

# ON THE PARTIAL (IN)ALIENABILITY OF USERS' RIGHTS

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Copyright law carefully allocates rights in creative works between owners and users. It enumerates several uses that are reserved exclusively to copyright owners, and therefore require others to obtain the owner's permission, while leaving all other uses free all. But copyright owners routinely accompany the works that they distribute with End User License Agreements, Terms of Use, or Technological Protection Measures (TPM) that often purport to restrict users from doing things that fall within the scope of users' right. Indeed, such restrictions have become commonplace in works distributed digitally: they may restrict the ways in which a work or product may be used or prohibit its resale; they may dictate that a product may be used in conjunctions with only some works or products but not others; they may prohibit the copying of facts or other non-copyrightable subject matter, or prohibit reverse engineering. All of these restrictions share a common feature: they purport to prevent users from engaging in acts which otherwise would be perfectly legal, and whose legality is not bug but rather a feature of what is supposed to be "a carefully balanced scheme".

Whether, when, and how such restrictions ought to be enforceable is a highly contentious question. This paper provides some answers.

## I. INTRODUCTION

In 2002, the Supreme Court of Canada presented the Copyright Act as "a balance between promoting the public interest in the encouragement and dissemination of works of the arts and intellect and obtaining a just reward for the creator" and held that "the proper balance among these and other public policy objectives lies not only in recognizing the creator's rights but in giving due weight to their limited nature."<sup>1</sup> In 2004, the Court reaffirmed that holding and declared that "[t]he fair dealing exception, like other exceptions in the *Copyright Act*, is a user's right. In order to maintain the proper balance between the rights of a copyright owner and users' interests, it must not be interpreted restrictively."<sup>2</sup> The Court reaffirmed this view that anything that Parliament has not granted to copyright owners constitutes a users' right in three additional cases decided in 2012.<sup>3</sup> According to the Court, Parliament has allocated rights between owners and users in a "carefully balanced scheme."<sup>4</sup> The concept of "users' rights", and the notion that the allocation of rights

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<sup>1</sup> *Théberge v Galerie d'Art du Petit Champlain inc* (2002), 2 SCR 336 at para 30–31 (ca SCC).

<sup>2</sup> *CCH Canadian Ltd v Law Society of Upper Canada* (2004), 1 SCR 339 at para 48 (ca SCC).

<sup>3</sup> *Society of Composers, Authors and Music Publishers of Canada v Bell Canada*, [2012] 2 SCR 326 (ca SCC); *Alberta (Education) v Canadian Copyright Licensing Agency (Access Copyright)* (2012), 2 SCR 345 (ca SCC); *Reference re Broadcasting Regulatory Policy CRTC 2010-167 and Broadcasting Order CRTC 2010-168* (2012), 3 SCR 489 (ca SCC).

<sup>4</sup> *Reference re Broadcasting Regulatory Policy CRTC 2010-167 and Broadcasting Order CRTC 2010-168*, *supra* note 3 at para 36.

between owners and users reflects “a carefully balanced [statutory] scheme” then, has now become deeply entrenched in Canadian copyright law.

So far so good. But copyright owners routinely accompany the works that they distribute with End User License Agreements, Terms of Use, or Technological Protection Measures (TPM) that often purport to restrict users from doing things that fall within the scope of users’ right. Indeed, such restrictions have become commonplace in works distributed digitally: they may restrict the ways in which a work or product may be used or prohibit its resale; they may dictate that a product may be used in conjunctions with only some works or products but not others; they may prohibit the copying of facts or other non-copyrightable subject matter, or prohibit reverse engineering. All of these restrictions share a common feature: they purport to prevent users from engaging in acts which otherwise would be perfectly legal, and whose legality is not bug but rather a feature of what is supposed to be “a carefully balanced scheme”.

The importance of *CCH* and its progeny has been noted extensively by others,<sup>5</sup> but the elevation of users’ status from sneaky loophole-seekers to right-bearers still leaves open an important question: are users’ rights alienable? Or in other words: are there limits to the private reordering of owners’ and users’ respective rights? For some, such private reordering constitutes an encroachment onto rights deliberately allocated to users and its proliferation a sign of a systematic failure of the statutory scheme. For others, such private re-ordering proves that the market framework contemplated by the *Copyright Act*, in which entitlements are exchanged for the transacting parties’ mutual benefit, is functioning exactly as intended. After all, a copyright owner unquestionably can assign her copyright in whole or in part to another person,<sup>6</sup> and she can waive her exclusive right by granting a license, which is merely a permission to do that which would otherwise amount to infringement.<sup>7</sup> She can thus alienate her exclusive right to others for a fee; or she can do that for free, and presumably limitations on the rights of users can be just as valid a currency in such a voluntary exchange.

Obviously, those who subscribe to the view that users’ rights are always, or at least generally, fully alienable, would also support the enforceability of the legal instruments that purport to effectuate them, whereas those who consider such private reordering repugnant to copyright law’s underlying public ordering also seek to invalidate any such arrangements and might favor an array of legal responses, ranging from simply rendering such restrictions unenforceable to more severe responses such as a finding of copyright misuse or perhaps even antitrust liability. Likewise, those who support alienability might also tend to support TPMs and prohibitions on circumventing them, while alienability-skeptics would also look skeptically at TPMs and favor liberal rights to circumvent them.

A third approach, treating users’ rights as partially (in)alienable, lies at the centre of this paper. It begins by explaining why treating user rights as either inalienable or fully alienable is unsatisfactory, and argues that a more productive question should be under what conditions users’ rights may be alienable. The paper will then proceed to develop a framework for determining the conditions of

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<sup>5</sup> E.g., Patry

<sup>6</sup> *Copyright Act*, RSC 1985 C C-42 [*Copyright Act* (CA)], sec 13(4).

<sup>7</sup> *Euro-Excellence Inc v Kraft Canada Inc* (2007), 3 SCR 20 at para 27–28 (ca SCC).

partial (in)alienability. The framework will answer three main questions: one, under what conditions private reordering of owners and user rights should be permitted and when it should not be. Second, when reordering is permitted, how such restraints can be enforced and against whom (e.g., merely as contractual obligations, or as copyright infringement). And third, when reordering is not permitted, are the restraints merely non-enforceable, or will the attempt to impose or enforce them bear some negative consequences for the copyright owner.

## II. PRESENTING THE PROBLEM

If owners can generally alienate their exclusive rights (by assignment or grant of licenses) can users' freely waive their users' right as well? Two simple approaches to this question must be easily rejected. The first approach views the set of rights created by the legislature (and expounded by the courts) as a publicly ordered and carefully balanced scheme that allocates the respective entitlements of owners and users. Accordingly, that which Parliament decreed as belonging to the public domain should remain there, and the liberties that Parliament granted to users, allowing them to use works in certain ways without permission, should not be taken away from them. To allow private reordering of this carefully balanced public scheme would make a mockery of it.

Despite its intuitive appeal, this approach cannot justify total inalienability of users' rights. In its strongest form, it can only be justified if we assume that the allocation of rights between owners and users as set by the *Act* is always, or almost always, optimal.<sup>8</sup> But why would that be the case? To see why it could not always be the case, consider the following example.

### A. FIRST EXAMPLE: YOUNG *POETA NOVUS*

*Poeta Novus* is a young and aspiring poet who wrote a few poems but has never published them. He has recently completed a joint MBA/English masters degree from the University of Prestigia and graduated with honours. *Poeta* is not sure whether he should pursue a professional career in poetry or get a "real" job (he's been offered a job as an investment banker), so he decides to seek the advice of *Critica Celebris*, a well known critic, known for talent in spotting young talent and nurturing it. *Poeta* sends *Critica* an e-mail, asking her if she would be willing to read his poems and let him know what she thinks about them: if she thinks the poems are good (or that at least she can identify potential) he would continue writing, and if she thinks they're crap, he would quit writing and become an investment banker.

*Poeta* does not attach the poems to the email, but instead provides a link that *Critica* can use to download them. His email explains that if she decides to click on the link, she will be directed to a webpage containing terms of use (TOU) that *Critica* must accept before she could download the poems. The TOU stress that *Poeta* is the copyright owner in the poems, that he grants *Critica* a limited license to download the poems for the sole purpose of evaluating them, and that the grant of the license is subject to the following conditions: (1) if *Critica* thinks that his poems manifest no talent, she should let him know, delete the email and any saved copy of the poems, as well as discard

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<sup>8</sup> A modified version of the argument can be that even if we can conceive of examples in which private ordering can improve on the initial public ordering, the cost of attempting to identify those limited examples or the consequences of misidentifying them are not worth the effort.

any printed copy that she might make; (2) Critica should communicate her comments and thoughts about the poems only to Poeta, and, unless he decides to publish them, she should refrain from ever commenting on or criticizing the poems publicly; she should not disclose the content of her comments to anyone else, should not mention that she had read the poems, or that she had even been contacted by Poeta without his express and written permission. To justify such sweeping demands, Poeta explains that he has a very sensitive soul that could not tolerate the humiliation of being publicly criticized by Critica, whom he admires so much.

Critica replies the next day, writing that she would love to read Poeta's poems and send him her comments. She adds that she considers it a privilege to have the opportunity to read the works of budding poets and perhaps even discover the Next Big Poet. She further writes Poeta that she fully understands his concerns about being humiliated by a criticism from someone like her, and assures him that she agrees to his terms and conditions without any hesitation. Critica then clicks on the link, reviews the TOU, clicks on the "I accept" button, and downloads the poems.

Basically, Poeta has given Critica a license to reproduce his poems, but the license terms require Critica to waive her right to comment on and criticize a copyrighted work—perhaps the most fundamental and least controversial of all users' rights. Critica unquestionably agrees and accepts those terms, which directly impinge on her freedom of expression. Would those terms be binding on her? And should Poeta be able to enforce them if Critica breaches?

In my view, in these circumstances the terms should be enforceable. Three reasons support this conclusion. First, although the right to criticize is not only a foundational user right, but also a right that scores high for its intimate connection to freedom of expression values and to the exercise of one's autonomy and humanity as a thinking being, Critica's autonomy also entitles her to remain silent if she chooses so, and promise to remain silent. Therefore, when Critica waives her right to criticize, she exercises her free will, and holding her to her promise affirms her human agency.

Second, as Critica is the only licensee, her undertaking not to publicly criticize poems written by an unknown poet that would never be published, or not to disclose the fact that he had considered becoming a poet, has, at most, only *de minimis* effect on the public interest.<sup>9</sup> Thirdly, despite the deviation from the initial allocation of rights between owners and users, enforcing the no-criticism condition could actually promote the underlying purposes of the *Copyright Act*. As a sensitive aspiring poet, Poeta considers being publicly criticized by Critica so damaging, that he would rather not write poems at all if he couldn't reduce the risk. Allowing creators to seek comments on their unpublished works-in-progress while controlling the risk of damaging pre-mature criticism is not only a common practice, but also one that supports the creative process.<sup>10</sup>

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<sup>9</sup> It might not be impossible to imagine circumstances in which the public might have a compelling reason to override the non-disclosure undertaking. For example, suppose that Poeta has become the Minister of Education and proposes to remove the study of poetry from public schools' curriculum, and replace it with study of "financial literacy", stating that he "could not understand why any young person in his right mind would ever be interested in poetry." It is conceivable that if Critica were to break her silence in order to expose Poeta's hypocrisy, or to shed new light onto what might have motivated him to adopt his unusual and highly controversial proposal, she might be excused for breaching her earlier commitment, see *Hubbard v Vosper* (Lord Denning-public interest defense). A more mundane example could be litigation involving Poeta and Critica during which the details of their earlier interactions become part of the courts' public record.

<sup>10</sup> Ariel Katz, "Substitution and Schumpeterian Effects Over the Life Cycle of Copyrighted Works" (2009) 49:2 *Jurimetrics* 113, online <<http://search.proquest.com.myaccess.library.utoronto.ca/docview/223213710>>.

If this analysis is valid, then we cannot say categorically that any attempt by copyright owners to control the criticism of their works should never-ever be enforced because it is repugnant to copyright law's purpose. Note, however, that thus far we only accepted that a limitation on Critica's right to criticize may be enforceable, but we have not yet identified the exact legal regime that renders such a limitation enforceable, or the remedy that might follow as a consequence of a breach. That is, were Critica to breach the no-criticism condition, would she infringe Poeta's copyright (because the license that he gave her to reproduce the poems was conditional on her silence, meaning that her breach turns or into a copyright infringer); is the source of her obligation not to criticize a contract that she had entered into; or perhaps her position as a celebrated critic entails some kind of duty (based on notions of trust) not to publicly criticize unpublished works of aspiring poets without their permission, and this duty would exist even if Poeta had not stated those conditions explicitly; or maybe such duty may be rooted in tort law: based on a duty of care owed by a renowned critic to prevent the foreseeable harm to an aspiring poet's reputation or the emotional distress that may be inflicted on him as a result of pre-mature criticism of his work by a renowned critic.

These may be important questions because the source of the obligation and the remedies that may be available for its breach can help elucidating whether the apparent tension between enforcing the obligation and copyright law's underlying public policies represent a real conflict or only imaginary one. I will return to these questions later, but for now suffice it to say that we have identified circumstances under which an enforceable limitation on a user's rights might support the conditions for creativity and thus be consistent with copyright law's purposes, rather than repugnant to them. It might be argued that this example is so contrived that it does not teach us any important lesson, but this would be wrong. The point of this example is not to "prove" that there is no problem with alienating users' rights, but only to reject the position that any alienation of a user's rights is inconsistent with copyright law's public policy goals and therefore should not be permitted.

Let us now consider the opposite argument, the one favouring free alienability of users' rights. Under this view, the *Copyright Act* only defines a set of default entitlements, around which individuals are free to contract whenever they find it mutually beneficial. Under this view, eloquently articulated by Judge Easterbrook of the U.S. Seventh Circuit in *ProCD v. Zeidenberg*<sup>11</sup> user rights should be totally alienable, and contracts stipulating such alienation are generally enforceable, "unless their terms are objectionable on grounds applicable to contracts in general (for example, if they violate a rule of positive law, or if they are unconscionable)."<sup>12</sup>

Moreover, under this view the concerns about unsettling the statutory balance are conceptually misplaced because conditions to which an owner and a user agree affect only them, the transacting parties. These conditions create only *in personam* obligations, not *in rem*. Third parties are not bound

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<sup>11</sup> *ProCD, Inc v Zeidenberg*, 86 F3d 1447 (7th Circuit, 1996).

<sup>12</sup> *Ibid*, at 1499. Judge Easterbrook did not use the term "user rights". He also did not elaborate on what terms might be regarded as unconscionable in this context, and in fact, unconscionability might be one of the doctrinal tools for implementing some of the considerations that will be developed below. However, *ProCD* and other contemporaneous decisions and speeches comfortably place Easterbrook at or near the end of the alienability side on the alienability-inalienability spectrum. See Ariel Katz, "The First Sale Doctrine and the Economics of Post-Sale Restraints" (2014) 2014:1 BYU L Rev 55.

by the license terms and therefore are free to exercise whatever user right the legislators assigned them.<sup>13</sup>

Lastly, according to Judge Easterbrook, license terms accompanying works or products are conceptually identical to any other feature of the products or its price. Both determine what the consumer can do with the product. Generally, courts do not design products, do not determine their prices, and therefore should not intervene in the conditions accompanying their sale. Competition, not judicial oversight, is the best protector of consumers' interests.<sup>14</sup>

Judge Easterbrook's approach in *ProCD v. Zeidenberg* would tend to support full alienability of users' rights, and if Critica were to breach her commitment and Poeta sue her, *ProCD* would provide good authority supporting his case. But to see why this approach might seem too simplistic, let's suppose that Critica actually liked Poeta's poems, that he began publishing his poems, and that within a decade Poeta has become a well-known poet.

## B. SECOND EXAMPLE: MATURE POETA NOVUS

Ten years after publishing his first poems, Poeta's is ready to publish his latest collection of poems, but despite his success, Poeta still doesn't handle criticism well. In his view, those who criticize his work are narrow minded and jealous individuals who fail to recognize the true genius that he is. He doesn't think highly on those who praise him either. In his mind, they too often misunderstand him, and he suspects that their praise is only a disguise attempt to bask in the glory of his fame, or otherwise is motivated by ulterior reasons. Therefore, he decides to publish his latest collection of poems exclusively as an e-book. Why? Because "buying" an e-book entails making a reproduction of the book on each device to which it is downloaded, thus implicating the copyright owner's exclusive reproduction right. Therefore, e-books, like many other works in digital format, are often sold accompanied by an End User License Agreement (EULA) that buyers must accept before they can download them.<sup>15</sup>

Poeta considers this an opportunity, and he decides to include in the EULA a term stipulating that the poems shall not be criticized without his express, written, and prior permission. Unlike many EULAs, this particular no-criticism condition is not buried in long and incomprehensible fine print. It is prominently displayed, drafted in plain English, and designed in such a way that nobody can buy the e-book without first seeing and understanding this term. In addition, the e-book is protected by TPMs that require the reader to accept the clear and visible no-criticism condition whenever the e-book is installed or accessed, and before any part of it can be copied electronically or sent to a printer. If a reader attempts to "copy-paste" a poem or part thereof, the no-criticism condition will be added to the new document, and it cannot be deleted without deleting the copied text itself. It will be added as a watermark whenever a reader attempts to send a poem or a part

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<sup>13</sup> *ProCD, Inc v Zeidenberg*, *supra* note 11 at 1454–55.

<sup>14</sup> *Ibid*, at 1453.

<sup>15</sup> Technically, temporary copies of the book will be created any time the book is read, e.g., on the device RAM (random access memory) or on its display. Many publishers take the view that users require their permission to make these temporary copies too, and many EULAs license the making of such temporary copies as well. Whether this view of those temporary copies is correct is at least open to debate.

thereof to a printer, and will even appear whenever someone tries to scan, photograph, or photocopy the display of the reading device. The point is to ensure that nobody could read any poem without seeing, understanding, and accepting the no-criticism condition.

This time, it seems that might be at least strong intuition that enforcing the no-criticism condition might be more problematic, and that the reasons supporting enforceability in the first example do not apply.

Judge Easterbrook's analysis might also appear not fully satisfying. For example, while the distinction between contract and property, *in personam* and *in rem* obligations, is a valid one, it loses force in the context of mass-marketed copyrighted works. When massively distributed works are sold with restrictive terms, and it becomes difficult to access works to which such terms do not apply, the practical result may be quite similar to an *in rem* obligation. When technological measures reinforce the restrictions and the law prohibits circumventing them, the distinction collapses altogether, because the restrictions affect everyone in touch with the work—even those who are not privy to the initial contract or the license.<sup>16</sup> I will return to other problems in Easterbrook's reasoning later, but for now, let's stick to the intuition that courts may justifiably be reluctant to assist copyright owners implementing a distribution system designed to prevent anyone from criticizing their work.

So here we stand between two indefensible propositions: we have rejected the notion of total inalienability of users' rights (because we identified some conditions under which alienating such right will be consistent with copyright law underlying rationales), but we also have an intuition that full alienability does not make full sense either (because we identified some conditions under which alienating such right might be inconsistent with copyright law's underlying rationales). We also noted that in general owners are free to alienate their exclusive rights—in fact the *Act* explicitly contemplates such alienation by way of assignments, exclusive licenses, and ordinary licenses and imposes very few limitations on such alienation.<sup>17</sup>

What we ought to do next is to look for a rational basis for determining whether limits to private reordering of owners' and users' rights exist, and if such limits exist, to develop a workable framework that would allow us to decide which rights may be reordered and under what circumstances. Understanding the logic behind copyright law's *initial* allocation of rights between owners and users provides a good starting point.

### III. THE LOGIC OF COPYRIGHT LAW'S ALLOCATION STRUCTURE

Copyright law allocates rights between owners and users. Is there a reason why some rights are allocated to owners while others to users, or is the law's allocation structure merely arbitrary, or no

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<sup>16</sup> Ariel Katz, Substitution and Schumpeterian Effects Over the Life Cycle of Copyrighted Works, 49 *Jurimetrics J.* 113, 144 (2009). [Discuss Hohfeld "paucital" and "multital" rights.]

<sup>17</sup> For example, under section 13(4) of the *Copyright Act* "The owner of the copyright in any work may assign the right, either wholly or partially, and either generally or subject to limitations relating to territory, medium or sector of the market or other limitations relating to the scope of the assignment, and either for the whole term of the copyright or for any other part thereof, and may grant any interest in the right by licence," and the only limitations pertain to the form of the assignment or grant of interest which is not valid "unless it is in writing signed by the owner of the right in respect of which the assignment or grant is made, or by the owner's duly authorized agent."

more than a historical accident? If there is a logic behind copyright law's *initial* allocation or rights between owners and users then this logic may also help in deciding which rights are alienable and under what circumstances. In the following sections I provide an economic framework that explains copyright law's allocation structure. I will later supplement this framework with two legal considerations, dealing with autonomy and the constitutional dimension of division between private power and regulatory (or state) power.

#### A. THE ECONOMIC LOGIC

In a previous paper I suggested the following three related dimensions provide a rational basis for the law's allocation between owners' and users' rights:

1. Incentive sufficiency: We would tend to allocate uses that generate marginally high incentives to owners, and otherwise to users.
2. Utilizing capacity: We would allocate usage rights according to the relative capacity to utilize the work for socially desirable purposes, including innovative purposes.
3. Transaction costs: We would consider the likelihood of value-maximizing voluntary exchanges. Ideally, when transaction costs, broadly understood, impede socially efficient bargaining, we would like to allocate usage rights to owners if allocating them to users would undermine the incentive to create or disseminate, and we would like to allocate usage rights to those who might have comparative advantage with respect to certain types of uses.<sup>18</sup>

This framework is both descriptive (as it explains why some aspects of copyright law are the way they are) and normative (in the sense that provides a basis for critiquing some aspects of copyright law that are inconsistent with it, or provides guidance for resolving unsettled or disputed questions about the scope of owners' and users' rights). Understanding why copyright law allocates rights the way it does will also help establishing a rational basis for deciding if there are any limits on the private reordering of this public allocation of rights and what those limits are.

##### 1. *Incentive Sufficiency*

The goal of copyright law is to ensure, through the grant of exclusive rights, sufficient incentives for the creation and dissemination of creative works, while minimizing the deadweight loss that may arise from such exclusive rights. If so, then it must be acknowledged that not all uses are equal in the amount of revenue that they could be expected to generate *ex ante*, and therefore exclusive rights over some uses can be expected to generate higher incentive than exclusive rights over others. Therefore, it would make sense to allocate uses that generate marginally high incentives exclusively to owners, but otherwise to users.

For example, most of the revenue (and this incremental incentive) from publishing a book can be expected to be generated from the sale of copies within the first few years (or even months) from publication.<sup>19</sup> Therefore, it is easy to see why anyone who distributes unauthorized copies of a book

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<sup>18</sup> Ariel Katz, "Copyright and Competition Policy" in Ruth Towse & Christian Handke, eds, *Handbook of the Digital Creative Economy* (Cheltenham, UK: Edward Elgar, 2013) 209 at 211.

<sup>19</sup> Katz, "Substitution and Schumpeterian Effects Over the Life Cycle of Copyrighted Works", *supra* note 10.

in a way that competes and undermines the sales of copies by the copyright owner is very likely to be viewed as infringer. However, discounting and depreciation imply that beyond a certain term ‘the incremental incentive to create new works as a function of a longer term is likely to be very small’.<sup>20</sup> Therefore, incentive sufficiency supports limiting the term of copyright, and even within the term, it may support more stringent protection at the beginning of the term and more lenient approach later on.<sup>21</sup>

The potential expected revenue from some derivative works, such as an adaptation of a novel to a movie, may also be high, albeit lower than from publishing the book itself (otherwise the author/publisher presumably would have produced a movie first, or attempted to partner with a suitable producer), and this may explain why copyright law includes such derivative works, or adaptation, within the bundle of authors’ exclusive rights. However, not all uses of one work in the creation of another can be expected to generate the same revenue, and beyond some core of predictable uses, an exclusive right that encompasses any way in which the work may be repurposed will provide a rapidly decreasing marginal incentive to create the work. Therefore, incentive sufficiency justifies limiting the exclusive right to a set of predictable uses, and allocating the right to other uses to users.<sup>22</sup>

Copyright law does that in several ways: it grants exclusive rights only with respect to a list of enumerated uses, and provides additional limitations on the scope of those exclusive rights. For example, copying an insubstantial part of a work is not an infringement. Facts and ideas—which can be repurposed in myriad and unpredictable ways—can be freely copied.<sup>23</sup> Fair use or fair dealing allow users to use works without authorization, employing a multi-factor analysis. The US Copyright Act requires courts to consider several factors: (1) the purpose and character of the use, including whether such use is of a commercial nature or is for nonprofit educational purposes; (2) the nature of the copyrighted work; (3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and (4) the effect of the use upon the potential market for or value of the copyrighted work.<sup>24</sup> The Supreme Court of Canada adopted a similar six-factor framework.<sup>25</sup>

In their analysis, courts have to determine whether the use is merely substitutive to the work or whether it is transformative, namely “whether the work ‘adds something new, with a further purpose or different character, altering the first with new expression, meaning or message. . . .’ [T]he more transformative the new work, the less will be the significance of other factors . . . that may weigh against a finding of fair use.”<sup>26</sup> It is easy to see why: if the use is for another purpose, it is less likely

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<sup>20</sup> William M Landes and Richard A Posner, *The Economic Structure of Intellectual Property Law* (Harvard University Press, 2003) at 473.

<sup>21</sup> Katz, “Substitution and Schumpeterian Effects Over the Life Cycle of Copyrighted Works”, *supra* note 10.

<sup>22</sup> Katz, “Copyright and Competition Policy”, *supra* note 18 at 213.

<sup>23</sup> Katz, “Copyright and Competition Policy”, *supra* note 18.

<sup>24</sup> *Copyright Act*, 1976, 17 USC [*Copyright Act* (US)], sec 107.

<sup>25</sup> *CCH Canadian Ltd v Law Society of Upper Canada*, *supra* note 2 at para 53–60.

<sup>26</sup> *Authors Guild, Inc v Hatbitrust*, [2014] 2014 WL 2576342 (2nd Circuit) (internal citations omitted). The significance of the “transformative use” concept has been demonstrated empirically, Matthew Sag, “Predicting Fair Use” (2012) 73:1 Ohio St LJ 47, online <<http://ssrn.com/paper=1769130>>.

to function as incentive-reducing substitute, and more likely to increase social utility.<sup>27</sup> Likewise, copying a smaller amount will tend to have a smaller incentive-impairing effect, and “Finally, the fourth factor requires us to assess the impact of the use on the traditional market for the copyrighted work. . . . To defeat a claim of fair use, the copyright holder must point to market harm that results because the secondary use serves as a substitute for the original work.”<sup>28</sup>

Likewise, copyright law grants owners some powers to design effective distribution systems (where the existence of such powers may be crucial for sustaining a high level of revenue), but the first sale doctrine limits their power to control subsequent transfer of copies or otherwise control downstream uses, that can generally be expected to generate decreasing marginal revenue/incentive values.<sup>29</sup>

## 2. Utilizing Capacity

Copyright law tends to allocate usage rights according to the relative capacity to utilize the work for socially desirable purposes, including innovative purposes. We can fairly assume that *ceteris paribus*, and relative to any other randomly chosen person or firm, creators have *some* advantage in utilizing a work for the purpose for which it was created and around the time it was created. Prior to publication, the advantage may simply reflect the fact that the author possesses the manuscript, but the advantage may also stem from the somewhat better information that an author may have about *her* work (relative to anyone else), which puts her, all things equal, in a slightly better position to choose suitable partners (such as publishers) who might best utilize it. This advantage weakens over time, while the cost of getting permission, if required, increases as the identity of the current owner and his or her whereabouts become more difficult to discern.<sup>30</sup> Moreover, at least for projects that reuse several existing works, the greater is the number of such component inputs that require permission, the higher will be the cost of getting it, as well as the likelihood of a tragedy of the anti-commons.<sup>31</sup>

Utilizing capacity can explain why in most cases the authors is also the first owner,<sup>32</sup> but also why when the work was made by an employee in the course of his employment, then in the absence of any agreement to the contrary, the employer rather than the employee is the first owner of the copyright.<sup>33</sup> But the advantage in utilizing a work by the owner is limited to the purpose for which the work was created and around the time it was created. It easy to see that the range and value of potential uses such as those incorporating non-substantial parts of a work, uses that repurpose ideas

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<sup>27</sup> Katz, “Copyright and Competition Policy”, *supra* note 18 at 214.

<sup>28</sup> *Authors Guild, Inc v Hatbitrust*, *supra* note 26.

<sup>29</sup> Katz, “The First Sale Doctrine and the Economics of Post-Sale Restraints”, *supra* note 12.

<sup>30</sup> Katz, “Copyright and Competition Policy”, *supra* note 18 at 211–12.

<sup>31</sup> Michael A Heller and Rebecca S Eisenberg, “Can Patents Deter Innovation? The Anticommons in Biomedical Research” (1998) 280:5364 *Science* 698, online <<http://www.jstor.org/stable/2895332>>.

<sup>32</sup> [*ca-legislation-first*].

<sup>33</sup> *Ibid*, sec 13(3); See also Michael D Birnhack, “Who Owns Bratz: The Integration of Copyright and Employment Law” (2009) 20 *Fordham Intellect Prop Media Entertain Law J* 95.

or facts embodying in a work, and uses that may use the whole works or a substantial part thereof in transformative ways, is not only vast, but entirely unpredictable. There is no reason to assume that a priori copyright owners would have any comparative advantage with respect to utilizing the work for those purposes, and presumably, every user of such idiosyncratic uses might have a slight comparative advantage with respect to his contemplated use.

Utilizing capacity thus explains why copyright owners' exclusive right does not extend to all possible uses of the work, and why the law allocates the right to engage in such uses to users. Allocating the right to engage in such uses to users maximizes social utility: it maximizes the use of works by effectively reducing the price of use to marginal cost, and since the marginal ex ante incentive value of such uses is low and decreasing, allocating usage rights to users does not undermine the incentive to create the work in the first place.<sup>34</sup>

### 3. *Transaction Costs*

The third factor, in addition to incentive sufficiency and utilization capacity consider the likelihood of socially efficient voluntary interactions. Ideally, when transaction costs, broadly understood, impede socially efficient bargaining, we would like to allocate usage rights to owners if allocating them to users would undermine the incentive to create or disseminate, and we would like to allocate usage rights to those who might have comparative advantage with respect to certain types of uses.<sup>35</sup>

Indeed, the pervasiveness of transaction costs explains both why the law grants copyrights to begin with, as well as why those exclusive rights are statutorily and judicially circumscribed, because in the absence of significant transaction costs, there would be no need for exclusive rights because authors could secure the necessary return on their investment by contracting with potential users: they would pitch their ideas to potential users and investors, and interested parties would undertake to finance those projects which they find meritorious. There would be no need for copyright because contracts and contract law would do the job.<sup>36</sup>

In the same vein, there would be no need to allocate rights to users, because owners and users will always be able to efficiently bargain about the efficient use of works. If greater freedom to use works is efficient (in the sense that welfare is greater if users can make such uses than if they cannot), the "market" will demand it, and for the right price copyright owners will permit it. If it were more efficient if users refrained from doing such acts then contracts between owners and users will restrict these acts regardless of whether the law allocates those rights to users or owners. If some consumers value any of these acts more than others do, then copyright owners would be happy to offer different versions of their works, with or without such rights, at different prices.

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<sup>34</sup> Katz, "Copyright and Competition Policy", *supra* note 18 at 213.

<sup>35</sup> Ariel Katz, "Copyright and Competition Policy" in Ruth Towse & Christian Handke, eds, *Handbook of the Digital Creative Economy* (Cheltenham, UK: Edward Elgar, 2013) 209 at 211.

<sup>36</sup> Harold Demsetz, "Information and Efficiency: Another Viewpoint" (1969) 12:1 *Journal of Law and Economics* 1 at 12, online <<http://www.jstor.org/stable/724977>>; Matthew J Sag, "Beyond Abstraction: The Law and Economics of Copyright Scope and Doctrinal Efficiency" (2006) 81 *Tul L Rev* 187 at 209, online <<http://heinonline.org/HOL/Page?handle=hein.journals/tulr81&id=203&div=&collection=journals>>.

However, if the pervasiveness of transaction costs prevents the market from being relied on to generate the right incentives to ensure adequate production and use of works and legal intervention is required, then the existence of transaction costs also helps determining how sticky the initial allocation of entitlements ought to be. The focus, however, should not be limited to the transacting parties' costs—by definition, whenever parties transact voluntarily, their own transaction costs must have been sufficiently low to make the transaction possible—but also includes the negative and positive externalities that may be involved in the transaction, but which the transacting parties will rationally ignore. Therefore, when transaction costs—thus broadly conceived—are sufficiently low, private reordering is more likely to increase social welfare, and the law should take a lenient approach to private reordering, but when transaction costs are high.

To illustrate the point, let us consider why transactions in which owners alienate their rights (by assignment or grants of different types of licenses) are not only commonplace but also do not raise much concern, whereas transactions in which users' alienate their rights appear to be more problematic.

#### A. OWNERS' RIGHTS ARE USUALLY ALIENABLE

Copyright may subsist in any original work of authorship, namely in any expression of an author's ideas, if it has been fixed in any tangible medium of expression.<sup>37</sup> Absent any legally valid restriction, an author is free to express her ideas thus fixed, to reproduce them in copies, perform them in public, etc. The freedom to use the work is not derived from the *Copyright Act* but from the absence of legal limitations on such use. Thus, the essence of the owner's copyright is not the privilege to use the work, but the exclusivity, namely the right to exclude others.<sup>38</sup>

Understandably, this exclusivity raises the concern that prices would be higher and output lower than if no exclusive right were granted, but that's exactly the point in granting a copyright and the resulting deadweight loss is built into the scheme. Thus, when the owner grants licenses that permit others to use the work those licenses increase output compared to if no licenses were granted. And when the copyright owner assigns her right or grants an exclusive license to another person the transfer should not have any effect on the owner's market power and the deadweight loss resulting from it: whatever market power is conferred by the grant of the exclusive right, the identity of the owner does not affect it.<sup>39</sup> If a transfer might result in an increase in market power (e.g., when the transferor and the transferee were suppliers of close substitutes but the transfer eliminates

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<sup>37</sup> *Copyright Act (US)*, *supra* note 24 sec 102.

<sup>38</sup> *Cf. Bauer & Cie v O'Donnell*, [1913] 229 US 1 (US Supreme Court) at 10 ("The right to make, use, and sell an invented article is not derived from the patent law. This right existed before and without the passage of the law, and was always the right of an inventor. The act secured to the inventor the *exclusive* right to make, use, and vend the thing patented, and consequently to prevent others from exercising like privileges without the consent of the patentee.").

<sup>39</sup> *Saturday Evening Post Co v Rumbleseat Press, Inc.*, [1987] 816 F 2d 1191 (Court of Appeals, 7th Circuit) at 1199 ("If these copyrighted illustrations confer lawful monopoly power on their true owner, the consumer will have to pay the monopoly price whoever that true owner is."); *Molnlycke Ab v Kimberly-Clark of Canada Ltd*, [1991] 36 CPR (3d) 493 (FCA) at para 10 ("Certainly the existence of a patent is apt to limit, lessen, restrain or injure competition - monopolies do - but its issuance and the inherent impairment of competition has been expressly provided for by an Act of Parliament, .... It is the existence of the patent, not the manner in which issue was obtained or how and by whom its monopoly is agreed to be enforced and defended, that impairs competition.").

competition and concentrates both substitutes in the hands of the transferee) then competition law may disallow it.<sup>40</sup> In such a case the transfer involves a negative externality: the additional market power gained by the transferee benefits the transferee but imposes an *additional* cost on society.

Therefore, to the extent that the alienation of owners' rights normally does not involve externalities, it makes sense to treat the initial allocation of owners' right merely as default allocations because the alienation of owners' rights may either result in grater use of the work or at least not increase the deadweight loss beyond that which inheres in the copyright itself. It does not mean that we can assume an efficient market in which copyright always end up in the hands of those who can make the best use of the copyright, or issue the optimal amount of licenses. Indeed, as the next Part discusses, markets for creative works may be plagued with imperfections, and those imperfections may explain why the law also allocates rights to users, but they do not affect the conclusion that owners' rights, as a general matter, should be freely alienable. But this conclusion does not imply symmetry when the alienation of users' rights is concerned. The next Part explains why.

## B. THE DIFFERENCE BETWEEN OWNERS' RIGHTS AND USERS' RIGHTS

Assume that a reader expects that his enjoyment from merely reading a book is worth \$10, that having the book signed and individually dedicated is worth additional \$2, and that the benefit that he may derive from exercising the bundle of his users' rights (e.g., criticizing the work, copy non-substantial parts from it, using it transformatively, reselling the book, etc.) may be worth \$2 extra. The reader will be willing to pay up to \$12 for a copy of the book (with the bundled users' rights), and up to \$14 for the book with the autograph. Suppose that the publisher offers the user to choose between three versions: a 'traditional' version (which includes the bundle of users' rights) for \$12, a 'premium' version (which also includes the autograph) for \$13.99, and a 'discount' version for \$9.99 (which allows the reader to read but not to exercise any other users' right). Between these three options, the user is better off with either the premium or the discount versions (because each of them leaves him with a tiny net surplus of \$0.01), whereas the traditional version leaves him with not net surplus at all.

There is no doubt that a copyright owner can alienate her exclusive right and accept money in return. Indeed, transactions in which owners alienate the whole or part of their exclusive rights and non-owners alienate their money are commonplace and uncontroversial. Even though the law grants the user an exclusive right in his money, and the copyright owner an exclusive right in the work nobody seems to suggest exchanging the one for the other undermine the public policy that underlies the statutory scheme. In fact, such exchange is part and parcel of the scheme. Is there something different about an exchange that involves not the user's money, but one or more of his users' rights, then?

*ProCD* would suggest that the answer is no.<sup>41</sup> It stands for the proposition that copyright law creates only default entitlements from which transacting parties can freely deviate by contract and that such contract terms are generally enforceable "unless their terms are objectionable on grounds

<sup>40</sup> See *Apotex Inc v Eli Lilly and Company*, [2005] FCA 361 at para 17–18 (ca FCA).

<sup>41</sup> *ProCD, Inc. v. Zeidenberg*, *supra* note 11; The following paragraphs are based on my discussion of a similar point in Katz, *supra* note 12 at 102–08.

applicable to contracts in general (for example, if they violate a rule of positive law, or if they are unconscionable).”<sup>42</sup> In this decision, Judge Easterbrook was clear that deviating from the entitlements set by copyright law does not “violate a rule of positive law” because the public policy embedded into copyright law’s choice of entitlement cannot be affected by contracts.<sup>43</sup> In other words, property is property and contracts are contracts. Unlike a copyright, which is “a right against the world,”<sup>44</sup> “[c]ontracts generally affect only their parties, [and] do not create ‘exclusive rights.’”<sup>45</sup>

According to Judge Easterbrook, license terms accompanying works or products are conceptually identical to any other feature of the products. Both determine what the consumer can do with the product, and both are reflected in the product’s price and mediated through the market. Generally, courts do not design products, do not determine their prices, and therefore should not intervene in the conditions accompanying their sale: “Competition, not judicial oversight, is the best protector of consumers’ interests.”<sup>46</sup> In principle, then there is no difference between a consumer’s preference for an author’s autograph and his preference for exercising any of his users’ rights.

The logic of *ProCD* derives from the Coase Theorem that asserts that in the absence of transaction costs, bargaining will lead to an efficient outcome regardless of the initial allocation of property rights.<sup>47</sup> Easterbrook used this framework explicitly in a lecture that he gave shortly before he rendered his decision in *ProCD*.<sup>48</sup> Unfortunately, this approach ignores Coase’s main contribution, namely, that transaction costs are pervasive and important and that the law does matter.<sup>49</sup>

Assuming away external effects, or as the judgment stated, “[c]ontracts generally affect only their parties,” the distinction between property and contract provides a seemingly elegant answer to the question of whether there is any problem in contracting around users’ rights. Assuming that such restrictions affect only their parties, the existence of a contract strongly indicates that—save for some extraordinary circumstances—the transaction must be efficient (in the sense of generating surplus). Assuming also that markets are perfectly competitive and consumers are fully informed, license terms can indeed be treated like any other product feature.<sup>50</sup>

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<sup>42</sup> *ProCD, Inc v Zeidenberg*, *supra* note 11 at 1449.

<sup>43</sup> *Ibid.*

<sup>44</sup> *Ibid.*, at 1454.

<sup>45</sup> *Ibid.*

<sup>46</sup> *Ibid.*, at 1453.

<sup>47</sup> R H Coase, “The Problem of Social Cost” (1960) 3 *Journal of Law and Economics* 1, online <<http://www.jstor.org/stable/724810>>.

<sup>48</sup> Stating that given the difficulty of setting optimal IP rules, Easterbrook argued that the most sensible approach is to encourage Coasian bargaining by creating clear and enforceable property rights, facilitating bargaining, and “enjoy[ing] the benefits.” Frank H Easterbrook, “Cyberspace and the Law of the Horse” (1996) 1996 *Univ Chic Leg Forum* 207.

<sup>49</sup> As Coase himself wrote, “[t]he world of zero transaction costs has often been described as a Coasian world. Nothing could be further from the truth. It is the world of modern economic theory, one which I was hoping to persuade economists to leave.” R H Coase, *The Firm, the Market, and the Law* (Chicago: University of Chicago Press, 1988) at 174.

<sup>50</sup> Indeed, in a lecture given shortly before he rendered his decision in *ProCD*, Judge Easterbrook explicitly referenced the Coase Theorem when he stated that given the difficulty of setting optimal IP rules, the most sensible approach is to encourage Coasian bargaining by creating clear and enforceable property rights, facilitating bargaining, and “enjoy[ing]

Under the logic of *ProCD* case, there is full symmetry between copyright owners' property rights in their works, users' property rights in their money, and users' rights: all are interchangeable, and ought to be fully alienable. All that the law has to do is treat users' rights as no more than a baseline for contracting, permit and uphold all subsequent bargaining, and then let us all "enjoy the benefits."

While attractive, this policy prescription is flawed. It is flawed because the world is not "Coasian", and the world of creative works (or information more generally) is notoriously non-Coasian. The need for intellectual property rights, and the need to define their limits, arises precisely because the world is not "Coasian".<sup>51</sup> As noted above, in a Coasian world, there would be no need for exclusive rights, nor reason to circumscribe their scope, because contracting authors and users would enter into voluntary contracts and the market will ensure an optimal level of production and use.<sup>52</sup> Assuming that important market failures compel public ordering through the grant of carefully circumscribed exclusive rights while also assuming that the market can guarantee socially optimal private reordering of those rights presents a serious tension if not outright contradiction.

Admittedly, so far this argument may prove too much. One may concede that prior to creating the intellectual good the world is non-Coasian, but still maintain that Coasian bargaining over the rights to use such goods, once created, is entirely possible. Arguably, then, once the law grants an exclusive right, any subsequent bargaining with respect to its use should be regarded as presumptively efficient. The problem with this view is that if the post-creation world were indeed Coasian, there would be no need to limit the duration and scope of copyright;<sup>53</sup> the term of exclusivity would be mediated through the market and the price system. There would be no need for fair use or other limitations on owners' rights because the socially optimal outcome would be achieved even if owners had total control. Any socially efficient use of the work would be authorized: "You want to criticize my work? Go ahead, here's a license"; "You want to build on my ideas to develop a better product that will displace my own? No problem, here's your license." Under this view, defining limitations to the copyright is either unnecessary, or at least can be justified on the basis that these limitations represent terms that users presumptively would be interested in, and allocating them to users by default may simply reduce transaction costs, for example by avoiding the need to specify them in each contract, or by overcoming an information gap between owners and users (copyright owners, which are presumably better informed than most users, would have to inform users about their desire to deviate from the default allocation). To the extent that this is the only function of users' rights, then, indeed, what copyright law allocates to owners and users respectively would serve only as a starting point from which transacting parties would freely negotiate to maximize their own, and society's, gains.

There are two main flaws in this view: a minor one and a major one. The minor flaw concerns what the existence of a transaction can teach about the transacting parties' private gains. It would

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the benefits." Frank H Easterbrook, "Cyberspace and the Law of the Horse" (1996) 1996 Univ Chic Leg Forum 207.

<sup>51</sup> Indeed, this is true for any type of property, not only IP. See Thomas W Merrill & Henry E Smith, "Making Coasean Property More Coasean" (2011) 54:4 J Law Econ S77 at 93 ("We have property and endow it with a basic architecture of exclusion rules supplemented by rules and standards governing proper use, precisely because of transaction costs.").

<sup>52</sup> *Supra*, Part III.A.3.

<sup>53</sup> *Cf.* Merrill & Smith, *supra* note 49 ("In a world of zero transaction costs, it would not matter whether property rights are broad or narrow, clear or ambiguous—or in rem or in personam.") at \_\_\_\_.

tend to treat the fact of a contract as proof that the contract has indeed made the parties better off. For this to be true, several strong assumptions about the market have to be true. It must assume that the relevant markets are sufficiently competitive, and that the parties are fully informed or at least not asymmetrically informed or biased. Only then, competition, rather than judicial oversight, can be presumed to be the best protector of consumers' interests.

There are at least two reasons why market competition may fail to perform its salutary role in the case of transactions involving the reordering of users' rights. Firstly, markets for copyrighted works are a far cry from being viewed as competitive because limiting competition is the *raison d'être* of copyrights.<sup>54</sup> Only the owner or her licensees can be the legal source of copies of any particular intellectual good. There cannot be unfettered competition between different sellers competing over price and license terms. Although competition from other noninfringing works may still exist, assuming that this competition resembles conditions in markets with near-perfect competition is conceptually flawed and empirically incorrect; if it were true, copyright would be totally useless<sup>55</sup> and only delusional publishers would care about lobbying for it.

Secondly, even if license terms can be conceived as equivalent to product features, the more complex the combination of features/terms/prices, the more likely it is that consumers will not be capable to fully comprehend on what they are contracting.<sup>56</sup> If such information gaps and asymmetries exist, the assumption that the market functions efficiently becomes less credible.<sup>57</sup> While it is true that competitors might be interested in bridging the information gap in order to increase their own sales at the expense of their rivals, competitors may not always find it worth their while to bridge the information gap,<sup>58</sup> and as noted above, copyright law intentionally reduces the intensity of competition anyway. Moreover, when the transaction involves waivers of users' rights, whose value is not easily monetizable or not monetizable at all, the assumption of efficiency becomes even less tenable.

So there might be something different between exchange that involves the user's money and exchange that involves one or more of the users' rights. However imperfect the market is, it is likely to function better when transactions involves exchange of money in return to a complex product but one that comes with a standardized set of legal rights, compared to exchange of money+rights in return to a bundle of a complex product and non-standard set of legal rights.

The major flaw concerns the erroneous conclusion that the fact that private parties transact implies that not only that the transaction enhances their private welfare but that it also increases total welfare. For this conclusion to be true, it must be the case that the transacting parties fully internalize all the costs and benefits arising from the transaction. But if externalities or collective

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<sup>54</sup> Ariel Katz, "Making Sense of Nonsense: Intellectual Property, Antitrust, and Market Power" (2007) 49:4 Ariz L Rev 837 at 851, online <<http://ssrn.com/paper=702462>>.

<sup>55</sup> *Ibid*, at 852.

<sup>56</sup> Margaret Jane Radin, *Boilerplate: The Fine Print, Vanishing Rights, and the Rule of Law* (Princeton, NJ, USA: Princeton University Press, 2012) at 103.

<sup>57</sup> *Ibid*, at 107–08.

<sup>58</sup> David Gilo and Ariel Porat, "Viewing Unconscionability through a Market Lens" (2010) 52 Wm & Mary L Rev 133, online <<http://heinonline.org/HOL/Page?handle=hein.journals/wmlr52&id=135&div=&collection=journals>>.

action problems exist, transacting parties' private costs and benefits are not fully aligned with social costs and benefits, and it does not follow that contracting around such limitation increases social welfare.

In fact, even when competition exists and users are fully informed about the rights they waive, such transactions may not be efficient because the transacting parties will fail to consider the externalities imposed on third parties.<sup>59</sup> Many users' rights (including copyright subject matter limitations) permit users to engage in creative activities that benefit not only the users themselves, but also third parties and society at large.<sup>60</sup> These users, however, can expect to internalize only part of the social benefits arising from their activities and will not take into account the positive spillovers conferred on others.<sup>61</sup> For example, a reader may buy a book and then decide to write a critique of it, or the book may inspire her to write additional works. If that reader has to pay for the right to criticize the book or for the right to be inspired by it, her willingness to pay will reflect only the private value that she might expect to derive from these activities, but not the value that her activities will generate to others. Copyright owners ignore those positive spillovers as well and would be especially reluctant to permit uses that might harm their own interests,<sup>62</sup> or they might strategically exploit situations of hold-up to extract the highest licensing fees possible.<sup>63</sup> Users may also rationally ignore negative externalities that their actions may impose. For example, to maintain high resale prices and eliminate competition from used books, a publisher may offer users to choose between two versions of a book: they buy a standard book (S) and resell it without any limitation, or they can buy a restricted version (R) which prohibits them from selling, giving or lending it to anyone else. Naturally, the restrictive version is less valuable for consumers so it must be cheaper than the unrestricted version. Assuming that consumers value the difference between the versions as  $\$X$ , consumers will rationally choose the restricted version as long as  $P_S - P_R > X$ . And they will choose the restrictive version even though they may fully realize that by choosing this version they limit the supply of used books, which allows the publisher to keep  $P_S$  and  $P_R$  at a higher level than they otherwise would be, and that if consumers refused to buy the restrictive version the price of the standard version would be lower.

In sum, there are several good reasons to believe that the market may fail to generate socially efficient allocation of rights between copyright owners and users. Not only these failures explain why the law circumscribe the rights of owners by defining ways in which users can exploit works without permission or payment, they also show that under conditions of full alienability of user

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<sup>59</sup> Katz, "Copyright and Competition Policy", *supra* note 18 at 214.

<sup>60</sup> *Feist Publications, Inc v Rural Telephone Service Co*, 499 US 340 (us US Supreme Court 1991); *CCH Canadian Ltd v Law Society of Upper Canada*, *supra* note 2 at para 23.

<sup>61</sup> Brett M Frischman and Mark A Lemley, "Spillovers" (2007) 107 Colum L Rev 280 at 262, online <<http://heinonline.org.myaccess.library.utoronto.ca/HOL/Page?handle=hein.journals/clr107&id=316&div=&collection=journals>>.

<sup>62</sup> *Campbell v Acuff-Rose Music, Inc*, [1994] 510 US 569 at 592 (recognizing that "the unlikelihood that creators of imaginative works will license critical reviews or lampoons of their own productions removes such uses from the very notion of a potential licensing market").

<sup>63</sup> Sag, *supra* note 50 at 212 (discussing strategic behavior).

rights, the market might very well fail to generate socially optimal transactions between owners and users.<sup>64</sup>

This Part described the economic logic behind copyright law's structure of allocating rights between owners and users. It showed not only why some rights are allocated to owners while others to users, but also why some rights should be regarded as generally alienable while in the case of others, especially users' rights, stickiness of the initial allocation may be justified. The next Part will provide a framework for deciding when and under what conditions users' rights may be alienable.

#### IV. FRAMEWORK FOR DETERMINING ALIENABILITY

In the following sections I develop a framework that will help us determine the limits of user rights alienability. The framework utilizes several factors. Some of these factors are economic, and build on the preceding analysis, but it also includes non-economic legal considerations, which I will describe first.

##### A. AUTONOMY—INTRUSIVENESS FACTOR

The first factor considers **autonomy vs. intrusiveness**. It is based on the premise that liberal societies value individual autonomy and impose limits on government regulation. It recognizes that the grant of exclusive rights to copyright owners impinges on the freedoms of users to freely engage with creative works, and that the recognition of users' rights secures spaces of individual autonomy that is free from intrusive regulation, and it further recognizes that allowing copyright owners to impose greater restrictions—to the extent that the state will be called upon to enforce them—may add an additional level of government interference with such autonomy, and that in a liberal democracy, such interference needs to be justified.

At the same time, this factor also recognizes that one's liberty includes the freedom to make enforceable promises, including promises to refrain from doing certain acts that one is otherwise free to do. Therefore, the autonomy/intrusiveness factor will measure how intrusive on individual autonomy the restrictive conditions are. The more intrusive the conditions are, the stronger is the need to justify them, either on grounds of public policy, or on the grounds that they reflect the user's full exercise of her autonomy.

##### B. PRIVATE POWER VS. REGULATORY POWER

The **second factor considers private power vs. regulatory power**. We can define private power as the power to control one's property, including through entering into binding contracts with others. Regulatory power, in contrast, is the power to control property that one does not own or control in excess of what otherwise the law recognizes as one's property.

Copyrights and patents confer upon their owners such limited regulatory powers, because they let their owners control how users, with which they have no privity of contract, use their own property, and resources, and exclude anyone from certain ways of using the works or invention without their owners' permission. This power is greater than the power that property law confers

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<sup>64</sup> Radin, *Boilerplate*, *supra* note 56 at 171.

upon owners of tangible assets, and this is why copyrights and patents are often referred to as “monopolies”, not in an economic sense, but in a legal sense.

Dating back at least to first half of the sixteenth century, “monopoly” describes the grant of various commercial and industrial privileges to individuals or companies.<sup>65</sup> Often, such privileges include the power to exclude others from enjoying similar privileges, license them, or collect fees for their enjoyments from third parties, and as such, those grants confer upon their grantees regulatory powers: the power to control property that one does not own or control in excess of what otherwise the law recognizes as one’s property. As the Court observed about patents in *Bauer & Cie. v. O’Donnell*, “[t]he right to make, use, and sell an invented article is not derived from the patent law. This right existed before and without the passage of the law, and was always the right of an inventor.”<sup>66</sup> What the grant of a patent *Patent Act* does, however, is securing “to the inventor the *exclusive* right to make, use, and vend the thing patented, and consequently to prevent others from exercising like privileges without the consent of the patentee.”<sup>67</sup>

Thus, because a patent confers upon its owner the power to control how others use their own property and manage their own affairs, the patent is properly termed as “monopoly”, and when courts express concerns about IP owners’ attempts to extend their “monopoly” beyond the scope of the statutory grant, they are not necessarily concerned about market harm, but with ensuring that the limited regulatory power of the IP owner (and which the courts might be called on to enforce), would be confined to the limits of the statutory grant. Their interest is not with harms to efficiency (either static or dynamic) but with ensuring the constitutional division of power.

Recognizing that the distinction between private power and regulatory power is not binary, this factor will interact with the other factors. It may also shed light on the question of on what legal basis alienation may be justified, and what remedies may be available for its breach. In general, when users may justifiably be required to waive their rights, the restriction should not be enforced under proceedings for copyright infringement, but as a matter of contract law.

### C. MARKET STRUCTURE AND SCOPE OF RESTRICTION

The **third factor considers market structure and the scope of the restriction**. This factor takes seriously both the distinction between *in personam* and *in rem* obligations, and the premise that market competition may alleviate some of the concerns the private reordering of owners and user rights. But it also takes seriously the limitations on the applicability of the contract/property distinction and the limits of market discipline. The basic inquiry here is the scope of the relevant market that would be affected by the purported alienability (e.g., are all users of a commercially distributed work required to waive their rights or does it affect only a narrow subset of them), what is the likelihood that prices effectively respond to changes in users’ rights (as opposed to a situation where consumers’ demand is not equally sensitive to changes in price and changes in associated

<sup>65</sup> Oren Bracha, “Monopolies”, in Stanley N Katz, ed, *The Oxford International Encyclopedia of Legal History*, vol 4 (Oxford University Press, 2009) 186.

<sup>66</sup> *Bauer & Cie v O’Donnell*, *supra* note 38 at 10.

<sup>67</sup> *Ibid.*

rights) and what is the likelihood that competition effectively would guarantee socially efficient reordering of owners' and users' rights.

#### D. EXTERNALITIES

Even when users are fully informed, are presented with meaningful choices, and fully and meaningfully consent to waive their rights, there will still be valid reasons to disallow the alienation when externalities exist. The externalities may take different forms. Some may involve terms and conditions that enhance the copyright owner's market power in the static sense. Others may limit innovative entry into a concrete market, still in other cases the limitations may, for the purpose of gaining some short-term private gains, contribute to conditions that are less conducive to innovation and speech. Thus, the degree, type, and severity of externalities will be a relevant factor for determining both whether users' rights will be more easily alienable, and what is the appropriate mechanism for enforcing such alienation.

#### E. THE INNOVATION INDEX

Related to externalities, the last factor focuses on whether the purported restrictions on users' rights are conducive to innovation or impair it. It recognizes that some restrictions on user rights can be consistent with the type of cultural innovation that copyright law seeks to encourage, either because such restrictions may be necessary to foster collaborative creative projects, or because they can allow copyright owners to maximize their reward and improve their desire and ability widely to disseminate works. But it also takes seriously the fact that the sources of innovation vary, and that users are becoming an important source of innovation and creativity more than ever before. User innovation depends critically on users' ability to modify existing works or use them as building blocks for other works and many user rights foster this. Therefore, as an instrument of innovation policy, it would be imprudent for copyright law to create rules supporting one model of creative innovation and suppressing others.

Any particular alienation of user rights can be analyzed and ranked according to each of these indices, and the combined score can help us determine not only whether the alienation should be allowed, but also if allowed, how and against whom might it be enforced, and what remedies might be available. Likewise, if the purported alienation were not to be allowed, this framework can also help determining what the consequences of an attempt to impose or enforce it might be: are they limited to being unenforceable, or might they attract graver consequences.

#### V. TO BE CONTINUED