatience and degree of consumer care in *Playboy v. Netscape*, 354 F.3d 1020 (9th Cir. 2001), p. 374.

⁸¹ As opposed to file sharing, watching the videos online is not tied to simultaneous reproduction and uploading of the file (uploading copies clearly constitutes a breach of copyright law). While end-user *BitTorrent* litigation in the film, music, and also adult entertainment industries may have a certain deterrence effect on illegal file sharing, it does not have an effect on the consumption of content via the tube sites.

all came together to undermine the traditional business model of creating and selling content.

Even if what had been previously felt as inelasticity of demand⁸² had held true through the recession, sales were suffering under the newer circumstance of paid material being (less imperfectly) substitutable through free material.⁸³ While five interviewees emphasized that their product was purposely distinguishable from the industry average, either in terms of content or quality, they did not disagree with the general idea that for many users, adult entertainment takes on the attributes of a commodity. Content is in high demand but consumers may not make much qualitative differentiation across the market. In other words, when times are tight, any supplier of content will do.⁸⁴

Furthermore, industry specialists claim that new generations of Internet users are becoming generally accustomed to an abundance of free material online. Nineteen of twenty-one producers echoed the sentiment that today's average user does not always purchase content.⁸⁵ Only two disagreed, claiming that the generation consuming free material had never belonged to their consumer audience. They agreed, however, that the number of people consuming had grown, while the number of paying customers had not. Compared to the less socially stigmatized mainstream entertainment industries, consumers of adult content may also display less loyalty towards creators, making it harder for producers to "guilt" users into financially supporting the content they consume.⁸⁶

⁸² The adult industry has been perceived as comparatively recession-resistant. *See for example* DAN AHRENS, *INVESTING IN VICE: THE RECESSION-PROOF PORTFOLIO OF BOOZE, BETS, BOMBS, AND BUTTS*, Macmillan (2004).

⁸³ *See also* Edelman, *supra* note 2, at 212.

⁸⁴ As one producer said "It's kind of like cable television. Most people don't only watch one channel. So if they can't get our content for free, there is plenty of other free content around that they can substitute."

⁸⁵ E.g. "The average adult consumer, in my opinion, doesn't want to pay for adult entertainment anymore. Because such a wide variety is available for free." *See also infra* Part IV.3. This sentiment is echoed in other industries, where file sharing persists, despite attempts at legal deterrence. *See discussion infra* Part V.

⁸⁶ Although industry specialists claimed that consumers of gay material displayed comparatively higher loyalty towards their preferred brands and companies. Also, producers and performers have launched a few awareness campaigns similar to those in the music industry, in which stars ask consumers to support them financially and not pirate adult content. *See for example* Kim Yoshino, *Adult Film Industry Launches Anti-Piracy Campaign*, LOS ANGELES TIMES (5 May, 2010), Local Section.

For adult entertainment, free access via file sharing or tube sites offers the additional benefit of privacy. Online payments are traceable, and users may prefer to create as few records as possible of their consumption.⁸⁷ Industry specialists confirm that pirated material has substantial advantages over purchased content both for privacy reasons,⁸⁸ and, relatedly, due to a past wave of identity theft and scams. A number of producers and experts spoke of a time several years ago when selling adult content online first became popular and was comparatively unregulated.⁸⁹ With the floodgates to the industry open for new entrants, the online adult business experienced an era of “get-rich-quick schemes” and consumer scams.

Besides annoying pop-up ads, adult websites were engaging in “mousetrapping” consumers on a page,⁹⁰ hijacking browsers, and installing malware on users’ computers. Many adult marketing partners used unlawful practices to promote content.⁹¹ Two popular schemes for subscription websites were credit card “banging” (using a customer’s credit card for unauthorized purchases, often only charging a multitude of small amounts), and pre-checked cross sales. Pre-checked cross sales would coerce users to sign up for website memberships at a low price or for a free trial version, but include an automatic subscription in the fine print unless cancelled, and additionally include sign ups to multiple affiliate websites “for free”, many of which renewed the subscriptions

⁸⁷ See Edelman, *supra* note 2, at 210.

⁸⁸ See Stephen Yagielowicz & Rhett Pardon, *DMCA: The Porn Industry’s Worst Nightmare*, XBIZ NEWSWIRE (July 18, 2012), available at <http://newswire.xbiz.com/view.php?id=151439>: “The biggest challenge for adult content is the reality that pirated material is ironically better than legitimate material. To access legitimate material, a user has to identify himself by subscribing and paying. Pirated material, by contrast, can be fully anonymous. That disparity exerts enormous pressure on the market, [it] distinguishes adult content from other forms of vulnerable content, where piracy has been at least partially displaced by the provision of high-quality, consumer-friendly legitimate content.”

⁸⁹ One example for a recent, game-changing Internet-inspired regulation is the June 2005 enacted extension of the 18 U.S.C. §2257 record keeping requirements to site hosts as “secondary producers”, which is defined as anyone who “inserts on a computer site or service a digital image of, or otherwise manages the sexually explicit content of a computer site or service that contains a visual depiction of, an actual human being engaged in actual or simulated sexually explicit conduct.” See 73 FED. REG. at 77, 468.

⁹⁰ See also Paul Barrett, *The New Republic of Porn*, BLOOMBERG BUSINESS WEEK (June 21, 2012), Features Section.

⁹¹ See also Edelman, *supra* note 2, at 214.

automatically for a fee after the trial period. Subscription websites would also lure paying customers with high quality trial content and then have only cheaply licensed, non-exclusive material in the member area (“*the same generic stuff that’s everywhere else... like, literally the same videos*”). Some did not honor customers’ subscription cancellations, continuing to charge their credit cards until a (often prohibitively embarrassing) call was made to the card company. One producer insisted that copyright infringement was far less of a problem than the fact that “*the industry destroyed its own business models.*”

Many companies, of course, did not engage in these tactics and preferred to invest in more sustainable business models. There were enough “bad players” entering the market over the time period of a few years, however, to erode general consumer trust. Industry specialists feel this played a substantial role in driving people toward copyright infringement. Consuming unauthorized content, while illegal, became a more attractive option for consumers worried about becoming victims of scams, having their personal data stolen, and facing potential embarrassment. Around the same time that the barriers to entry changed and the unsustainable scam businesses began to die out,⁹² content was becoming available on the tube sites and could now be consumed both legally and anonymously, leading consumers to flock to the free platforms.

The crash of the economy, a general cultural shift in consumer expectations, users’ privacy preferences, a lack of loyalty towards creators, and the erosion of trust through scam proliferation all came together to cultivate the unauthorized use and dissemination of digital content. As a result, copyright infringement has become both common and pervasive in the online adult entertainment industry.⁹³ The following examines in more detail why it is difficult for content owners to enforce their rights through the legal system.

⁹² A recent study of the current landscape of malware-infected websites found that religious and ideological websites are now three times more likely to be affected than adult content sites. See Symantec Corporation, *Internet Security Threat Report: 2011 Trends*, Vol. 17 (April 2012), p. 33, available at http://www.symantec.com/content/en/us/enterprise/other_resources/b-istr_main_report_2011_21239364.en-us.pdf.

⁹³ Furthermore, a factor that contributes to the spread of free content (and the ineffectiveness of enforcement, as seen below) is that consumers will sometimes treat adult material more like a commodity than a highly differentiated product, see *infra* Part III.4.

3. *Enforcement Difficulties*

U.S. copyright law grants authors protection against unauthorized reproduction and distribution of copyrighted content under Title 17 of the United States Code. Adult content owners can therefore take legal action against infringers who do not comply with the law. The effectiveness of the methods at their disposal, however, is limited. The following parts describe the enforcement possibilities against unauthorized uses of copyrighted material by individuals and intermediaries.

a. Individual Use

Under federal copyright law, infringers face civil⁹⁴ or criminal⁹⁵ sanctions for the unauthorized reproduction or distribution of copyrighted works. When individuals directly host copyrighted material on their websites without authorization, right owners can litigate to remove the content and recover damages. As mentioned above, individual infringement of this sort is not perceived to be a large problem. It requires locating infringing material, but once the unauthorized use gains enough traction to be a threat to a content owner, it is likely to become visible and is fairly easy to shut down. Interestingly, when this type of online copyright infringement first began to occur, a number of adult entertainment companies did not attempt to use the legal system to prevent the use of their content. While one reason for the smaller producers could have been that the costs of monitoring and enforcing were prohibitively high,⁹⁶ some of the larger companies apparently did not fight this type of infringement, either, because they saw value in the free distribution of their material.⁹⁷

⁹⁴ Title 17 U.S.C. Section 501(b).

⁹⁵ Title 17 U.S.C. Section 506(a): criminal prosecution applies to willful infringement of copyright for purposes of commercial advantage or private financial gain.

⁹⁶ In theory, statutory damages are calculated to make litigation cost-effective. However, for the often 'mom and pop' style businesses, even acquiring legal counsel can be a prohibitively daunting undertaking, be this due to information deficiencies, credit restrictions, or behavioral biases.

⁹⁷ See *infra* Part IV.3.

b. Peer-to-Peer Network Users

In early cases of file sharing, courts affirmed that using peer-to-peer networks to copy and distribute copyrighted content constitutes direct infringement.⁹⁸ A number of adult content producers have therefore attempted to use the legal system to collect damages and deter users from sharing content over the networks.⁹⁹

In order to pursue file-sharers, copyright owners must locate their content by searching the network and identifying the Internet Service Providers (ISP) of infringing users. The ISPs are required to hand over the name and address of the individual account owner if subpoenaed by the copyright owner. This requires a so-called “John Doe” lawsuit to be filed with a court and the subpoena approved by a judge. Once the copyright owner has retrieved the name and address of the account holder from the ISP, it can then proceed to file a civil lawsuit against the alleged infringer.

In practice, copyright owners will generally contact the account owner and request a settlement amount. Alleged file sharers can then theoretically decide whether to pay the requested amount or be taken to court for copyright infringement.¹⁰⁰ Given the large number of file sharers and the scale of infringement for individual files, copyright owners have begun to bundle multiple users into one court action, rather than to seek subpoenas for each individual infringement. Both of these strategies are theoretically permissible.¹⁰¹ In fact, they can be an economic necessity to keep the cost of litigation within an affordable range. If content owners were not able to collect settlements or bundle allegedly infringing users in these cases, the costs of enforcing their copyrights would be prohibitively

⁹⁸ *MGM Studios, Inc. v. Grokster, Ltd.*, 545 U.S. 913 (2005); *Recording Industry Association of America v. Verizon Internet Services*, 351 F.3d 1229, Case No. 03-7015 (D.C. Cir., December 19, 2003) cert denied 125 S.Ct. 309 (2004).

⁹⁹ See for example *infra* notes 104, 105, 109, 110, and 115.

¹⁰⁰ Court-imposed damages can range from \$750 to \$150,000, see 17 U.S.C. § 504(c). Furthermore, court procedures are both tedious and costly, so both parties have a strong incentive to settle out of court.

¹⁰¹ Based on the Federal Rules of Civil Procedure (FED. R. CIV. P. 20 – “Permissive Joinder of Parties”), multiple defendants can be joined in one action, so long as the “Does” use the same ISP and P2P networks to infringe the same copyright.

high.¹⁰² However, these two strategies have posed difficulties for adult content owners.

First of all, courts have questioned the legitimacy of asking for settlements given consumers' high valuation of privacy in this particular industry. Many users are willing to settle and pay, not only because the settlement is cheaper than what they would face in court,¹⁰³ but also to prevent the knowledge of their adult content consumption from becoming public. In some cases, account owners may pay up even if they are mistakenly targeted,¹⁰⁴ simply to protect their privacy. Some parties have been accused of using shaming tactics to extort settlements from users.¹⁰⁵ It is imaginable that even in cases where litigants do not intentionally extort users and make a conscious effort to target large-scale file-sharers and ask for 'reasonable' amounts, it is difficult to determine the boundaries of an efficient settlement system when users' privacy preferences come into play. Once defendants are agreeing to settle for the 'wrong reasons,'¹⁰⁶ the system ceases to work as intended. The fact that privacy preferences make a difference is illustrated by a comparatively higher amount of settlement success stories in the area of gay adult content, where users are more likely to value avoiding publicity.¹⁰⁷

Courts are aware of the privacy issues with adult content settlements and cases have been dismissed. While the dismissals themselves are based on a variety of reasons, industry specialists suspect that the underlying

¹⁰² See *infra* note 117.

¹⁰³ In theory this would be the economically desirable reason within the system.

¹⁰⁴ For example owners of open wireless Internet networks that were used by others and who have not engaged in any copyright infringement themselves. See for example *VPR Internationale v. Does 1-1017* (C.D. Ill. April 29, 2011), or *Malibu Media v. John Does 1-10, 12-cv-3623* (C.D. Cal. pending). Judge Otis Wright: "[T]he potential for abuse is very high. The infringed work is a pornographic film. To save himself from embarrassment, even if he is not the infringer, the subscriber will very likely pay the settlement price,"

¹⁰⁵ See *id.* See also *AF Holdings, LLC v. Comcast Cable Communications, 12C3516* (D.C. Cal. 2012), Memorandum in Opposition to Plaintiff's Motion For Order To Show Cause, in which the ISP refuses to hand over the defendants' information and asks a federal judge to deny the subpoenas because "Plaintiffs should not be allowed to profit from unfair litigation tactics whereby they use the offices of the Court as an inexpensive means to gain Doe defendants' personal information and coerce 'settlements' from them."

¹⁰⁶ In other words, defendants may settle not because they face the probability of higher monetary damages if taken to court and found to have infringed, but rather because they face public embarrassment in any case.

¹⁰⁷ According to conversations with industry specialists.

cause is a general lack of support for this settlement model. Courts have denied subpoena requests based on the plaintiffs bundling file-sharers from different jurisdictions,¹⁰⁸ from different swarms¹⁰⁹ and times,¹¹⁰ or with potentially different defenses.¹¹¹ Requests have also been denied based on the finding that identifying an account owner is not enough evidence to determine who actually was sharing the file over the network.¹¹² A number of “John Doe” suits involving adult material have thus been refuted, indicating difficulties for copyright owners. Aside from the issue of settlement versus extortion, some of the interviewed lawyers rumored that courts are generally unsupportive based on the nature of the content in question. They also claimed that not only are these cases hard-pressed to get sympathy from courts because of their subject matter, but that the staff is “fed up” with mass end-user lawsuits, which require a lot of internal effort and resources. Weary of the paperwork that the John Doe litigation brings without ever actually reaching a trial,¹¹³ lawyers say that the courts will oftentimes find any reason within their power to dismiss the cases.¹¹⁴ Furthermore, a number of players have fallen into

¹⁰⁸ See for example Nate Anderson, *Judge: Don't Bring Me Any More Anonymous File-Sharing Lawsuits*, ARS TECHNICA (May 23, 2011), available at <http://arstechnica.com/tech-policy/2011/05/judge-dont-bring-me-any-more-anonymous-file-sharing-lawsuits/>; Nate Anderson, *Judge Eviscerates P2P Lawyer: "I Accepted You At Your Word"*, ARS TECHNICA (March 9, 2011) available at <http://arstechnica.com/tech-policy/2011/03/judge-eviscerates-p2p-lawyer-i-accepted-you-at-your-word/>.

¹⁰⁹ See *Pacific Century International Ltd., v. Does 1-101, 11-02533* (N.D. Cal. July 8, 2011), in which the judge found that the particular torrent files may not be similar enough for the plaintiff to join John Does from different swarms into one lawsuit over downloading the “same” copyrighted work.

¹¹⁰ See *On The Cheap, LLC v. Does 1-5011, 10-04472* (N.D. Cal. filed October 4, 2010), in which the judge dismissed all but 1 of over 5000 defendants, saying they were improperly joined because they participated in the same swarm, but it is not clear whether they participated at the same time.

¹¹¹ See for example Rhett Pardon, *N.Y. Magistrate Judge Tosses 4 Porn BitTorrent Suits*, XBIZ NEWSWIRE (May 7, 2012), available at <http://newswire.xbiz.com/view.php?id=148101>.

¹¹² See *supra* note 104.

¹¹³ According to federal court records, none of these cases have ever reached a trial verdict. See M. Alex Johnson, *Porn Piracy Wars Get Personal*, NBCNEWS.COM TECH (July 20, 2011), available at http://technolog-discuss.nbcnews.com/_news/2011/07/20/7113220-porn-piracy-wars-get-personal?d=1.

¹¹⁴ See for example Nate Anderson, *Random Defendant Outlawyers P2P Attorney, Gets Lawsuit Tossed*, ARS TECHNICA (February 26, 2011), available at

bad graces with judges through their tactics, earning themselves hefty fines¹¹⁵ and negative publicity.¹¹⁶

As mentioned above, attempting to directly settle with alleged infringers and bundling multiple John Doe lawsuits may currently be the only cost-effective ways to efficiently enforce copyrights against file-sharers with sufficient compensation effect. Filing fees (and other administrative expenses, such as subpoena fees) make litigating the cases against each individual user prohibitively costly.¹¹⁷ On the other hand, privacy preferences make the system susceptible to abuse in the context of adult content, which draws negative public attention. Recent cases have attracted the involvement of privacy advocacy groups like the Electronic Frontier Foundation¹¹⁸ and come under scrutiny in both the tech blog scene and the mainstream news media.¹¹⁹ Adult content right holders that

<http://arstechnica.com/tech-policy/2011/02/random-defendant-outlawyers-p2p-attorney-gets-lawsuit-tossed/>; see also *supra* notes 104, 109, 110.

¹¹⁵ See for example Mick Haig Productions, *e.K. v. Does 1-670*, Case No. 3:10-cv-1900-N (N.D. Tex September 2011), imposing a court sanction of \$10,000 on the attorney.

¹¹⁶ See for example Mike Masnick, *Copyright Troll Claims Sanctions Against Him Are 'Bulls**t' And He's Going To Keep Sending Questionable Subpoenas*, TECHDIRT (July 16, 2012), available at <https://www.techdirt.com/articles/20120716/o8573019710/copyright-troll-claims-sanctions-against-him-are-bullst-hes-going-to-keep-sending-questionable-subpoenas.shtml>.

¹¹⁷ Even when full statutory damages are taken into account. Currently, the average filing fee for U.S. District Courts is \$350. Subpoenas cost around \$150. Lawyers cost money, as well. Subtracting these costs from the settlement amount, and then taking into account that there is often no money to be collected, the economic problem is apparent. Filing fees can be recovered in the case of a favorable judgment, but John Doe cases are only ever intended to reach the courtroom as a last resort (and most never do). Going through a court procedure would incur many additional costs to everyone, which is why our legal system allows for settlements in the first place.

¹¹⁸ See Electronic Frontier Foundation, *Judge Blocks Copyright Trolls in Porn-Downloading Lawsuits*, (press release, December 16, 2010), available at <https://www.eff.org/press/archives/2010/12/16>; Electronic Frontier Foundation, *Copyright Troll Gives Up in Porn-Downloading Case*, (press release, January 31, 2011) available at <https://www.eff.org/press/archives/2011/01/31>; Robyn Hagan Cain, *Evan Stone gets EFF-ed Up In Porn Copyright Trolling Sanctions*, FINDLAW FIFTH CIRCUIT NEWS AND INFORMATION BLOG (July 15, 2012) available at http://blogs.findlaw.com/fifth_circuit/2012/07/evan-stone-gets-eff-ed-up-in-porn-copyright-trolling-sanctions.html.

¹¹⁹ See Timothy B. Lee, *This Week's Local News Scare: Porn Trolls are Coming For You*, ARS TECHNICA (July 30, 2012), available at <http://arstechnica.com/tech-policy/2012/07/this-weeks-local-news-scare-porn-trolls-are-coming-for-you/>; Mackenzie Warren, *Internet Providers Turn To Attorneys To Protect Content*, NBC MY NEWS 3 (July

litigate are now regularly accused of being “copyright trolls”¹²⁰ and settlements scornfully deemed “a good way to make an easy buck.”¹²¹

In interviews with both producers and industry lawyers, the answers on whether they engaged in lawsuits against file sharers, or thought that end-user litigation could be an effective part of a business strategy, were divided. At the time of this study, only eight companies in the U.S.-based adult entertainment production industry are known to have engaged in actions against file-sharers.¹²² The three of those interviewed for this study were large companies. They said they undertook it for the compensation effect of settlement money. The other two interviewed large companies, which do not litigate, as well as the majority of the medium and smaller producers claimed that there was generally too little money to be made, even assuming the full support of the courts.¹²³ Two small companies disagreed with the general statement that it is not effective, saying that it was a reasonable tactic for large companies, but that they themselves could not afford it. All of the non-litigating companies felt that litigation was not cost-effective. The three producers that had filed end-user lawsuits all stated that it was part of a larger strategy and by no means enough on its own to effectively prevent copyright infringement and recoup costs. Furthermore, while some industry lawyers encourage their clients to proceed with end-user litigation, others have advised their clients against it.¹²⁴

25, 2012), available at <http://www.mynews3.com/content/news/story/Internet-providers-turn-to-attorneys-to-protect/g1viHJEjFo25YN56WlU33A.csp>; Kurtis Ming, *Call Kurtis: Could ‘Copyright Trolling’ Happen To You?* CBS SACRAMENTO (June 2012), available at <http://sacramento.cbslocal.com/2012/06/18/call-kurtis-could-copyright-trolling-happen-to-you/>.

¹²⁰ See Warren, *supra* note 119; Lee, *supra* note 119.

¹²¹ See Johnson, *supra* note 113: “The incentive to settle is to keep from being named forever in court records as a porno fiend, which ‘seems to me like it’s a good way to make an easy buck,’ said Julie Samuels, a staff attorney for the Electronic Frontier Foundation.”

¹²² As confirmed through correspondence with fightcopyrighttrolls.com, which keeps track of file-sharing litigation. Three of these companies were part of this interview study.

¹²³ Contrary to what industry specialists had indicated, the gay studios that were interviewed did not differ from the straight adult content studios in their likelihood to pursue filesharers. It is possible that this result is skewed, given the small sample size of interviewees.

¹²⁴ This is interesting given the financial opportunities for legal counsel in copyright enforcement. Lawyers (as rent-seeking agents) have less incentive to push companies

Of the eighteen interviewed producers that do not litigate, most said that they had never gone, nor did they plan to go after file sharers as part of their business model. The stated reasons were manifold. Particularly small producers felt that it was too costly. Even if they could afford to hire legal counsel and pay fees for court actions, they felt that the returns were too low and that litigation would never be cost-effective.¹²⁵ Yet others said that they did not believe in “suing customers”, claiming that file sharing had expanded the audience for porn consumption and with it the number of potential paying users. They said that while some consumers would get most or all of their content for free, there were also people who would occasionally purchase,¹²⁶ and the companies that were cracking down on consumers against the current social norms of file sharing would not remain in a favorable position to sell anything.¹²⁷ Relatedly, some felt that litigating against this technological disruption was not a long-term solution,¹²⁸ stating that they preferred to apply their efforts and resources elsewhere.¹²⁹ Finally, some simply said that file sharers could not be

away from litigation and towards alternate business models that do not rely on copyright enforcement. Yet in representing the interests of their clients, some are vocal about their belief that that P2P copyright infringement suits are not a good option. See also Greg Piccionelli, *10 Things To Consider Before Engaging A Firm To File A Mass Copyright Infringement Lawsuit*, XBIZ NEWSWIRE (January 2011), available at <http://bit.ly/HWtbj9>.

¹²⁵ As one producer described: *“Fighting that is just a nightmare in itself. You spend a lot of money, you spend a lot of energy, you spend a lot of time, and you usually lose. Because that piece of content, once it's ripped off, it's ripped off not only once, it's ripped off, you know, tens of thousands of times, so how are you going to stop all this from happening? You start with one person, it's already duplicated hundreds of thousands of times from that one person. So it's a lose-lose battle if you're trying to stop it for monetary reasons.”* Another producer said: *“There's only been a few cases where anyone has ever gotten anything out of these judgments. So you can get all of the judgments and injunctions you want, but these people... you're still dealing with some teenage boy in the Netherlands, who was just [...] trading it around. Or some guy in Russia.”*

¹²⁶ Either specific content or other convenience and experience goods offered by the company (for more on this see *infra* Part IV).

¹²⁷ *“Litigation's just going to mold it into an even worse thing. Even more aggressive. And put it in the hands of people who are malicious.”*

¹²⁸ *“There's no way to prevent it. [...] obviously it's going to evolve and move forward, but not from litigation.”*

¹²⁹ *“Watching some other companies take a really proactive approach, or an actively aggressive approach and going after copyright infringement is interesting, too, because they're spending a lot of money on it. And for very little reward. Because they'll get judgments, but they're never collecting the money.”*

convinced to buy content through lawsuit threats, since these users were not going to pay for content either way.¹³⁰ Rather than try to “*go after students who are just going to go get stuff from the tube sites if they can’t download it,*” they thought that companies should focus their efforts on targeting their actual customers, “*people with disposable income.*”¹³¹

Interestingly, while those companies that litigate tend to be the larger ones, not all larger companies litigate. As mentioned above, producers generally feel that the crux of the copyright infringement problems has been the availability of free content on tube sites. Even if file sharing were completely eliminated, this free material serves as a substitute commodity, undermining producers’ ability to sell copyrighted content. The individual users who upload stolen content to tube sites are anonymous and prohibitively difficult to track down. Given the general difficulties of suing individual sharers of unauthorized content, the following section looks at possibilities for taking legal action against distributors, facilitators, and user-uploaded content website owners: the intermediaries.

c. Intermediaries

When it comes to the intermediaries in online copyright infringement, the Digital Millennium Copyright Act (DMCA) exempts certain service providers from liability, granting them a “safe harbor” in Section 512.¹³² The exemption protects them from being held responsible for direct copyright infringement, such as when they themselves make unauthorized copies (for technical reasons), but it also protects them from being held responsible for copyright infringement through their users. In shielding

¹³⁰ “[K]ids, it’s already engrained in them: the music’s free, and video’s free. You don’t pay.” (See also *infra* Part IV.3.) Or: “The site can get shut down, the network connection too can get shut down, but it’s just gonna proliferate somewhere else or in another direction.”

¹³¹ Interestingly, at business-to-business industry conferences during panel discussions, views were heavily divided on whether and how to pursue piracy. While most everyone agreed that it has been a problem, the debates over solutions were lively and differentiated, strikingly unlike the copyright enforcement dialog in other entertainment industries.

¹³² See Title 17 U.S.C. Section 512 - Limitations on liability relating to material online. (Implementation of the Online Copyright Infringement Liability Limitation Act of 1998).

the intermediaries from this secondary liability, the “safe harbor” provision attempts to sustain a balance of interests between right holders and online service providers.¹³³ Because of the “safe harbor” provision, attempts of adult entertainment right holders to hold intermediaries liable for copyright infringement have been largely unsuccessful.¹³⁴

These judgments have followed in the footsteps of their non-adult industry counterparts.¹³⁵ As for other intermediaries, it is true that *BitTorrent* websites and file lockers have recently come under more pressure from mainstream right holders, for example with judgments against the prominent *BitTorrent* website *The Pirate Bay*,¹³⁶ and file locker website *Megaupload*.¹³⁷ Some of these intermediaries, which have been accused of facilitating access to entire libraries of stolen content, are being denied legal protection for various reasons that go beyond copyright infringement, including breaches of their terms of service and accusations of hosting criminally prosecutable illegal content.¹³⁸ While this has led to a number of file lockers shutting down,¹³⁹ the ultimate effectiveness of these judgments is questionable. In England, when Internet Service Providers were directed to block access to *The Pirate Bay*, this was immediately subverted through proxies.¹⁴⁰ A recent study shows that

¹³³ See Preamble to the *World Intellectual Property Organization: Copyright Treaty* of December 20, 1996.

¹³⁴ See for example *Perfect 10 v. Google, Inc., et al.*, 416 F. Supp. 2d 828 (C.D. Cal. 2006); *Vivid Entertainment LLC v. Data Conversions, Inc. et al.*, Case No. 2:2007cv08023 (C.D. Cal. Dec 10, 2007), two prominent examples for cases that failed to reach judgments establishing liability for providers. See also Edelman, *supra* note 2, at 212-213.

¹³⁵ See for example *Viacom International, Inc. v. YouTube, Inc.*, No. 07 Civ. 2103 (S.D.N.Y. June 23, 2010), the prominent mainstream case, in which Viacom’s claims that YouTube is liable for copyright infringement through its users have so far been dismissed.

¹³⁶ The four *Pirate Bay* founders were sentenced to jail and fines by the district court (tingsrätt) of Stockholm, Sweden, case B 13301-06 (April 17, 2009).

¹³⁷ *Megaupload’s* owners were arrested and its sites were shut down by the Department of Justice on January 19, 2012, pending trial.

¹³⁸ For instance child pornography.

¹³⁹ Some of these closed down on their own accord following the recent judgments against others, for example, *Filesonic* and *Fileserve*, two prominent cyberlocker services, ceased their operations within three days of *Megaupload’s* shut down.

¹⁴⁰ See for example Sebastian Anthony, *The Pirate Bay evades ISP Blockade With Ipv6, Can Do It 18 Quintillion More Times*, EXTREME TECH (June 8, 2012), available at

preventing access to such websites has no discernible effect on the amount of file sharing that occurs.¹⁴¹ To the extent that there is no deterrence effect, enforcement against these intermediaries may only provide a short-term compensation to the individual litigator.

Seventeen of the twenty one adult content producers expressed frustration with the “safe harbor” provision for online service providers,¹⁴² in particular for the tube sites.¹⁴³ Because 17 U.S.C. §512(c)(1)(A)(i) states that the service provider is not liable if it “does not have actual knowledge that the material or an activity using the material on the system or network is infringing,” the right holders must locate all unauthorized uses of their material themselves and subsequently alert the intermediary using a takedown procedure.¹⁴⁴ Because not all firms have the necessary time and resources to monitor the sites for their material and send the required notices, some have outsourced this to external companies that specialize in the task. Others are working on technological solutions to automatically identify their content and send notification. Both of these solutions are costly, yet effective to the extent that large amounts of content can be tracked and located. Four producers were confident that these means would be able to stop (enough of the) unauthorized content distribution.

Once notified, the intermediary must respond “expeditiously” to comply with the takedown notice.¹⁴⁵ In practice, this will usually be a period of around 24-48 hours, which for the adult tube sites means that the content may have already been viewed millions of times.¹⁴⁶ Furthermore, once the content has been taken down it will often quickly

<http://www.extremetech.com/internet/130627-the-pirate-bay-evades-isp-blockade-with-ipv6-can-do-it-18-septillion-more-times>.

¹⁴¹ See Joost Poort & Jorna Leenheer, *Filesharing 2©12, Downloaden in Nederland*, Report: Instituut voor Informatierecht and CenterERdata (October 16, 2012) (Dutch), available at http://www.ivir.nl/publicaties/poort/Filesharing_2012.pdf.

¹⁴² See *supra* note 132.

¹⁴³ Although also other media sharing sites, such as social networks like *4chan* or *Tumblr*.

¹⁴⁴ See also Yagielowicz & Pardon *supra* note 88.

¹⁴⁵ 17 U.S.C. Section 512(c)(1)(C). See also Debra Weinstein, *Defining Expeditious: Uncharted Territory of the DMCA Safe Harbor Provision*, 26 *CARDOZO ARTS & ENT. L. J.* 589 (2008), p. 589.

¹⁴⁶ See Anthony, *supra* note 13.

reappear. While repeat infringers are required to be banned from posting to the site, the content will simply be uploaded under a different user account,¹⁴⁷ leading to a continuous circle of takedown notices and uploads that producers likened to “*cat and mouse games*” or “*whack-a-mole*”.¹⁴⁸

Based on the suspicion that the tube site operators themselves were uploading stolen content in order to increase traffic to their sites,¹⁴⁹ one of the large producers said they had taken legal action against some of the intermediaries, and gotten favorable settlements. However, according to the DMCA, and confirmed by a landmark decision in the case of *Viacom v. Google (YouTube)*,¹⁵⁰ so long as the site operator has no knowledge of infringing user-uploaded content, it is only required to take down as notified by the content owner. Tube sites and other user-uploaded content aggregators are therefore able to continue to operate, so long as they are not proven to be directly infringing or purposely allowing users to infringe despite knowledge of the action.

Given the financial impact for producers of losing exclusive control over their content, many continue to engage in the takedown procedure and are investing in technological strategies¹⁵¹ as well as partnership models with the tube sites.¹⁵² Producers and industry specialists expressed acute awareness, however, that these measures will neither eliminate

¹⁴⁷ See also Yagielowicz & Pardon, *supra* note 88: “A UGC [User Generated Content] site with a repeat offender (whether a “real” user or spurious staffer) that is required to terminate that user’s account will only see user John_123 quickly come back as John_124 or under some other bogus identifier or “nick” (short for “nickname”). The signup process’ relative anonymity prevents any effective due-diligence — even by those UGC sites that may be actually interested in keeping infringing content uploads at bay.”

¹⁴⁸ A producer who uses automated software that checks every two hours for fingerprinted content said “*It’s really eye-opening: [...] Let’s say it’s up for a day [...] in that short window over a hundred million people had already viewed it. In that short window. So even though we get it down, a lot of these tube sites, their whole business is the front page. Whatever is new. Whatever is new is a day or two. So if they take it down a day or two later, it doesn’t matter, they’ll have new stuff up.*”

¹⁴⁹ Implied also in Yagielowicz & Pardon, *supra* note 88.

¹⁵⁰ See *Viacom International, Inc. v. YouTube, Inc.*, *supra* note 135.

¹⁵¹ E.g. digital watermarks and fingerprinting systems.

¹⁵² For example the Free Speech Coalition’s Anti-Piracy Action Program (APAP) which seeks revenue-sharing models with participating tube sites in exchange for the adoption of technological measures to police for fingerprinted material. See <http://fscapap.com/tube.html>.

online copyright infringement, nor be an effective way to recoup costs within the traditional business model of creating and selling content.

4. Summary

Copyright protects adult content. But infringement has become technologically easy and commonplace online. Fully enforcing exclusive rights is prohibitively difficult. In order to effectively protect their copyrights, producers must sue the individual users that upload pirated content (to tube sites or onto file-sharing networks), send whack-a-mole takedown notices to user-uploaded content sites, or litigate against intermediaries, who often cannot be held liable. The obstacles to these actions and the general difficulty of preventing online copyright infringement undermine producers' ability to retain exclusivity of their material. Furthermore, many producers are competing with free content that serves as a partial substitute, making it more difficult to sell content as a way of recouping the costs they have invested in its production. If content has the attributes of a commodity, enforcing copyright becomes a rather useless exercise. Settlements from peer-to-peer end-user litigation may have a (short-term) compensation effect for those who engage in it, and potentially a slight deterrence effect on general file sharing or the unauthorized use of a specific company's material. However, enforcement remains largely ineffective in helping to salvage the traditional model of selling content, because it is undermined by the availability (and substitutability) of free material.¹⁵³

Because of the barriers to, and ineffectiveness of, copyright enforcement, both producers and industry specialists confirm that the industry cannot rely on the copyright system as it was originally intended to function. In the absence of the economic incentives provided by copyright law, simply attempting to prevent copyright infringement within a traditional business model of creating and selling content is deemed a losing strategy. Producers are therefore moving to adopt other methods of recouping investment costs.

¹⁵³ See *infra* Part IV.3 on why free material is unlikely to disappear – not only does pirated content remain available on the tube sites, but content producers are also giving part of their content away as a loss leader.

Since the function of copyright is so severely undermined in the online adult entertainment industry, it is an interesting space to analyze in the context of markets with low IP protection. Previous literature has found shifts in the type of innovation that is produced.¹⁵⁴ The next Part explores a similar shift in the online adult entertainment industry, where new kinds of goods are emerging. Furthermore, while production may have suffered setbacks, either in quantity or quality, it looks at why some incentive to produce traditional content may remain.

IV. INDUSTRY SHIFT AND NEW PRODUCTION INCENTIVES

"You know, in this industry, when we started, you made a movie and you put it out on DVD and that was your income. And anybody that just stuck with that model? They're not around anymore."

The conventional theory behind copyright predicts that the production of goods will be insufficient where copyrights are missing. While such 'underproduction' is difficult to measure in practice,¹⁵⁵ the common belief among industry members is that production of adult content has indeed decreased in recent years, not only because of the economic downturn, but also as a result of copyright infringement.¹⁵⁶ As the industry has struggled to maintain content exclusivity, its production levels appear to

¹⁵⁴ See *infra* Part IV.2.

¹⁵⁵ As one of the smaller producers put it: *"It's really impossible to quantify how much of an impact it's had on any one company. You know you're making content, you know it's stolen out there, but you don't know how many consumers would have bought it if it hadn't been out there. So you don't know how much you would have earned, or maybe lost, you can't really ever do it, it's just guessing. You just generally feel it has an impact."*

¹⁵⁶ While common lore has it that the demand for adult material is comparatively inelastic (i.e. more recession-resistant than for other entertainment goods), the economic crisis is likely closely linked to copyright infringement because free content serves as a (imperfect) substitute for paid content, even if it is of lesser quality, see *supra* Part III.3.

have suffered. The key question, however, is whether anything else is happening.

Looking at how the industry has steadily weathered previous changes,¹⁵⁷ technological disruptions have generally always been times of struggle as many companies go out of business. But they have also always cleared the way for new market entrants, and the companies that have survived and been successful in the long-term have been flexible enough to quickly and fundamentally adapt their business models in times of change.¹⁵⁸ What is currently perceived, particularly in the news media, as the “death” of the industry,¹⁵⁹ might simply be a turnover of old players being replaced by new players with new strategies.

If there is an industry that is most likely to survive whatever hardship is thrown at it, adult entertainment seems a strong contender.¹⁶⁰ Part of the industry’s general flexibility may be due to the fact that it has historically been unable to fall back on law enforcement or policy makers when dealing with technological disruption.¹⁶¹ The socially stigmatized business has little political clout and adult entertainment companies are comparatively weak in lobbying policy makers to represent their interests.¹⁶² Because using politics to resist change is not an option, some of the long-term successful companies in the business may be especially quick to accept new environments as a given and figure out how to work with them.¹⁶³

¹⁵⁷ E.g. the development of home video technology, or the Internet prior to broadband, see Bakker & Taalas, *supra* note 4; BARSS, *supra* note 8; see also FREDERICK S. LANE III, *OBSCENE PROFITS: THE ENTREPRENEURS OF PORNOGRAPHY IN THE CYBER AGE*, Routledge (2001).

¹⁵⁸ For an example of the adaptability of companies like *Playboy*, see *supra* Part IV.3.

¹⁵⁹ See *supra* note 17.

¹⁶⁰ See for example Dan Cameron, *Edge Of Gay: Of Machines and Men*, XBIZ NEWSWIRE (July 20, 2012), available at <http://www.xbiz.com/articles/151390> (Site NSFW): “The business is never settled,’ Valenti says. ‘If you think it’s settled, you’re about to hit an iceberg. This is a tremendously innovative industry, Darwinian sometimes’.”

¹⁶¹ “[T]he porn industry is a different one. We don’t have any cache with lawmakers,” said one producer, adding that “the entertainment industries are trying to rewrite all the laws and make anyone a criminal just for whistling a tune when they walk down the street. Completely overkill.”

¹⁶² Although the industry does have a (small) political lobby in the form of the *Free Speech Coalition*, a non-profit trade association that “opposes the passage and enforcement censorship and obscenity laws,” see <http://www.freespeechcoalition.com>.

¹⁶³ Or, as more than one producer put it, to “adapt or die.”

The new environment in this particular case is the architecture of the Internet, which allows content to be liberally copied and distributed by unauthorized users. While this has created considerable difficulties in protecting the exclusivity of copyrighted material, some industry specialists and producers claimed that increased access and wide availability has also greatly expanded the consumer base for adult content, including many who are willing to spend money. What they feel has changed in recent years, however, is for what exactly the average consumer is willing to pay.

While times have been tough, conversations with industry specialists and qualitative interviews with content producers indicate that the industry is restructuring itself to adapt to this new environment. Companies are shifting towards selling what cannot easily be copied or offered for free¹⁶⁴ and looking for ways to recoup costs. Interestingly, it appears that some of the new business models could sustain the production of traditional content,¹⁶⁵ as well as increase investment in types of goods that are less easily replicable.

When asked whether and how copyright infringement had impacted adult entertainment, all twenty-one of the interviewees felt that unauthorized content distribution had changed the industry over the last five to eight years.¹⁶⁶ While they confirmed that many adult entertainment production companies were struggling or had gone out of business as a result, most believed that those companies had largely disappeared because they failed to change their business models. Five producers were more conservative with their answer, stating that those that had perished were not good enough at what they were doing, rather than that they did not change. The interviewees also stated that in addition to unauthorized content distribution, the traditional business models of the industry were facing an additional problem: the circumstance that many producers were giving away content for free, undermining the ability of others to sell theirs. Several noted that consumer expectations had significantly changed, in that people expected to be able to get (at least some) content free of charge, and that they were trying to accommodate these new

¹⁶⁴ See discussion below for examples.

¹⁶⁵ Not at the same level as previously, but at a higher level than assumed by conventional IP theory, *see infra* Part V.

¹⁶⁶ The most commonly stated defining change factors were the popularization of the tube sites followed by the economic downturn.

expectations. When asked what strategies they and others were using to recoup costs, especially the large producers reported to have changed, or be in the process of changing or expanding their main revenue sources. All of the twenty-one producers and the majority of industry specialists noted a perceived shift in the industry towards selling experience-based goods, with an increased focus on services and interactivity. While about three quarters of the respondents reported to have reduced their level of content production, some said they had not. While all but three indicated that they were trying to supplement their revenue sources with activities other than just selling content, none of the twenty-one interviewed producers expressed the belief that they would discontinue the production of traditional, copyable material.

The following parts take a closer look at convenience goods, experience goods, and the incentives to continue producing traditional content.

1. Convenience Goods

"Ultimately, I think the defense is a good offense. You know, create a good product, have it easily available at a good price point, so people don't want to go around trying to find it."

"Whenever there's a new way for people to consume, we'll get there. And we'll get there quick."

While average consumers may be less likely to pay for content that they can find freely available elsewhere, a part of consumers seems willing to pay for content when it is tied to services. Unlike a music consumer, who may download an album to listen to later on, adult entertainment is often intended for immediate use, and consumers are willing to make purchases quickly and compulsively - a consumption pattern that providers can oftentimes exploit. Also, browsing well-displayed content is frequently part of the consumption experience. According to industry specialists, consumers value the quality of content curation, preferring to browse content pre-consumption that is specifically tailored to their preferences, and many are willing to pay simply for the convenience of not having to search through free material to find the content that they want. Finally,

both privacy and location are of significant importance to consumers. Services that enable content streaming to mobile devices or allow users to store material in the cloud are becoming popular and are potentially profitable. This part describes the curation, access, and storage services increasingly offered by providers in more detail.

Because of the importance of browsing, content providers will invest in the visual aesthetic and usability of their websites¹⁶⁷ and try to cater to visitors' preferences by offering services that free websites cannot. While it may be possible to find all of the posted material through unauthorized sources shortly after a release, the producer sites provide reliability, convenience, more tailored aesthetics; are able to cater to individual tastes through a more narrow categorization of content; and provide consumers with descriptions, trailers, crowd-sourced ratings, and more. Teasers and links to "more from this performer" or "more from this genre" are apparently of value to the average consumer, who will rarely be looking for a very specific product (such as consumers in other industries might look for a particular music album or film) and be more prone to browsing in preferred genres prior to a purchase. The browsing process can even be seen as part of the consumption, as the points in time of acquiring and consuming content are generally very close together. For these reasons, well-designed sites offer an added service value to the consumer and ultimately allow producers to sell material that is available for free elsewhere. Many websites still offer subscriptions, tying in users with the promise of continuously updated content that is easily found and immediately available.¹⁶⁸ The curation and browsing convenience aspect could be the reason why these subscription models are still successful. Although less lucrative than about five to eight years ago, producers report that subscription models continue to attract paying customers and

¹⁶⁷ Producers do this, for example, by exploiting every technique available for attracting a browsing user's attention and catering to the wants of frequent visitors. Landing pages are content heavy and well-designed, the newest videos are prominently displayed and usually feature free screenshots and trailers that are expertly produced to interest consumers in purchasing the full film. The purchase itself is made as simple as possible. See for example Hugh Hancock, *Why a Good Porn Site Makes Our Web Show Pages Look Like Crap*, GUERRILLA SHOWRUNNER (February 25, 2011), available at <http://guerillashowrunner.com/2011/02/why-a-good-porn-site-makes-our-web-show-pages-look-like-amateurish-crap>.

¹⁶⁸ Subscriptions to websites are usually monthly, but users are sometimes offered shorter- or longer-term options. Most subscriptions allow full access to all of the material on the website. See Edelman, *supra* note 2, at 212-213.

contribute to their income.¹⁶⁹ When asked why users would pay for their service if they can find the same (or similar) films or photos elsewhere, many guessed that their customers value not having to navigate or sift through free material to find the content that they want.¹⁷⁰ By establishing themselves as service providers, production companies distance themselves from needing to protect their proprietary content rights as the sole means of income.

As described above, content is often copied and distributed without authorization, and some producers will also attempt to license their content non-exclusively at a very low price. Because of this, many websites offer duplicates of the same content available on other websites. This situation is reminiscent of the post-vaudeville era of stand-up comedy, where jokes were generic and freely appropriated,¹⁷¹ creating an environment in which stand-up comedians competed over performance rather than content.¹⁷² What adult entertainment providers in this case end up essentially competing over is distinctions in service, design, format quality (for example in the form of higher resolutions, faster downloads, or streaming video), content curation, search functions, media integration, selection, and so forth. This would suggest that in these cases there is less investment in the quality of content production – non-exclusively licensed content appears to be among the cheapest produced.¹⁷³ However, at the same time this model incentivizes higher investments in other aspects, namely those of performance. Service

¹⁶⁹ A (non-representative) survey by Xcritic.com of 400 respondents found that more than half of online consumers still pay to watch porn, see Bob Johnson, ‘*Sex Tracker*’ Survey Reveals Users Still Pay To View Porn, XBIZ NEWSWIRE (5 March, 2012), available at <http://newswire.xbiz.com/view.php?id=145219>.

¹⁷⁰ They also cited brand loyalty as a reason. Part of the reason may also be that consumers sign up for a monthly payment model to access something specific and then neglect to cancel the subscription, which is typically renewed automatically. See Edelman, *supra* note 2, at 213: “In a dataset I received from a top-10 seller of online adult entertainment, [...] 54 percent of customers continued subscriptions beyond their first month of service via the seller’s automatic renewal service. Of the sites Rabbit’s Reviews examined, 47 percent offered short trials (three days or less), which typically automatically become monthly subscriptions at the end of the trial period.”

¹⁷¹ See Dotan Oliar & Christopher Sprigman, *There’s No Free Laugh (Anymore): The Emergence of Intellectual Property Norms and the Transformation of Stand-Up Comedy*, 94 VA. L. REV. 1787 (2008), p. 1847-1850.

¹⁷² See *id.* at 1853-1854.

¹⁷³ But see *infra* Part V. for discussion of quality and “optimally low” production costs.

distinctions are more radically improved, because companies are focused on competing through services rather than content. Furthermore, as discussed in more detail below, some incentive to invest in higher quality on the content level remains intact, particularly for producers that are able to brand their material.¹⁷⁴

Another form of ‘convenience’ that some producers are increasingly beginning to offer is catering to specific preferences in niche markets. Similar to the way that the music and book industries have been able to expand into less popular areas with online distribution,¹⁷⁵ some producers are now focused on exploiting the long tail of the adult entertainment market.¹⁷⁶ By accommodating narrower and more personal customer requests, producers remain able to create and sell traditional content, because it is difficult to find a rare or specific thing elsewhere.¹⁷⁷ Even if the products are later copied and circulated without authorization, production costs are sufficiently low, and consumers remain willing to pay a high enough price to commission individual, personalized projects. Furthermore, this allows a brand to build a loyal customer base that is willing to pay and return for more. Some niche producers are able to effectively make the case among their consumer community that their specific content will die out without financial support.

Companies are also currently playing with a variety of new video-on-demand models. Available technologies for home viewing over television now include built-in Smart TV platforms,¹⁷⁸ external boxes that can be

¹⁷⁴ This is because they will try to distinguish their product and tie the material to their services and other offerings, e.g. to strengthen their brand, provide consumers with a reason to visit or revisit a specific website, purchase a subscription or other services, or to draw people to their website for purposes of advertisement revenue, *see infra* Part IV.3

¹⁷⁵ *See, e.g.*, Erik Brynjolfsson, Yu Jeffrey Hu, and Michael D. Smith, *The Longer Tail: The Changing Shape of Amazon’s Sales Distribution Curve*, working paper (September 20, 2010), available at <http://ssrn.com/abstract=1679991>.

¹⁷⁶ The “long tail” of a market in this context commonly refers to the demand for many different small quantities of unique goods, rather than large quantities of more popular goods. *See id.*; *see also* Erik Brynjolfsson, Yu Jeffrey Hu, and Michael D. Smith, *From Niches to Riches: Anatomy of the Long Tail*, 47 SLOAN MANAGE. REV. 67 (2006), p. 67-71.

¹⁷⁷ In this regard, niche content has far less attributes of a commodity than “non-niche” content.

¹⁷⁸ These platforms give users access to streaming content providers over their home television displays. ‘Smart TV’ generally refers to the merging of Internet services into television sets.

connected to a Smart TV, and subscription models similar to the popular non-adult film rental service *Netflix*.¹⁷⁹ For example, adult content providers will offer individual films for purchase, or unlimited streaming of on-demand video over authorized platforms for a monthly fee.¹⁸⁰ The fact that instant access to digital film rental or purchase over Smart TV systems appeals to consumers is plausible: similar models for cable television¹⁸¹ and video-on-demand in hotel rooms have previously enjoyed wide success.¹⁸²

The main reason the producers feel that consumers are willing to pay for this type of service is the convenience and location of video-on-demand content, which gives it an edge over free content offerings. This superiority partly relies on the fact that unauthorized content is currently more complicated to access technically over most Smart TV platforms. However, similar to non-adult entertainment goods, and perhaps even more so, even a small convenience barrier appears to suffice to generate willingness to pay.¹⁸³ Low content production costs for adult material¹⁸⁴ may make free subscription models supported by advertisements and premium content upgrades sustainable.

While individual service models may face some obstacles,¹⁸⁵ producers agreed that delivery of content has become an increasingly important

¹⁷⁹ The company *Netflix, Inc.* (founded in 1997) offers streaming media services. While they started with DVD rental, now they are a major provider of on-demand Internet streaming of movies to compatible devices.

¹⁸⁰ The older model of sending home-video formats like DVDs via physical mail is also still effective, but increasingly outdated for younger generations. Consumers value instant access, perhaps even more so than compared to other entertainment industries like non-adult film and music - a consumer may be more impatient than wanting to order a film via snail mail.

¹⁸¹ See for example Lynn D. Wardle, *Cable Comes of Age: A Constitutional Analysis of the Regulation of "Indecent" Cable Television Programming*, 63 *DENV. U. L. REV.* 621 (1985), p. 624-626.

¹⁸² See for example Arnold H. Loewy, *Obscenity: An Outdated Concept for the Twenty-First Century*, 10 *NEXUS* 21 (2005), p. 26.

¹⁸³ See for example L. Richard Ye, Y. Zhang, Dat-Dao Nguyen, and James Chiu, *Fee-based Online Services: Exploring Consumers' Willingness to Pay*, 13 *J. INT. TECH. INF. MAN.* 133 (2004), p. 133-141.

¹⁸⁴ See also *infra* Part V.

¹⁸⁵ For instance being banned from certain devices and mainstream channels due to the nature of the content.

aspect of their revenue stream. Their competition with other producers, and especially the competition with free content, is often over tying content to services. While they say that producing content is still important to them, many feel that they compete over “*bringing content to the consumer.*”

“We’ve tried to adapt by offering an optimal customer experience.”

One area that producers claim has grown significantly in both size and relative importance in recent years is the mobile market. Adult content providers were quick to move into the smartphone space. Now, in the current mobile device landscape, tablets are particularly attractive to exploit because of their screen size and portability. *Apple* products, which currently make up a significant portion of the market,¹⁸⁶ do not permit adult-themed apps on their smartphones and tablets, but adult companies have optimized their websites to enable easy browsing and purchasing and have found workarounds to *Apple*’s restrictions by developing web apps that run within the standard browser on devices.¹⁸⁷ Two producers claimed to have developed the first-ever WAP site for smartphones.¹⁸⁸ While it may perhaps be disputable which company was the very first, adult websites were undoubtedly among the pioneers of smartphone-platform compatibility and mobile-friendly design. Providers have been quick to become proficient in HTML5 and device-friendly video formats,

¹⁸⁶ See Rhoda Alexander, *Apple’s Share of Media Tablet Hits More than One-Year High in Q2*, HIS ISUPPLI MARKET RESEARCH (press release, August 14, 2012), available at <http://www.isuppli.com/Display-Materials-and-Systems/News/Pages/Apples-Share-of-Media-Tablet-Market-Hits-More-than-One-Year-High-in-Q2.aspx>; ComScore, *July 2012 U.S. Mobile Subscriber Market Share: Apple’s Share of Smartphone Market Grows to 1 in 3 Subscribers*, COMSCORE (press release, September 4, 2012), available at http://www.comscore.com/Insights/Press_Releases/2012/9/comScore_Reports_July_2012_US_Mobile_Subscriber_Market_Share.

¹⁸⁷ See PR Newswire, *Vivid Entertainment Launches ‘Vivid Touch- First Browser-Delivered Web App For Apple Smart Phones And Tablets*, PR NEWswire (press release, September 24, 2012), available at <http://www.prnewswire.com/news-releases/vivid-entertainment-launches-vivid-touch---first-browser-delivered-web-app-for-apple-smart-phones-and-tablets-170982821.html>.

¹⁸⁸ A WAP (Wireless Application Protocol) site is a website that has been designed/optimized for mobile phone viewing.

and they claim that they will remain on the cutting edge as technology continues to evolve. There is an allegedly thriving market for Android apps, which so far are not subject to the kinds of restrictions that *Apple* has in place.¹⁸⁹

Not only are mobile devices convenient as such, but producers can also offer the convenience of cross-platform compatibility. This service can have an edge over pirated material if users wish to access content from multiple devices. Often, unauthorized files must be converted to, or downloaded in, different formats in order to move them, which can be a tedious and time-consuming process. Producers are now quick to offer their content in every possible format and are beginning to provide instant wireless access and cross-platform streaming to any device (for example from web to mobile devices, but also to *Blu-ray* players and game consoles like *Playstation*). Producers said there is increasing demand for video streaming to devices and that the companies that moved quickly have been able to profit financially. They expect to be able to further capitalize on streaming services as they become more widespread.

New advances into offering streaming from cloud and locker services are interesting, because providers will additionally store content for the consumer. This not only has the advantage that it can be accessed from any place and device with an Internet connection, but also that the library is not stored on the user's device. This saves storage space, and comes with a significant privacy advantage, because it leaves less record of consumption to be discovered, e.g. by other household members or device users. Payment models range from purchase, to subscriptions (allowing limited or unlimited access to content libraries), to rental, to pay-per-minute streaming access. Even if consumers can find the same content by searching through free websites or file-sharing networks, it seems that paid providers are able to capitalize on the convenience and privacy aspects of their services.

¹⁸⁹ While some stores do not permit adult content apps, the Android platform does not restrict third-party app development. App stores like *MiKandi* are therefore able to offer adult content, as well as services for creating, developing, and publishing apps. See Jason Kincaid, *Android's App Store For Pornography, MiKandi, Adds Support For Paid Applications*, TECHCRUNCH (November 23, 2010), available at <http://techcrunch.com/2010/11/23/androids-app-store-for-porn-mikandi-adds-support-for-paid-applications/>.

"We might not make as much money on DVDs anymore, but now we have all of these other revenue streams, and all added up together, from cable TV to VOD to Internet to all this stuff added up, that creates the revenue that you need in order to make it successful"

Furthermore, capitalizing on convenience is not the only way that producers are attempting to recoup their investment costs. The following part looks at a further exploitable aspect of adult entertainment consumption: Experience.

2. Experience Goods

"[T]he industry is adapting - there's a lot more "live" stuff going on, there's also a lot more gaming, interaction."

"You see more companies dabbling in interactivity with the content. So I think that as an industry, we are evolving."

According to interviewees, the most significant way that adult entertainment is adapting to compete with free content and recoup costs is by focusing on experience goods. From new home viewing technologies to live chat and live camera shows, producers are looking to increase immersiveness and interactivity. They are also trying to engage consumers through gaming and virtual worlds, as well as through real-life community building. All of these methods aim to create an enhanced and more personalized experience for the consumer, while at the same time being inherently difficult to appropriate and copy.

The loss of a large part of the traditional content market to free material makes producers especially dependent on other sources of income. As an interviewee described one of the challenges:

"There's not another industry in the world that is media that is for a very specific reason. You can go watch a YouTube video for hundreds of thousands of different reasons. To laugh, to cry, to show your friends, to learn to hack, to whatever, it's everything. But pornography is just to

get off. That's the only reason to watch it. So how do you monetize it [if content is free]?"

A few of the interviewed producers¹⁹⁰ are currently not only working on enhancing the consumption experience, but also on creating new reasons and new contexts for engaging with adult entertainment. Home video technologies with high resolutions and large screens allow for a substantial difference in viewing quality. When faced with the option of searching through masses of lower quality material that is available for free, or purchasing formats in high quality, some users will choose the latter based on their investment in home viewing systems. The fact that consumers in this case are not obtaining the high quality formats from unauthorized sources relies partly on technological factors,¹⁹¹ and partly on the convenience factors illustrated above.¹⁹² But interestingly, producers also believe it is driven by the fact that the act of purchasing the material is part of the experience. This is one of the reasons that two producers say to have changed their strategy to actively target couples – a market they claim did not exist over a decade ago. As one producer explained:

"We're more a couples-oriented company now. You're not going to want to sit with your girlfriend or your wife in front of a tube site and look at clips. You want an experience, you want something that... You sit down, you put in a DVD or a Blu-ray and you want to watch it on your big-screen TV, or in your bedroom, you know, have an "evening". So even though we're pirated a lot - we're the number one company that gets pirated - at the same time people will go buy the DVD because they want to have that experience."

Makers of adult entertainment 'parodies',¹⁹³ a long-time popular format, continue to produce, despite the fact that these films are an expensive investment compared to less intricate films with lower

¹⁹⁰ Specifically two of the large firms.

¹⁹¹ See for example Edelmann, *supra* note 2, at 213 (on video resolution quality).

¹⁹² See *supra* Part IV.1.

¹⁹³ 'Parodies' are adult film versions of popular mainstream films, TV show, and books, often mixing adult content with general entertainment (humor, drama) and featuring comparatively elaborate props, costumes, and effects.

production costs or short video clips.¹⁹⁴ To a small but present extent, high-end material like full-length feature films is able to capture an aspect of experience. While sales have reportedly declined compared to a few years ago, two interviewees claimed to be witnessing new, capturable trends in consumer interest. They said that not only has their consumer base expanded to include more couples and more women, but also that there are other reasons to purchase their products in the first place, for example that younger generations of adults will treat their material as social entertainment.¹⁹⁵ They ascribe these trends to changing social norms surrounding adult content. These market expansions tie into the experience aspect in that they capture new reasons and motivations to consume that are often linked to willingness to pay, both in order to ensure high quality, and also to create a specific environment.¹⁹⁶

Future developments in home-viewing technology are expected to generate both interest and revenue. Some producers are keeping a close eye on technologies that are expected to be marketable within the next five to ten years. One given example was 3D-home-viewing on screens that do not require glasses.¹⁹⁷ They said they believe that moving into 3D formats may be worthwhile, because while unauthorized distribution serves as a partial substitute, the users who invest in high quality home-viewing technology will likely also purchase easily accessible, good quality content. 3D is believed to create a sufficiently different atmosphere that consumers are willing to invest in.¹⁹⁸

There are other immersive viewing contrivances on the horizon. Producers are playing with concepts of “virtual spaces” and thinking

¹⁹⁴ See also *infra* Part V.

¹⁹⁵ Consumers will allegedly purchase movies to watch with friends and even organize parties and social events around prominent releases.

¹⁹⁶ While these also apply to the non-adult entertainment movie industry, which may also be facing hardships due to content piracy, adult entertainment is comparatively much cheaper to produce, see *infra* Part V.

¹⁹⁷ This technology is still in development. See for example Adam Mann, *New Tech Could Mean 3D Movies With No Glasses*, WIRED (August 21, 2012), online edition, available at <http://www.cnn.com/2012/08/21/tech/innovation/3d-movies-no-glasses/index.html>.

¹⁹⁸ This format is more difficult to copy for technical reasons, and therefore may have less attributes of an information good. See Stephanie Pappas, *3-D Movies are Harder to Pirate, for Now*, TECHNEWS DAILY (February 8, 2010), available at <http://www.technewsdaily.com/109-3d-movies-are-harder-to-pirate-for-now.html>. Although this could change at some point, leading to a new DRM-technology war.

about ways to create enhanced experiences with various kinds of new technologies. For example, some companies have invested in, or recently launched, online “virtual strip clubs” and other digital 3D worlds, where users can watch media and interact with performers and each other using avatars.¹⁹⁹ When *Google* announced its *Project Glass* in Spring 2012,²⁰⁰ adult entertainment companies quickly applied for developers’ versions and began to brainstorm potential uses.²⁰¹

"[I]t's a good way of creating something that's harder for people to replicate, because you're creating an interactive experience."

Another way to generate a more immersive experience is through increasing ‘in-film’ interactivity by giving consumers more control over what is happening, rather than just providing static viewing of content. Some producers have switched from making full-length movies with subsequent scenes to shooting a variety of individual scenes in one setting, which are then offered to the consumer in a ‘choose your own adventure’-style model. For example, users may go to a website, watch some initial content for free, and then pay to have the scenes unfold according to their preferred options and pace.²⁰² While the individual video clips may be taken and distributed without authorization, well-designed, interactive services that offer a smooth experience appear to have an edge over free viewing that is static, or requires the effort of piecing together the same ‘story’ of content elsewhere. The ‘choose-your-

¹⁹⁹ See for example John Sanford, *Wasteland BDSM Virtual World Launches*, XBIZ NEWSWIRE (November 12, 2012), available at <http://newswire.xbiz.com/view.php?id=156454>.

²⁰⁰ Google Glass is an augmented reality head-mounted display (HMD) in the form of glasses, currently in prototype stage and being made available to selected developers. See David Pogue, *Google Glass and the Future of Technology*, THE NEW YORK TIMES (September 13, 2012), Section B.

²⁰¹ See Sascha Segan, *Porn on Google's Project Glass Is Inevitable*, PC MAGAZINE (June 28, 2012), available at <http://www.pcmag.com/article2/0,2817,2406481,00.asp>.

²⁰² The reason for the tokens being (aside from the fact that people are undoubtedly more willing to spend tokens than see an actual price every time they make a payment) that the industry is unable to use micropayments the way that other industries can. Because adult companies fall into a high-risk category for credit card companies, there is effectively a minimum on accepted amounts that is too high for small, single-dollar purchases. For this reason, companies must persuade their customers to buy a stash of virtual tokens (e.g. worth \$20) at once and then have them cash in the tokens gradually, mimicking a system of small payments.

own-scene' model is both more engaging and more difficult to replicate for free.²⁰³

One of the most important and frequently cited current interactivity trends in adult entertainment is live chat and live camera. Many adult entertainment providers now feature popup chat windows in addition to static content on their websites. The chat adds interactivity, attempting to engage website visitors. Forms of popup chats vary – some are fully automated 'bots', others feature an actual person on the other end, and some will begin as an automated conversation and transfer to a person later on. But they all aim to generate interest through activity, interactivity, and increased personal engagement. For example, providers will attempt to motivate customers to enter paid areas of a website through notification of performers who are "currently online." Personal attention through live chat is one of the strategies that pay sites now use to set themselves apart from free sites.²⁰⁴

All twenty-one producers mentioned live camera as a significant new revenue source in the general industry. Performers will establish a direct connection to consumers via webcam, either out of their own homes, or from a studio. Live camera platforms, which are becoming popular and widespread, provide a personal experience that is significantly different to consuming recorded content. The increased investment in this type of model is based not only on consumer interest, but also on the extremely relevant fact that this type of good is not easily replicable. The content of a live chat can be recorded and the resulting video material distributed without authorization, but the recording of someone else's chat is a different type of product.

"You can steal the feed, but you can't steal the experience."

²⁰³ It is more difficult to replicate for the consumer. In theory, other providers could invest in offering the same service and free-ride on other producers' production by stealing the material. So far, this does not appear to be a problem, both because of the upfront investment in the technology and perhaps also because by using other content, providers could still be held directly liable for copyright infringement. To this extent, copyright would still play a role in protecting production investment costs.

²⁰⁴ See also Edelman, *supra* note 2, at 213.

In fact, distribution of recorded chat content, whether authorized or unauthorized, may actually serve as marketing for live camera websites. So long as the video is sufficiently branded as to be traceable to a provider, it will potentially generate awareness and attract users. Should a consumer become interested in the live experience, the only way to obtain it is then to pay a fee.²⁰⁵

Some reasons that consumers may prefer paid live camera over free static video include customizability and personal connection. Live chat and personal camera shows offer a greater level of diversification than one-way video, because the experience is customizable to specific requests. Another interesting thing about live camera chat is that it can cater not only to a variety of content preferences, but also to more diverse motivations to seek out the entertainment in the first place. For example, one live chat website operator claimed to have a customer who spends hours every week playing chess with one of the performers. He said that in that sense, his ‘product’ has expanded from a very narrow focus toward meeting new demands, for example the desire for personal connections.

It is worth noting that many of the mainstream news articles that have predicted the economic downfall of the industry use adult entertainment “stars” as an example.²⁰⁶ They provide anecdotal evidence that the “porn star is dying”, citing lower average wages and recounting stories of established adult performers having more difficulty finding work.²⁰⁷ But according to industry specialists, this narrative does not take webcam performers into account. They say that many of the performers making money through live camera and chat websites are not interested in being

²⁰⁵ For more on the strategy of using free video content as marketing, see *infra* Part IV.3.

²⁰⁶ See Theroux, *supra* note 17, on “How the internet killed porn” and “Twilight of the Pornstars”; Susannah Breslin, *How Porn Went From Boom To Bust*, FORBES (July 11, 2012), available at <http://www.forbes.com/sites/susannahbreslin/2012/07/11/how-porn-went-from-boom-to-bust/>.

²⁰⁷ See *id.* Although some of the interviewed industry specialists argued that this is the economy in general, not piracy, and that the market has been flooded with new workers because people need jobs. Additionally, some industry specialists claimed that adult entertainment work is becoming increasingly socially acceptable, with more people taking pride in the profession, and also with recent stories of performers (James Dean, Sasha Grey etc.) who have ‘crossed over’ into non-adult entertainment, something that was less likely to happen in previous eras. Should factors such as economic necessity and/or the lottery-style prospect of lucrative or socially rewarding non-adult entertainment careers contribute to an increase in available workforce, this is also likely to drive wages down.

“stars”, because it might actually hurt their business. When what they offer is a personal, intimate, exclusive experience, it would decrease the value of the service to the consumer if the experience were too obviously shared with many. In this case, the illusion of exclusivity is part of the purchase.

“There's the whole porn star thing, but then there's webcam girls. You know, webcam girls don't want to be known. 'Cause then that blows the opportunity of making a lot of money from people who are spending a lot of money. The guys who are spending hundreds of dollars a day to watch them on webcam, they're not gonna spend it if everyone knows who she is. 'Cause they want that exclusivity. More like, “oh this is my girlfriend”-type feeling, as opposed to being star struck or in awe of the girl. And if you look at how many webcams there are, I think that porn stars are over. It's like novelty, almost. Like the old-school porn is. I think it [old-school porn] can always exist, it's just more of a novelty than it is a business that's making a lot of money.”

Another area where producers can create immersive interactivity is gaming. The adult industry has previously faced a number of obstacles in the video game market. Not only have adult companies been unaccustomed to the comparatively large *ex-ante* investments necessary for quality game production,²⁰⁸ but they have also been restricted from platforms, mainstream advertising, and standard distribution channels. With fairly recent technological advances allowing for the possibility of high quality online games, however, distribution and cost becomes less problematic.²⁰⁹ Furthermore, with increasing consolidation and structural changes in the industry, firms appear more able and willing to make the

²⁰⁸ A study conducted by the market research company M2 Research in 2009 shows average video game development costs of \$10M for one platform, and \$18-28M for multiple platforms. See Wanda Meloni, *THE BRIEF – 2009 Ups and Downs*, M2 RESEARCH (January 5, 2010), available at <http://m2research.com/the-brief-2009-ups-and-downs.htm>.

²⁰⁹ The 2009 M2 Research study estimates a less daunting \$30K-\$300K for online games that do not deal with the packaging and marketing materials necessary for reaching offline retailers, see *id.*

necessary long-term development investments. Some of the larger producers have thus been experimenting with games, releasing initial trial versions for free to attract users and then offering paid upgrades or in-game purchases. One producer claimed that early tests have shown the majority of their users to “*get hooked*” and continue past the trial version, paying for upgrades. Producers try to increase the customizability of the experience with options like allowing players to create their own 3D scenes. While pictures and videos of such scenes may be appropriated and shared without authorization, technically constituting copyright infringement, producers feel that the distribution of customized scenes is not only unproblematic, but in fact desirable. The same way that in-game videos of massively multiplayer online role-playing games (MMORPGs) like *World of Warcraft*²¹⁰ go ‘viral’,²¹¹ this generates more attention for the game as a marketing tool. The experience itself cannot be replicated, and the copied material is not customizable. Producers are therefore even considering making the user-generated scenes freely available themselves.²¹²

Finally, companies are searching for ways to build not only virtual, but also real-life social communities around their products. Producers face the difficult circumstance of consumers’ privacy preferences - word-of-mouth marketing is less practiced, videos are not as widely shared among friends and strangers. Adult entertainment providers also face the difficulties of being restricted from some of the more popular social media platforms, such as *Facebook*. Music streaming services like *Spotify*,²¹³ for example, can more easily tie into social media platforms and piggyback off existing social networks, driving adoption and popularity. Not all platforms restrict adult content, however: *Tumblr* allows for curation and

²¹⁰ *World of Warcraft* (WoW) was released by American video game developer *Blizzard Entertainment* in 2004 and is currently the world’s most popular MMORPG (as measured by number of players).

²¹¹ See for example Joel Warner, *The Legend of Leeroy Jenkins*, DENVER WESTWORD NEWS (March 8, 2007), available at <http://www.westword.com/2007-03-08/news/the-legend-of-leeroy-jenkins/>.

²¹² See for example also Rhett Pardon, *Pink Visual Launches Sex Simulator MaleSpectrumGames*, XBIZ NEWSWIRE (September 10, 2012), available at <http://newswire.xbiz.com/view.php?id=153755>.

²¹³ *Spotify*, launched in 2008 by a Swedish company of the same name, is a music streaming service that collaborates with and offers material from the major (and many independent) record labels.

community building around specific preferences,²¹⁴ and many people in the adult industry use *Twitter* to establish and maintain contact to (and among) customers and fans. Furthermore, there are a number of adult social network alternatives to *Facebook* that are available and allegedly gaining popularity.²¹⁵

The concept of building social interaction and community appears to work especially well for more specific content preferences, like niche markets. For example, one of the larger U.S. ‘fetish’ producers has for some time now successfully invested in building a participatory, interactive experience around its community. The business models range from offering tours of its facilities and shooting locations to interested members of the general public, to allowing people to watch live shows in-person or even participate in scenes. It is also creating a social network and live webcam community.

All of these strategies attempt to provide an experience to consumers rather than selling static content. While this is a natural shift given the difficulties of preventing traditional material from being copied, some incentives to continue producing content may still remain intact. This is explored in the following Part.

3. *Traditional Content Production*

“To me, I think there's more money to be made in offering some of your content for free than in trying to protect it.”

“We can blame piracy, but at the same time we're dealing with a new generation of potential consumers.”

As adult entertainment producers shift towards selling services and experiences, they are not necessarily giving up on traditional content

²¹⁴ Although one producer lamented the other side of the coin, claiming that social network sites like *Tumblr* or *4chan* lead to a proliferation of unauthorized content being shared by members amongst themselves.

²¹⁵ One need only google adult-themed variations of the name.

production. Copyrightable content (video, photos) still serves a function, not only where it can be sold as the basis of convenience or experience, but also as a marketing tool. This is one of the reasons producers stated for continuing to create standard content.

Looking at the history of the online business, giving content away as a loss leader²¹⁶ is not a new strategy. *Playboy*, for example, adopted this approach in the 1990s, when it realized that its images were being copied and shared online. Rather than attempt to enforce its rights, it began to harness and exploit the unauthorized distribution of its content for marketing purposes, using it to increase traffic to its website and attract new customers. Recognizing that allowing others to use its images would strengthen its brand and function as free advertisement, the company simply made sure to mark all of its material with its logo, the *Playboy* bunny. Not stopping there, *Playboy* went beyond tolerating and began to actively encourage the use of its material, contacting the people who were hosting the images and offering them a business proposition: should they add a link back to the *Playboy* website, *Playboy* would pay \$25 (or more) for any subscriber who was directed to them through the link.²¹⁷ It even offered the host sites assistance in improving their web pages.²¹⁸ So while continuing to produce high quality images, *Playboy* actively began to focus on selling consumers subscriptions or pay-per-view offers,²¹⁹ in other words, conveniences for which people were still willing to pay.

Today, producers are engaging in similar tactics. Given the high visibility of content on tube sites,²²⁰ producers are able to distribute video clips to a large audience quickly and cheaply. They can provide this material without having to pay for hosting or bandwidth, which, many producers said, had become a heavier financial burden than content

²¹⁶ A loss leader is a good that is sold (or given away) below its cost price in order to attract customers to purchase other goods from the provider, who then aims to make a profit on the subsequent purchases.

²¹⁷ See John Schwartz, *The Pornography Industry vs. Digital Pirates*, THE NEW YORK TIMES (February 8, 2004), Section 3, Column 2; Money and Business/Financial Desk, p. 1.

²¹⁸ See *id.*

²¹⁹ See CARL SHAPIRO & HAL R. VARIAN, INFORMATION RULES: A STRATEGIC GUIDE TO THE NETWORK ECONOMY, Harvard Business Press (1999), p. 89-90.

²²⁰ See Anthony, *supra* note 13.

production itself.²²¹ The tube sites are able to cover their bandwidth costs through advertising revenue, as well as through economies of scale. Many producers now actively place their own content on the tube sites in the form of short, branded video clips. Sometimes this happens as part of a partnership with the site operator. Producers also distribute branded video clips over file-sharing networks: *“we seed our own torrents [...] - when you search for a pirated version, you find us, first.”*

Many also host free content on their own websites, saying that while this costs them bandwidth, the traffic that it generates (and subsequent purchases and/or sign-ups) is worth the cost.

“People [...] see the value of making a piece of content that can be ripped off easily and giving it away, and then monetizing elsewhere. You know, things that can't be stolen.”

“I work with musicians and all day long I tell them ‘give your music away for free.’ Because of the eyeballs. If you get maybe a couple thousand people buying your music, that's nothing compared to hundreds of thousands of people who will download it if you give it away. And then [...] you get them to buy x, you know, something that you can sell. [...] and I think that's way more valuable than a piece of intellectual property and fighting that.”

In order to attract interest in their particular brand, studios continue to produce their own content, rather than use or license others'. Even if producers have trouble selling their material exclusively due to it being copied and shared, some incentive to create it remains, as long as it can be tied to their brand.²²² The ways in which producers distinguish their products vary. For commodity content, the main goal may be simply to

²²¹ Said one: *“Production costs are a one-time cost, but the main cost is bandwidth”* Or another: *“one of the advantages of putting promotional content on tube sites is that we're no longer carrying the cost of feeding bandwidth to the world.”*

²²² Granted, this relies on another type of IP, but trademark performs a different function in this case. *See also* discussion below.

drop a name that sticks in a consumer's mind, while other producers will try to highlight their specific genre, style, or quality.²²³

As mentioned above,²²⁴ producers do not only attribute the difficulty in sustaining the business model of selling content to copyright infringement: many of them also spoke of changed consumer expectations and commoditization of content. While these three factors are inextricably linked, the majority of the interviewed producers, both large and small, expressed a sense that the environment they are operating in today has changed so fundamentally with new generations of Internet users that there is little to be done other than to mitigate the damage and try to adapt.

"It's really challenging, because there's a whole generation of people growing up thinking that they don't have to pay for things."

"I've tried to have this conversation with 20-year-olds that I know, that work in our office or their friends, and almost all of them - in this age group that's under 30 right now - they think of porn as free. They think of porn as something that's been accessible to them more than half their lives freely on the Internet. They don't see it as theft in any way. It doesn't even occur to their brains that one of us is producing the very thing they're watching. That someone had to pay for the creating."

"If you look at these guys, if you take a look at a Tumblr blog, a lot of them will say something like 'this is all stuff I found on the public domain of the Internet.' So they believe because they've seen it, it's part of the public domain, so they're free to re-share it as many times as they want. Or [...] they join the membership site and steal it. And then they, but

²²³ Also, while only a few companies sign performers exclusively, those that do will also tie the performers to their brand for marketing purposes.

²²⁴ See *supra* Part III.3.

then they don't think they're stealing it, they think they paid to be able to redistribute it.”

Because of this sharply perceived divide between law and social understanding or behavior,²²⁵ producers feel that they need to give away part of their content as a loss leader, not just because it may be appropriated for free anyhow, but also because they are trying to adapt to changed consumer expectations.

“As a whole, the production companies are responding by putting even more of their stuff out there for free to begin with, in the hopes of capturing more eyeballs to come in.”

“The whole thing's a double-edged sword, I mean, you can lock down your website so it would be impossible for people to redistribute the stuff, but then it's really going to affect what people's expectations are. People expect when they come to a website they're gonna see videos, photos, and if they like the video they can download it and have it. So there's a hunting and gathering on top of a horny desire that causes people to join these sites. And if you take that away from them, then they're unfulfilled. And [...] you have to satisfy the people who are legitimately there, and that also means that there are some people who are going to take advantage of that and redistribute it when they shouldn't.”

Furthermore, while it is debatable to what extent specific material is a commodity, many of the producers indicate that it is substitutable enough that their model of selling content is undermined by other producers giving theirs away.²²⁶

²²⁵ For further discussion of this, see *infra* Part V.

²²⁶ See also Edelman, *supra* note 2, at 212: “Sellers of adult entertainment face a variety of competing free material. For one, almost all sellers make a portion of their material available without charge, often styled as a “tour” or “preview” intended to draw

“The desire to have specific content is being completely set aside by the fact that you can just get other stuff.”

“With adult, we're facing not just piracy, but also free content.”

Once this cycle has started, it is difficult to switch strategies, because producers who do not use content as a loss leader are rendered at a disadvantage. Some indicated that the current situation resembled a prisoners' dilemma,²²⁷ in that no company has the incentive to deviate from giving away content, even though the industry might be better off if everyone played by the same rules. However, given the difficulties of copyright enforcement discussed above, it is unlikely that a coordinated strategy, even if possible, would salvage traditional business models.

“It's already changed, so why try to stop it? You have to learn what the new business model is to make money with that environment. And, you know, yeah, it's kind of fucked up, but a lot of things are fucked up. And it is a reality, so there's no way to change it.”

Currently, the producers continue to produce and freely give part of their content away. A few indicated they did so as part of a win-win business model. Sixteen of the producers felt that they simply had little choice in the matter, either because their material was likely to be appropriated and distributed through unauthorized sources anyhow, or because their consumers expected free material and would substitute elsewhere if they did not make theirs available. In producing and giving away content as a loss leader, companies now try to draw attention to

attention to paid offerings. Such free trials act as an imperfect substitute for a paid subscription.”

²²⁷ A prisoner's dilemma is a game theoretical situation in which individuals do not cooperate, even when in their best interests to do so, because if they choose to “play nice” and someone does not cooperate, they will lose to the deviator.

their brand, their websites, their services, and other goods, as illustrated above.²²⁸

There is another changing circumstance that contributes to companies' ability to cross-subsidize production and other goods, namely consolidation within the industry. These changes are explored in the following Part.

4. *Changing Industry Structure*

"We are at that stage in the lifecycle of this industry where there is a lot of change happening, and it will continue to happen. You have early entrants who are now looking to exit, you have business models that have not adapted or changed and are fading away, you have consolidation of entire parts of the industry. These will all drive a dramatically different landscape in the next few years. There are plenty of changes to come."²²⁹

"I know a lot of people who have been fucked, but... it's a new industry. You get too settled in to what you're doing, and you lead yourself off a cliff. [...] 3-4 years ago, I saw it crumbling. But the people who are now at the frontline really didn't ever complain about it. They adapted."

"[They] are consolidating the industry. And it's probably the smartest thing you can do right now. It's about to change - it's about to go through that metamorphosis. And I think in the end it's going to create better content for the consumer."

²²⁸ See *supra* Parts IV.1 and IV.2.

²²⁹ See Cameron, *supra* note 160.

While several adult entertainment production companies have gone out of business,²³⁰ there are also new companies that have entered the industry and existing companies that have grown.²³¹ Two noticeable structural changes among current companies in the market are vertical integration and consolidation. Firms are increasingly incorporating production, marketing, distribution, etc., and becoming larger, more organized structures. Producers are partnering with live camera operators and mobile technology providers and expanding into multiple market segments. Adult entertainment companies are folding into each other, as in, for example, the owner of a large network of tube sites acquiring a growing mass of production companies. While most people today know prominent adult entertainment names such as *Playboy* or *Hustler*, fewer people will have heard of a company called *Manwin*. Yet in recent years, these new players have come to dwarf their more famous predecessors in size and market power.

These fundamental changes in structure come with rising barriers to entry in the industry. Copyright infringement and the proliferation of free content, as well as recent Internet-inspired legal restrictions on content distribution,²³² have raised the bar. Many new business models, for example live camera operations, require upfront investments in technology. According to producers, the times in which individuals could set up a simple website with a minor investment and easily make a living simply selling material are over. Those able to enter the market and succeed are comparatively professional and strategic companies, as well as companies that have the financial means to invest in a variety of different business models as the industry adapts to environmental changes. Consolidation and integration allow firms to cross-subsidize their operations, working with content as a loss leader and investing to make other goods profitable.

As the industry restructures itself to adapt to its low-IP environment, this raises a more general question: How are these changes to be

²³⁰ Most of the interviewees stated at one point or another that many companies, in particular smaller ones, had gone out of business. But also larger ones, for example recently the well-known “Girls Gone Wild” franchise, see e.g. Mary Elizabeth Williams, *Did The Internet kill “Girls Gone Wild”?* SALON (March 1, 2013), available at http://www.salon.com/2013/03/01/did_the_internet_kill_girls_gone_wild/.

²³¹ For instance the live camera affiliate networks.

²³² See *supra* note 89.

evaluated within the economic framework of innovation policy? This is explored in the following part.

V. IMPLICATIONS

When asked about their predictions for the future of the industry, all twenty-one of the interviewed producers expressed the belief that the adult entertainment business would continue despite its hardships. One could argue that the answer of the interviewees, who represent active companies in the industry, is susceptible to bias. After all, it can be part of a CEO or high operational person's job to portray optimism about their business, particularly the success of their own business strategies. This study therefore also consulted knowledgeable individuals who were not or no longer part of active companies, general industry experts, and other information sources. The industry specialists did not display any large disparities in comparison to the twenty-one interviewees in their optimism for the industry. The feeling from the large majority of sources was that the industry was changing, rather than dying.

"I don't think it's going to kill the porn industry. No way. There's way too much money to be made right now. I mean, webcams are just ridiculous. So it's just people who understand this [the changed world] that are going to do well. [...] I don't think piracy is gonna kill this industry."

Contrary to common lore in the press and the basic intuition behind copyright policy, this study shows that the adult entertainment industry is surviving. Although copyright has become widely difficult to enforce, and traditional content production has allegedly declined, the business of adult entertainment appears to be sustainable. This is explained by a shift towards selling convenience and experience, both of which are more difficult to copy. Furthermore, traditional content continues to be produced for marketing purposes and in its function as a loss leader. This

study explains both the current coping mechanisms of the industry, as well as indicating how the industry could continue to survive in the face of copyright difficulties.

Given the robustness of the adult entertainment industry in the face of changing markets, it is worth looking at whether there is anything to be learned for innovation policy. Some industry-specific factors may translate to other creative industries on a case-by-case basis,²³³ and the shift towards convenience and experience goods, which is echoed in previous literature,²³⁴ seems both broadly applicable and fundamentally important to consider in the context of innovation policy. Without necessarily undermining copyright theory, it adds another perspective to consider in the (so far oversimplified) debate over what types of creation we as a society wish to incentivize and how to best support creators and content makers.²³⁵

To illustrate, take the example of coffee.²³⁶ Coffee can be sold to consumers in different ways. One way is by packaging coffee beans that people purchase as a product. Another way is to provide a service, i.e. selling prepared cups of coffee. In this case, consumers are paying not just for the product, but also for the convenience of having it prepared and ready for immediate consumption. Yet another way is to construct an experience around the product, such as a *Starbucks* coffee house, where people will pay not just for the coffee and the convenience, but also for the surrounding atmosphere. The interesting thing about this type of market is that the different goods (products, service goods, experience goods) can cross-subsidize each other. Even if coffee beans are made available for free, consumers will still be willing to pay for the services and experiences.

Applied to the online adult entertainment industry, coffee can be likened to traditional content (photography, film, etc). In this case,

²³³ For example, the fashion industry has short production cycles, *see, e.g.*, C. Scott Hemphill & Jeannie Suk, *The Law, Culture, and Economics of Fashion*, 61 *STAN. L. REV.* 1147 (2009); the alternative film industry Nollywood has low film production costs, etc.

²³⁴ *See supra* Parts II and IV.2 and also discussion below.

²³⁵ *See also* KAL RAUSTIALIA AND CHRISTOPHER SPRIGMAN, *THE KNOCKOFF ECONOMY – HOW IMITATION SPARKS INNOVATION*, Oxford University Press (2012), p. 167-168, on how our current theory of copyright may be oversimplified.

²³⁶ The following example has been modified from B. Joseph Pine & James H. Gilmore, *Welcome To The Experience Economy*, 76 *HARVARD BUS. REV.* 97 (1998), p. 97-105.

however, content is a non-exclusive, non-rivalrous information good. It can be easily copied once produced, leading to unlimited availability. Since consumers can get content for free, businesses therefore attempt to offer convenience and experience goods for which consumers are willing to pay. At the same time, they continue to produce information goods to which they can tie their brand in an attempt to build their reputation. One relevant difference to physical goods like coffee lies in the fact that distribution of information goods is cheap. In fact, the very mechanisms and platforms that limit producers' ability to sell content also allow for a highly cost-effective marketing model. Free material that is distributed through content aggregator websites can get hundreds of millions of views per day. The bandwidth costs for hosting the content are covered by the content aggregator provider (for instance through advertising revenue, or through cross-deals with content producers).²³⁷ Producers therefore have continuing incentives to provide traditional content, both to feed the convenience and experience goods, and also to strengthen their brand and draw attention to their businesses. This system relies on brand protection through trademark law, so it is not a "system without IP" in the broadest sense. The trademark protection, however, serves a completely different function than the function of copyright, rather than simply being wielded as a substitute as is occasionally seen in industries where there is overlap between trademark and copyright protection.²³⁸

Our current copyright law is based on a simplified blanket theory, without regard for factors or circumstances that may sustain some of the mechanisms in practice, or steer investment incentives in other directions rather than eliminate them.²³⁹ If coffee beans can be easily replicated, producers will have insufficient incentive to invest in coffee production. The market for coffee beans will die. To correct this, limited exclusive rights are created, taking into account that this will also limit access and distribution.²⁴⁰ To be clear: one cannot claim that an exogenous shock which makes coffee beans available to everyone for free will not cause

²³⁷ See also *supra* Part IV.3.

²³⁸ For instance in the fashion industry, see Hemphill & Suk, *supra* note 233, at 1177; Kal Raustiala & Christopher Sprigman, *The Piracy Paradox: Innovation and Intellectual Property in Fashion Design*, 92 VA. L.REV. 1687 (2006), p. 1723.

²³⁹ See also Oliar & Sprigman, *supra* note 171, at 1857.

²⁴⁰ The tradeoff inherent to copyright is between limiting access to works and creating incentives to invest in their production, see William M. Landes & Richard A. Posner, *An Economic Analysis of Copyright Law*, 18 J. LEGAL STUD. 325 (1989), p. 326.

negative market effects, just as one cannot claim that unauthorized piracy and content aggregators have not caused negative economic effects in the adult entertainment industry. Even if a system of cross-subsidizing various types of goods is sustainable, production of the base good may still be at a level below what we as a society desire, both in terms of quality and quantity. Another theoretical concern is whether there are negative effects associated with a shift in investment towards less desirable goods.²⁴¹

The main argument for copyright protection is based on the utilitarian theory of incentivizing artistic production.²⁴² While stimulating creative innovation is undoubtedly a noble cause and can generally be regarded as socially desirable, it is important to remember that its encouragement through our current copyright system of exclusive rights constitutes a tradeoff. The economic theory behind copyright law assumes that creating artistic works of social value comes with costs. Because information goods are easily copied once they are made available, creators' profits will be eroded by copyists, preventing the former from recouping their investments.²⁴³ In anticipation of this, the necessary efforts will no longer be made, resulting in underproduction. The chosen remedy to this market failure is to grant creators appropriability in order to incentivize their investment. However, granting these exclusive rights reduces the distribution and accessibility of artistic works.²⁴⁴ Furthermore, there are enforcement costs to a system of such rights to be taken into account, particularly since copyright covers intangible goods that are sometimes difficult to define.²⁴⁵ Appropriability should therefore only be granted to the extent necessary to sustain a socially desirable level of creation.²⁴⁶ In

²⁴¹ For instance towards ephemeral goods, rather than those with long-term value, *see id.* at 332. This is discussed in more detail below.

²⁴² *See for example* GOLDSTEIN, *supra* note 16, at § 1.14 ("Economic Foundations of Copyright"); NIMMER, & NIMMER *supra* note 16, at 17-18. The U.S. Constitution enables copyright laws that grant "Authors [...] the exclusive Right to their [...] Writings" in order "to promote the progress of Science", U.S. CONST. art. I, § 8, cl. 8. *But see also* Dan L. Burk, *Law and Economics of Intellectual Property: In Search of First Principles*, 8 ANNU REV. L. SOC. SCI. 397 (2012), p. 397-414.

²⁴³ *See* Robert M. Hurt & Robert M. Schuchman, *The Economic Rationale of Copyright*, 56 AM. ECON. REV. 421 (1966), p. 435.

²⁴⁴ Landes & Posner, *supra* note 240, at 326.

²⁴⁵ *See id.* at 331.

²⁴⁶ "To give greater property rights than are needed to obtain the desired quantity and quality of works would impose costs on users without any countervailing benefits to

other words, the social benefit of copyright must be weighed against the social costs it imposes. Both sides of the tradeoff are incredibly difficult to measure, so lawmakers and society must rely on the best possible information available when making policy decisions.²⁴⁷

Previous industry-specific studies that assess the relationship between intellectual property and creation incentives in individual markets have come to the conclusion that the ‘market failure’ assumed to happen in absence of formal IP protection is not always as strong as predicted by traditional theory.²⁴⁸ While it may be the case that content production in the adult entertainment industry has not disappeared as simplified copyright thinking would suggest, one should be hesitant to conclude that a blanket removal of copyright protection would strike the right balance for production. Just because an industry can survive without, or with less, copyright protection does not mean that economic market failure is absent. Theory predicts that in absence of copyright protection, the level of content production will be lower than what economics would deem optimal.²⁴⁹

Based on this interview study, it is realistic to assume that production of traditional content has to some extent gone down as a result of increased copyright enforcement difficulties. This study also demonstrates, however, that content production can nevertheless persist, and also that there appears to be increased investment in other areas. The standard basis for copyright does not take into account that there could be incentives to produce and give away traditional content for branding purposes or as a loss leader for other types of goods. As discussed below, this is something that other creative industries are experiencing, as well, and it is something that theory and policy may need to take into further consideration.

One theoretical concern could be a reduction in content quality rather than quantity. In absence of copyright protection, production may focus

society. To give fewer property rights than are needed to support this investment would give users freer access, but to a less than socially desirable number and quality of works.” See GOLDSTEIN, *supra* note 16, at § 1.14.

²⁴⁷ See *id.*, claiming that the “[Q]uantity and quality of [...] works that are socially desirable” is a value judgment and the effectiveness of copyright policy in achieving it an empirical question.

²⁴⁸ See *supra* Part II.

²⁴⁹ See Landes & Posner, *supra* note 240, at 332.

on cheaper, ephemeral works, with less upfront investment and more immediate gains.²⁵⁰ This is a legitimate worry for creative industries, and it is here that there may be a significant difference between the adult entertainment industry and some of the other entertainment industries in practice. Generally speaking, it appears that this type of inexpensive, ephemeral good is produced regardless of whether or not exclusivity is granted to producers. Whether this is due to a general substitutability of content, or due to specific consumer preferences, if adult entertainment consumers do not place sufficient value on high-investment, high-quality works, production costs will be low to begin with.

Even during the boom of filmmaking in the industry, when producers could have invested high amounts in the film quality of their content, production costs for adult material steadily remained far lower than for the major non-adult entertainment film industry. For example, “Pirates”, the most expensive adult movie ever produced, cost a total of \$1 million,²⁵¹ as compared to the \$317 million cost of Hollywood blockbuster “Pirates of the Caribbean – At World’s End”.²⁵² Furthermore, “Pirates” was a full-length spectacle featuring stars, acting, glossy editing, an unusually elaborate plot, and expensive sets and costumes. The majority of adult films are produced far less elaborately at a fraction of the cost. While high-quality production is undeniably of certain value to some consumers, it would be difficult to claim that the average user of adult content prefers a market with a smaller number of full-length, expensive films to one with very many different films that are short, simple, and inexpensive.²⁵³ Consumer preferences are likely part of the reason that most standard content producers have never really invested large sums of money in high-quality plots, creative content, expensive sets or special effects, focusing instead on short product cycles and high output rates.

²⁵⁰ See *id.* at 332.

²⁵¹ See Dana Harris & Thalia Ron, ‘Pirates’ Pic Unbuckled, VARIETY (September 15, 2005), available at <http://www.highbeam.com/doc/1G1-137212080.html>.

²⁵² See Jenny Aluning, *Top Ten Most Expensive Movies Of All Time*, STAR CENTRAL (January 17, 2010), available at <http://www.starcentralmagazine.com/the-ultimate-top-10-list/2010/01/17/top-ten-most-expensive-movies-of-all-time/>.

²⁵³ A TIME Magazine article from 2005 claims the average time that hotel in-room adult entertainment movies are watched is 12 minutes, see Richard Corliss, *That Old Feeling: When Porno Was Chic*, TIME MAGAZINE (March 29, 2005), online edition, available at <http://www.time.com/time/arts/article/0,8599,1043267-1,00.html>.

Further indication of ‘socially optimal’ low production costs can be found in the phenomenon of “Gonzo pornography” - professionally produced content that is made to look especially cheap. The narrative behind the popularity of such material begins with the decline of prices for computers, webcams, and all of the technology necessary to produce and distribute home-made video material. The success of mainstream platforms like *YouTube* has partially been driven by the fact that the barriers for anyone to create and share content have all but disappeared. Amateur-produced adult content for some time experienced a similar boom, because anyone could make and distribute home-made material.²⁵⁴ In the United States, legal requirements have since created considerable barriers to this type of production.²⁵⁵ However, despite the fact that ‘user-generated’ has become difficult in the United States, cheaply-made U.S. content has become rampant over the last decade, and interestingly, much of the popular material on tube sites is actively portrayed as low-budget productions by amateurs, despite being professionally produced.²⁵⁶

Of course, the wide availability of this material cannot immediately be interpreted as popularity in terms of consumer preferences. Some claim

²⁵⁴ Conventional economic theory would attempt to explain the phenomenon of user-generated content with indirect monetary incentives – producers and actors are willing to invest in creation of material that is freely distributed, because they hope that this will lead to their discovery and subsequent possibilities of making a career in the professional adult industry. However, insights from other literature implies that people may also create out of a desire for non-monetary prestige in the form of peer recognition (*see for example* Lydia P. Loren, *The Pope’s Copyright? Aligning Incentives with Reality by Using Creative Motivation to Shape Copyright Protection*, 69 LA. L. REV. 1 (2008), p. 8-9 on amateur and home photography; *see also* Josh Lerner & Jean Tirole, *Some Simple Economics of Open Source*, 50 J. INDUS. ECON. 197 (2002) on open-source software; Yochai Benkler, *Coase’s Penguin, or, Linux and The Nature of the Firm*, 112 YALE L.J. 369 (2002) on peer-production. Producing and uploading content that is well received may yield social rewards such as appreciative comments from others, or even popularity and fans. Another incentive to invest the necessary time or money could simply be intrinsic joy in creating (and/or exhibiting) adult content, for the same reason that people invest time and money in hobbies: because they derive utility from activities that are fun. A further reason could be creation of content for own use, the product of which is then basically costless to share with others. (*See for example* ERIC VON HIPPEL, *DEMOCRATIZING INNOVATION*, MIT Press (2005).)

²⁵⁵ *See for example supra* note 89.

²⁵⁶ This study focuses on U.S.-based production. In other countries with less legal restrictions and/or more illegal activity, ‘real’ amateur adult content continues to be produced and can be accessed over non-U.S. based services and providers.

that the vast supply of ‘amateur’ content is no reflection of what adult content users value most, arguing that many settle for a ‘low-quality’ version out of convenience.²⁵⁷ However, others claim that ‘amateur’ films do indeed reflect a prevalent consumer preference.²⁵⁸ Home-made-style content is felt to be more appealing to many because it seems more “authentic” and is easier to relate to.²⁵⁹ In fact, professional adult content producers seem to believe that this is the case, because the real or perceived popularity of ‘amateur’ adult content in the 1990s is what spawned this specific type of professionally produced films. “Gonzo pornography” effectively imitates user-generated content. The style of filming tries to capture the look and feel of a non-professional production, usually omitting scripts, plots, acting, costumes, and expensively groomed stars, and will even use bad lighting, cheap sets, and a shaky camera on purpose, to create the illusion of ‘authenticity’.²⁶⁰ Often, one person will do the directing, filming, and participate in the film all at the same time, enabling the production team to consist of as few as one to three people.

Needless to say, the costs of producing ‘amateur-style’ content are extremely low. Assuming that some consumers actually do value this type of content more than expensively produced feature films,²⁶¹ this would theoretically mean that the investment costs necessary to keep production at a socially desirable level are low. Even when also accounting for quantity, and catering to the other consumers who value more ‘polished’ content, the overall costs for economically optimal adult content production would still be significantly lower than they are for traditional Hollywood studios. The fundamental current reality for adult entertainment is that its market is facing difficulties in exclusively selling

²⁵⁷ See for example Cog, *Sexual desire, authenticity, and Internet business models*, THE ABSTRACT FACTORY (January 8, 2011), available at <http://abstractfactory.blogspot.com/2011/01/sexual-desire-authenticity-and-internet.html>.

²⁵⁸ See for example Natasha Vargas-Cooper, *Hard Core: The New World of Porn is Revealing Eternal Truths About Men and Women*, THE ATLANTIC (January 4, 2011), available at <http://www.theatlantic.com/magazine/archive/2011/01/hard-core/8327/>.

²⁵⁹ See *id.*

²⁶⁰ As one producer described: “*It's like a documentary, or reality show. You feel like it's real.*”

²⁶¹ A reason for this could be that this preference has always existed without being as socially acceptable, or without being recognized by producers, or could be due to changing preferences in society. Interestingly, if one assumes preferences to be path dependent, the implications would be that society’s “need” for content production can ultimately be fulfilled by cheaper content.

content. This situation will naturally cause a decrease in production investment. However, this decrease may not be as substantial as for other industries. Furthermore, the function of content as a loss leader will allow some to distinguish themselves from their competitors by offering more expensively produced content and then capturing the consumers that prefer “high quality” material with services and experience goods.²⁶² Relatedly, the incentive to meet consumer interests remains intact, so while there may be a drift towards lower-quality, inexpensively produced material, this can also simply mean a placement of investment elsewhere, rather than the loss thereof.

Regarding the shift towards other goods, a final concern derived from theory is that this may focus investment in less desirable directions.²⁶³ Looking at previous literature on markets with low IP protection, many have found investment in types of content that are more difficult to replicate. For example, French chefs develop intricate recipes that require additional know-how or personal assistance to copy,²⁶⁴ fashion designers will favor creating some kinds of products over others,²⁶⁵ and tattoo artists will customize and personalize their artwork.²⁶⁶ The findings of these prior studies echo the above-mentioned, yet seldom discussed implication, namely that the absence of IP protection may affect not the *amount* of investment in artistic production, but rather the *kind* of content produced.

Interestingly, this effect need not be a negative one. Oliar & Sprigman (2008)²⁶⁷ argue that, contrary to popular economic wisdom in IP theory, the shift they observe in stand-up comedy of content versus performance cannot be easily evaluated in terms of what type of investment is more

²⁶² “[Gonzo] is kind of like Walmart - cheap fast and everything's there. But there's people that want the Guccis and the Louis Vuittons, and the, you know, the Mercedes and things like that, so I think there's a market for both.”

²⁶³ See Landes & Posner, *supra* note 240, at 332, on a potential shift towards goods that are less easy to copy.

²⁶⁴ See Emmanuelle Fauchart & Eric A. von Hippel, *Norms-Based Intellectual Property Systems: The Case of French Chefs*, 19 *ORG. SCI.* 187 (2008), p. 8.

²⁶⁵ See Hemphill & Suk, *supra* note 233, at 1177-1178.

²⁶⁶ See Aaron Perzanowski, *Tattoos & IP Norms*, 98 *MINN. LAW REV.* (forthcoming 2013), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2145048, p. 38, 66.

²⁶⁷ *Supra* note 171.

socially desirable.²⁶⁸ While it is difficult to make the case from a purely economic perspective that necessity drives optimal innovation,²⁶⁹ and while it would be far-fetched to claim that there is no ‘market failure’ in the traditional sense to be observed in the struggling adult industry, the development towards experience goods may in fact not be quite as forced or suboptimal as assumed. In fact, some would say that one of the reasons adult entertainment drives new media formats so strongly is not only because of general high demand, but also because of demand for novel methods of consuming content.²⁷⁰ If users continuously and actively seek out newer ways to enhance their overall consumption experience, they will be particularly responsive to new formats. One producer spoke at length about technology adoption and consumption methods in the industry over history, pointing out that in succession, all successful new media developments for adult content ultimately strived toward creating the most “immersive” experience possible. She postulated that the trend towards selling interactivity and experience, while partially spurned by current copyright protection issues, was essentially a natural development that had less to do with hardship-induced necessity and more to do with what technologies were available now.²⁷¹

With regard to other major entertainment industries, the broad change this study observes in the adult market is by no means unique. Other industries are seeing a parallel shift towards experiences and services. For example, while declining sales in the major music recording industry are attributed to file sharing,²⁷² at the same time there has also been an

²⁶⁸ See *id.* at 1857.

²⁶⁹ This is because it effectively limits the available investment options by forcefully removing some of the possibilities, rather than let investments be guided by competition and market demand. On the other hand, some would argue that demand is neither static, nor a good measure of social desirability.

²⁷⁰ See for example BARSS, *supra* note 8, at 2 on how photography was driven by porn, not because of increased consumer privacy, but because it was an entirely new (and exciting) way to consume and experience adult content.

²⁷¹ For instance the fact that personal webcams have become far more affordable than a decade ago, and that broadband connections are common, allowing for video chat opportunities that were not available previously.

²⁷² See Stan J. Liebowitz, *Economists Examine File Sharing and Music Sales*, in: INDUSTRIAL ORGANIZATION AND DIGITAL ECONOMY, Gerhard Illing and Martin Peitz eds., MIT Press (2006), 145, p. 145-173; Stan J. Liebowitz, Research Note, *Testing File Sharing’s Impact on Music Album Sales in Cities*, 54 *MANAGE SCI.* 852 (2007), p. 852-859; George Barker, *Evidence of the Effect of Free Music Downloads on the Purchase of Music CDs in*

impact on complimentary markets for live performances,²⁷³ as well as for electronics and communication services.²⁷⁴ Some also observe complementary effects, wherein consumers will browse free or unauthorized content not as a substitute for purchasing, but rather in order to help them make an informed decision.²⁷⁵ Amidst these shifts, both the quantity as well as the quality of music²⁷⁶ may not suffer as much as traditional theory assumes. The major movie industry, despite declining DVD sales,²⁷⁷ appears to be successfully using the increase in broadband and digital networks to reach a much wider audience through services, and also profit through broader and more targeted advertising.²⁷⁸ Independent musicians are trying to give content away as a loss leader to build their fan-base and capitalize on live performances,²⁷⁹ and independent filmmakers and authors are using crowd sourcing to

Canada, 9 REV. ECON. RES. ON COPYRIGHT ISSUES 55 (2012), p. 55-78; but see Oberholzer-Gee & Strumpf, *supra* note 74.

²⁷³ See Alan Krueger, *The Economics of Real Superstars: The Market for Concerts in the Material World*, 23 J. LABOR. ECON. 1 (2005), p. 1-30; Marie Connolly & Alan Krueger, *Rockonomics: The Economics of Popular Music*, in: HANDBOOK OF THE ECONOMICS OF ART AND CULTURE, Victor A. Ginsburgh and Charles David Throsby eds., Elsevier (2006), p. 667-720.

²⁷⁴ See Oberholzer-Gee & Strumpf, *supra* note 74, at 19-20, and 44-45 who also argue that file sharing has increased consumer welfare substantially.

²⁷⁵ See for example Birgitte Andersen and Marion Frenz, *Don't Blame the P2P File-Sharers: The Impact of Free Music Downloads on the Purchase of Music CDs in Canada*, 20 J. EVOL. ECON 715 (2010), p. 715-740; see also Stefan Bechtold, *Law and Economics of Copyright and Trademarks on the Internet*, in: THE NEW PALGRAVE DICTIONARY OF ECONOMICS, Steven N. Durlauf and Laurence E. Blume eds., online edition, Palgrave Macmillan (2013), available at http://www.dictionaryofeconomics.com/article?id=pde2013_L000245.

²⁷⁶ See Joel Waldfoegel, *Copyright Protection, Technological Change, and the Quality of New Products: Evidence from Recorded Music since Napster*, 55 J. LAW ECON. 715 (2012), p. 715-740; see also Bechtold, *supra* note 275, noting that the existing empirical studies in this area are predominantly focused only on quantity.

²⁷⁷ See for example Alejandro Zentner, *Measuring the Impact of File Sharing on the Movie Industry: An Empirical Analysis Using a Panel of Countries*, working paper (March 10, 2010), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1792615.

²⁷⁸ See Michael D. Smith and Rahul Telang, *Piracy or Promotion? The Impact of the Broadband Internet Penetration on DVD Sales*, 22 INF. ECON. POLICY 289 (2010), p. 289-298.

²⁷⁹ See YOCHAI BENKLER, *THE WEALTH OF NETWORKS: HOW SOCIAL PRODUCTION TRANSFORMS MARKETS AND FREEDOM*, Yale University Press (2006), p. 421, 426; RAUSTIALIA & SPRIGMAN, *supra* note 235, at 179-184.

fund their upfront investments in content production.²⁸⁰ Law and economics research is increasingly attempting to understand and evaluate the effects of digitization and the Internet on copyrighted works and producer strategies.²⁸¹

The perceived divide between social norms and law that the adult entertainment producers articulated is regarded as a more general issue in online copyright infringement.²⁸² In 2002, POSNER explored the relationship between social norms and legal norms, in particular the factors of internalization, compliance, and risk, arguing for policy makers to take differences and their effects into account.²⁸³ A large divide between social norms and legal norms can cause less compliance, leading some to argue that the legal system should adapt to a perceived social norm of “sharing” on the Internet.²⁸⁴ Others argue that the law should be structured to inform social norms in the case of online copyright infringement, rather than the other way around.²⁸⁵ While the appeals to policymakers thus differ, content producers are currently left to their own devices. In absence of changed or enforced laws, creative markets appear

²⁸⁰ See Alison Flood, *Kickstarter Becomes Fourth Biggest Publisher of Graphic Novels*, THE GUARDIAN (July 11, 2012), online U.K. ed., available at <http://www.guardian.co.uk/books/2012/jul/11/kickstarter-fourth-biggest-publisher-graphic-novels>; Inge Ejbye Sorensen, *Crowdsourcing and Outsourcing: The Impact of Online Funding and Distribution on the Documentary Film Industry in the UK*, 34 MEDIA CULT. SOC. 726 (2012), p. 726-743.

²⁸¹ For an overview, see Bechtold, *supra* note 275.

²⁸² See for example Ben Depoorter, Sven Vanneste, and Alain Van Hiel, *Copyright Backlash*, 84 SOUTHERN CALIF. LAW R. 1251 (2011); Christopher Jensen, *The More Things Change, the More They Stay the Same: Copyright, Digital Technology, and Social Norms*, 56 STAN. L. REV. 531 (2004), p. 531-570; LAWRENCE LESSIG, *CODE: AND OTHER LAWS OF CYBERSPACE*, Basic books (1999), p. 53; Steven A. Hetcher, *The Music Industry's Failed Attempt to Influence File Sharing Norms*, 7 VAND. J. ENT. L. & PRAC. 10 (2005), p. 10-39.

²⁸³ See ERIC A. POSNER, *LAW AND SOCIAL NORMS*, Harvard University Press (2002); see also Eric A. Posner, *Law and Social Norms: The Case of Tax Compliance*, 86 VA. L. REV. 1781 (2000), p. 1781-1819.

²⁸⁴ See for example Depoorter, Vanneste, and Van Hiel, *supra* note 282; Daniel J. Gervais, *The Price of Social Norms: Towards a Liability Regime for File-Sharing*, 12 J. INTELL. PROP. LAW 39 (2003), p. 73; HOWARD RHEINGOLD, *SMART MOBS: THE NEXT SOCIAL REVOLUTION*, Basic Books (2002); Neil Netanel, *Impose a Noncommercial Use Levy to Allow Free Peer-to-Peer File Sharing*, 17 HARV. J. L. TECH. 1 (2003), p. 1-84.

²⁸⁵ See for example Mark F. Schultz, *Reconciling Social Norms and Copyright Law: Strategies For Persuading People To Pay For Recorded Music*, 17 J. INTELL. PROP. LAW 59 (2009), p. 59-88.

to be adapting to social norms, both in the adult entertainment industry and elsewhere.

While the general trend towards services and experiences is the same, what is effective in some industries to recoup socially desirable investment may be less so in others. The adult entertainment industry is characterized by attributes like low production costs, commodity-type goods, high demand, and somewhat unique consumer needs and preferences. This industry appears to be in a better position to capitalize on demand-driven traffic, immediacy, and privacy, while other entertainment industries may be in a better position to capitalize on ancillary markets for merchandise,²⁸⁶ social values,²⁸⁷ or crowd-sourced funding.²⁸⁸ Most importantly, it could be that the costs and benefits to having a system of exclusive rights vary strongly across industries, depending on the individual parameters.²⁸⁹ Even with a fully-functioning copyright system, the economic costs of granting protection to traditional adult entertainment content may be lower than for other entertainment goods, because content is more substitutable. This means that the monopoly-like effect of exclusive rights is lower. While this is reflected in the investment that producers may make in quality, social welfare may not suffer if consumers value access more than high quality content. This particular evaluation could be different for the shifts that other industries are currently experiencing in absence of efficient copyright protection. It could be that the change in adult entertainment towards more live camera, service-based goods, and experience technologies comes at lesser loss to social welfare than similar shifts in the mainstream film, music, or book publishing industries. A relevant question is what types of investments get lost in new funding models. For example, some criticize crowd-sourced funding for the arts as a shift towards populist projects with lesser long-term value to society, or as deterring to projects that carry legal and other risks.²⁹⁰ Changes in documentary film funding in the

²⁸⁶ E.g. the film and music industry, *see* Oberholzer-Gee & Strumpf, *supra* note 74, at 46.

²⁸⁷ For instance in convincing people to financially support creators.

²⁸⁸ E.g. through platforms like Kickstarter.

²⁸⁹ *See for example* Martin Peitz & Patrick Waelbroeck, *Piracy of Digital Products: A Critical Review of the Theoretical Literature*, 18 INF. ECON. POLICY 449 (2006), p. 449-476.

²⁹⁰ *See* EVGENY MOROZOV, *TO SAVE EVERYTHING, CLICK HERE: THE FOLLY OF TECHNOLOGICAL SOLUTIONISM*, Public Affairs (2013), p.26-28.

United Kingdom have been shown to affect the types of films that people invest in producing.²⁹¹ Whether socially desirable investments get lost in new models of content funding that rely less on copyrights is an industry-specific question that requires both empirics and value judgment.

This study furthers the insights from previous literature on industries with low IP protection.²⁹² Previous studies indicate that changing copyright regimes may be more likely to influence type of goods, rather than quantity, and that these shifts in type need not necessarily be negative.²⁹³ The interviews and collected information in this study clearly establish a shift towards service and experience goods, reaffirming the suggestion of prior literature. This study, however, also indicates that creative industries may differ in their innovation policy tradeoffs. Policy makers may want to consider where consumers, given the trade-off inherent to copyright law, may prefer an increase in access over an increase in product quality. While it is difficult to measure in absolute terms whether this is the case in the adult industry, this study sheds some first light on what is inevitably a value judgment for policy makers in practice.²⁹⁴ By looking at a large entertainment industry, and both reaffirming and furthering the findings of prior studies, this study makes a contribution to the literature on low IP markets.

Even based on this study, it seems overly simplified to argue, as some have suggested,²⁹⁵ that entertainment industries function just as well without copyright, and that the system of exclusive rights can be discarded.²⁹⁶ The general idea behind intellectual property, that it aims to correct a market failure and compensate creators for their investments, cannot simply be cast aside without a better understanding of the involved costs. As the debate about the tradeoffs of, and alternatives to, current innovation policies evolves, more information is required. Providing detailed, industry-specific insights into the types of investments and entertainment goods that are produced or affected by a change in law

²⁹¹ See Sorensen, *supra* note 280, at 739-740.

²⁹² See *supra* Part I.

²⁹³ See Oliar & Sprigman, *supra* note 171, at 1857; RAUSTIALIA & SPRIGMAN, *supra* note 235, at 179-184.

²⁹⁴ At least until we have further available information. However, it may remain difficult to quantify these variables in practice.

²⁹⁵ See for example Boldrin & Levine, *supra* note 23, at 40-42.

²⁹⁶ See *id.* at 7.

are therefore valuable. How these insights are applied more generally depends on what types of goods policy makers want to incentivize, as well as the goal of the system and the desired tradeoffs: whether the aim is to support creators and help them make a living, or whether it is to ensure widest possible distribution of works and lower social costs without too severely reducing incentives to invest in creation. Copyright law is but one way to correct the theoretical market failure inherent to information good production. Recent policy debates have brought alternatives to the table: politicians and academics are suggesting various ways to ensure that creators get compensated for their work, which at the same time attempt to mitigate the costs to society of granting exclusive rights. Whether evaluating the trade-offs of an industry-specific approach to innovation policy,²⁹⁷ or discussing systems of taxation and wealth redistribution outside of a copyright framework,²⁹⁸ it is useful to analyze the workings of individual industries in order to achieve a better understanding of how to meet the needs of consumers and creators.

CONCLUSION

This study has looked at content production incentives in the online adult entertainment industry, where copyright has been difficult to enforce in recent years. Because of copyright infringement and the proliferation of substitutable, free content, producers have struggled with the previously successful business model of producing and selling material. Through qualitative interviews with industry specialists and content producers, this study finds that the industry has been effectively unable to rely on the economic benefits that copyright intends to provide. As a result, the industry has shifted towards other strategies to recoup costs, with increased focus on services, experiences, and interactivity. Traditional content continues to be produced, partially as a basis for these new goods, and partially for use as a loss leader. While production is likely to have suffered in terms of quality and quantity compared to previous

²⁹⁷ See Raustiala & Sprigman, *supra* note 238, at 1762-1764.

²⁹⁸ See for example Netanel, *supra* note 284, at 1-84; CHRISTIAN ENGSTROM MEP AND RICK FALKVINGE, THE CASE FOR COPYRIGHT REFORM (2012), available at <http://www.copyrightreform.eu/>.

times, this study indicates that the market for adult entertainment may be sustainable. This sustainability relies partially on industry-specific factors, such as consumer privacy preferences, consumption habits, low production costs, and high demand. It also relies on a shift in business models, as well as changes in industry structure. By analyzing the relationship between copyright and innovation in the online adult entertainment industry, this study attempts to make a valuable contribution to the growing literature on low-IP industries. Studying real-world markets in the context of innovation may grant helpful insights to the policy discussion as we think about revising our laws in the digital age.

CONCLUSION

The research in this thesis has explored the economic effects of specific regulations and general innovation policy with different methodologies. In particular, it has been interested in how copyright laws affect markets and individuals' behavior in practice. The provided insights might be useful for a better understanding of the costs and benefits these legal rules entail.

Two theoretical papers have looked at legislation that is aimed toward creator compensation, finding potentially unconsidered and undesirable economic effects. The first paper dealt with restrictions of new-use-right grants in copyright law. Although such regulation is meant to protect creators' financial interests, the analysis found that economic effects of the law, in particular high transaction costs, might thwart the intended goal. The paper demonstrated that new-use-right restrictions may warrant further consideration and might be unsuitable for protecting creators' interests, as well as how transaction costs might be reduced within the system. The second paper evaluated a differently structured legal rule with a similar purpose, namely author termination rights. Instead of transaction costs, which are less of a problem in this environment, the analysis found price changes, risk shifting, hold-up problems, and skewed incentives to be hindrances to the legislative goal, as well as to the utilitarian purpose of (in this case United States) copyright law. By applying economic theory to legal rules, both of these papers draw attention to effects that may be relevant to lawmakers, suggesting that such laws be reconsidered or reinterpreted.

The literature review and empirical industry study have compared the general incentive theory underlying intellectual property law and its market failure predictions to specific settings in practice. The first of these provided an overview of current literature on 'low IP' industries – studies that examine information production incentives in creative or innovative environments without (or with a low level of) formal intellectual property protection. Many of these studies have found that the relationship

between creation and intellectual property is more complex than assumed. In particular, information production markets can sometimes be sustained through additional factors that may be insufficiently considered by current policy. If intellectual property law is based on the utilitarian theory of incentivizing creative or innovative works, the findings of these studies draw the function and extent of our laws into question. The literature review situated the 'low IP' industry research in the body of literature on law and social norms and elaborated on its merits and shortcomings. Addressing some of the shortcomings, in particular the question whether information production can only be sustained in small communities with strong social norms, the forth paper then followed with a contribution to the 'low IP' literature in the form of an empirical industry study. Through qualitative interviews, it found that weakened copyright protection in the online adult entertainment industry has shifted innovation towards alternative business models, but also that content production incentives remain despite copyright enforcement difficulties. This paper endeavored to contribute some additional perspective to copyright policy discussion in the digital age.

This thesis thus comprises four attempts to provide relevant insights into the relationship between law and innovation. Intellectual property is commonly based on the economic justification of a tradeoff. It intends to balance the costs and benefits of creation incentives, prices, access, and distribution. The traditional theory behind our intellectual property laws, however, may sometimes be overly abstract. Applying theory and empirics, the work in this thesis looks more closely at specific laws and settings, and evaluates the effects of innovation policies from an economic perspective. In doing so, it has identified areas that may warrant reconsideration, especially in light of continuous technological progress.

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