

PRICE DISCRIMINATION AND THE FAIR USE  
OF COPYRIGHTED WORKS

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INTRODUCTION

The law of copyright is a balance of economic interests granted to authors to give them the incentive to create, but with the ultimate goal that such works be publicly disseminated.<sup>1</sup> In recent years, much controversy and commentary have accompanied the doctrine of fair use of copyrighted works--that the owner of a copyrighted work need not be compensated for certain uses of the work. Much of this discussion has centered on the difficulty of preventing non-paying consumers from copying or using works. This emphasis, while often useful, is misplaced, and leads to reliance on excessive private control or to government subsidy. Instead, the inquiry should focus on a more fundamental question: given the special cost characteristics of copyrighted works, the pricing of such works should reflect the value of the work to each consumer through a system of discriminatory prices. Fair use

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1. See Gordon, Fair Use as Market Failure: A Structural and Economic Analysis of the Betamax case and its Predecessors, 82 Colum. L. Rev. 1600, 1602-05 (1982).

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determinations, in turn, can indirectly adopt such a pricing system.

Part I discusses the economics of copyrighted works, the emphasis on excluding non-paying consumers and the economic rationale behind the fundamental cost issue. Part II examines recent cases regarding fair use, which have been criticized as inconsistent and incoherent, and proposes an alternative, economic explanation for them. Part III proposes how courts can apply the economic principles discussed in Part I to future cases concerning fair use.

I. EXCLUSION MECHANISMS, PRICE DISCRIMINATION,  
AND THE ECONOMICS OF PUBLIC GOODS

It is commonly recognized that copyrighted works have the characteristics of what is known economically as a "public good." Generally, a public good is characterized by the fact that consumption by one person does not prevent others from consuming equal amounts of the same good.<sup>2</sup> For example, eating an apple (a "private good"<sup>3</sup>) prevents

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2. Besen, *New Technologies and Intellectual Property: An Economic Analysis 1* (Rand Note N-2601-NSF 1987).  
(continued...)

others from eating the same apple, but watching a television program does not prevent others from watching the same program.<sup>4</sup> Public goods often have two additional characteristics, a high cost of excluding nonpurchasers and a declining cost per user to supply the good as the number of users increases.<sup>5</sup>

Copyrighted works possess these public good characteristics in two manners, in the copyrighted work itself and in the medium in which the work is distributed.<sup>6</sup> Regarding the work itself, the expression (which is protected by copyright law) and the ideas underlying the expression (not protected by copyright law) are public

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2. (...continued)

Technically, the marginal cost of providing the good to another consumer is zero.

3. A private good is one as to which another person's consumption reduces the amount that can be consumed by others. Besen, *supra*, at 1.

4. In some cases, however, congestion may result, as in for example, a crowded theater.

5. Besen, *supra*, at 1--2. This declining cost characteristic, to be discussed later, is that as the number of total users increases, average total costs of production decrease. See 1 Kahn, *The Economics of Regulation* 123-26 (1988).

6. Compare Besen, *supra*, at 1 (public good characteristic of underlying intellectual property) with Davis & Whinston, *On the Distinction between Public and Private Goods*, 57 *Am. Econ. Rev. (Papers & Proc.)* 360, 361-63 (1967) (public good characteristics of medium).

goods. The medium on which the work is distributed may also have many public goods aspects: for example, books and television broadcasts resemble public goods,<sup>7</sup> because the marginal cost of providing for an extra reader or viewer is practically zero, and it is difficult to exclude non-paying readers or viewers. Other media provide copyrighted works in the form of a private good, for example, where the purchase of one seat in a theater precludes another person from attending.<sup>8</sup> Because the public good aspects of the ideas of a work are not protected by copyright law, the analysis that follows concentrates on the public good aspects of the expression of a work and of the medium.

These public good characteristics create a dilemma for creators and society, because "free riders" will take advantage of the joint consumption and non-excludability characteristics to consume the good without contributing to its cost. If enough free riders exist, the public good may need to be provided by the government or may not be provided at all. Due to the significant public and First

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7. See Davis & Whinston, *supra*, at 360.

8. See Adelstein & Peretz, *The Competition of Technologies in Markets for Ideas: Copyright and Fair Use in Evolutionary Perspective*, 5 *Int'l Rev. L. & Econ.* 209, 221 (1985).

Amendment interest in disseminating information from sources other than the government, this Article concentrates on public goods provided by private markets.

Two conditions must be fulfilled for a public good to be provided efficiently by a private market. First, for a public good to be provided by a private market at all, an exclusion mechanism must exist in order to exclude consumers who will not or cannot pay for the good.<sup>9</sup> Second, for a public good to be provided efficiently by the market, the supplier of the public good must be able to price discriminate among his customers.<sup>10</sup> Much of the discussion in connection with fair use and the economics of public goods has focused on the first condition,<sup>11</sup> and has either ignored the second condition or implicitly accepted it without further analysis. However, such a focus distorts

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9. See Lee, *Discrimination and Efficiency in the Pricing of Public Goods*, 20 *J. L. & Econ.* 403, 403 (1970).

10. See Besen, 4-5; Demsetz, *The Private Production of Public Goods*, 13 *J.L. & Econ.* 293, 304 (1970).

11. See, e.g., Goldstein, *The Private Consumption of Public Goods: A Comment on Williams & Wilkins Co. v. United States*, 21 *Bull. Copyr. Soc'y* 204, 212 (1974); Adelstein & Peretz, *supra*, at 217-26. The requirement of an ability to exclude nonpurchasers is common to both private and public goods. Demsetz, *supra*, at 295. However, because one person's consumption of a public good leaves the good fully available for consumption by others, the exclusion problem is somewhat more important with respect to public goods than to private goods.

the analysis and the conclusions arising from it. This section explores the limitations of the first condition and sets forth the issues raised by the second condition.

#### A. Exclusion Mechanisms

For a public good to be provided by the market, the supplier of the good must be able to exclude consumers who do not pay for the good. Such exclusion can be achieved both by technological exclusion mechanisms (e.g., a lock on the door of a theater) or by legal exclusion mechanisms (e.g., an injunction issued against a copyright infringer).<sup>12</sup> Much of the debate concerning fair use and incentives in copyright law concerns the effectiveness of the exclusion mechanisms that society desires or can tolerate.

##### 1. Technological Exclusion Mechanisms

Technological exclusion mechanisms are discussed first because they seem to be immediately obvious and to

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12. Besen, *supra*, at 7.

provide a common sense solution to otherwise difficult problems.

The development of communications technology has spawned new types of works to be protected and new uses for all sorts of copyrighted works. However, the new technologies have also created the ability for many consumers and competitors to copy or otherwise appropriate works much more quickly and cheaply than in the past.<sup>13</sup> In response, technologies have also been developed to prevent such copying and appropriation, such as lockboxes and other screening devices, scramblers, and copy-protection schemes. These are technological exclusion mechanisms that enable copyrighted works, as public goods, to be provided by a private market.<sup>14</sup> Although many of these devices are impressive, they are not foolproof, and technologies to defeat such exclusion mechanisms have been developed.

Despite the problems that have arisen with such exclusion technologies, the law has increasingly recognized them as a solution to problems created by new

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13. Adelstein & Peretz, *supra*, at 226-33.

14. See Davis & Whinston, *supra*, at 363; Lee, *supra*, at 419.

technologies in the realms of copyright<sup>15</sup> and of the First Amendment.<sup>16</sup> However, aside from their technical drawbacks, the limitations of technological exclusion mechanisms have not received wide attention.

The key question regarding technological exclusion mechanisms concerns the extent of control that society can tolerate.<sup>17</sup> Copyrighted works can be provided both as a good and as a service (and less often, as a hybrid of both). The potential extent of control and potential danger of such control depends on whether the work is provided through a good or by a service. Goods, which circulate freely, rapidly and anonymously in the economy, are much less subject to control by copyright owners and by the government. Services, which tend to be provided in a centralized manner, are much more subject to private

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15. See J. Goodale, All about Cable section 5.10, 5.11[4] (1988) (discussing scrambling of television programming delivered by satellite).

16. See, e.g., 47 U.S.C.A. section 544(d) (1988 Cum. Supp.) (requiring cable operators to provide devices to enable subscribers to prohibit viewing of particular cable services); Tovey, Dial-a-Porn and the First Amendment, 40 Fed. Com. L. J. 267, 276-80 (1987) (describing exclusion mechanisms on telephone network).

17. Cf. Goldstein, *supra*, at 212 (a high cost of policing and the existence of privacy interests are sometimes related).

control and governmental oversight.<sup>18</sup> Recent dilemmas over fair use generally concern new uses of copyrighted works as an uncontrollable good<sup>19</sup> or at the interface of services and goods,<sup>20</sup> rather than the uses of services alone.<sup>21</sup> What perhaps bothers many about proposed technological exclusion mechanisms is that they limit the use and transfer of goods, which traditionally were not so limited. More troubling however, is the movement toward digital media and computer networks that connect users of various works. Such media and networks enhance the ability of

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18. See Fleishmann, *The Impact of Digital Technology on Copyright Law*, 70 J. Pat. & Trademark Off. Soc'y 5, 21 (1988).

19. See *id.* at 19-20 (digital audio tape).

20. See *Sony Corp. v. Universal City Studios, Inc.*, 464 U.S. 417 (1984)[hereinafter "Betamax"].

21. But see *Legi-tech, Inc. v. Keiper*, 766 F.2d 728 (1985) (fair use of service); *Telerate Systems, Inc. v. Caro*, Slip. Op., No. 85 Civ 9132 (S.D.N.Y. June 10, 1988) (finding contributory infringement). Commentators have recognized a sort of "natural copyright" that arises when a proprietor can control access to a work in a service-like setting, for example, in controlling admission to movie theaters. See Adelstein & Peretz, *supra*, at 221.

private persons<sup>22</sup> and the government to more closely monitor and control uses of works.<sup>23</sup>

Due to these problems with basic enforcement and undue control and censorship concerns,<sup>24</sup> technological exclusion mechanisms cannot be the sole response to the problems created for copyright by the new technologies.

## 2. Legal Exclusion Mechanisms

Technological developments have created new opportunities for uses of copyrighted works, but some of these uses create externalities,<sup>25</sup> whose value cannot,

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22. The creators' and disseminators' interest may not be equivalent. Additionally, because no state action has occurred, the potential exists for private individual or oligopolistic censorship to occur. See Tovey, *supra*, at 280-83.

23. See Fleishmann, *supra*, at 21.

24. Other, more minor problems exist as well. For example, in the absence of comprehensive government regulation, hardware manufacturers face a prisoners' dilemma in adopting technological exclusion mechanisms, because such mechanisms (a) raise the cost of production of hardware, thereby raising prices to the consumer and (b) further dampen demand by consumers for the particular product with an exclusion mechanism. See Fleishmann, *supra*, at 20.

25. Externalities are side effects of providing a good or service, the value of which are not reflected in prices charged or resources used. P. Steiner, *The Economy of Public Finance* 249 (1974). "Internalizing" such effects  
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primarily due to technological reasons, be captured by the copyright proprietor. Property law has traditionally developed as a means to internalize such externalities by capturing them within the rules of the market system, to make possible the use and transfer of rights for the benefit of the community. As a system of property rights, copyright law has expanded to respond to the externalities created by technological development in the media. That is, the copyright system itself is an exclusion mechanism.<sup>26</sup> This expansion has primarily expanded the rights in a work controlled by the copyright proprietor.<sup>27</sup> For example, revisions of the Copyright Act even before the 1976 Copyright Revision Act have increased the number of enumerated rights reserved to the author, in response to externalities created by technological development of the media.<sup>28</sup> Additionally, rights under the 1976 Act

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25. (...continued)

is a process, "usually a change in property rights" that brings such beneficial or harmful effects to bear on the parties. See Demsetz, *Toward a Theory of Property Rights*, 57 *Am. Econ. Rev. (Papers & Proc.)* 347, 348 (1967).

26. Breyer, *The Uneasy Case for Copyright: A Study of Copyright in Books, Photocopies and Computer Programs*, 84 *Harv. L. Rev.* 281, 287 (1970).

27. See Litman, *Copyright, Compromise and Legislative History*, 72 *Corn. L. Rev.* 857, 883-85 (1987).

28. See Litman, *supra*, at 887.

attach at an earlier stage than before--when the work is fixed in a tangible medium of expression, rather than upon publication.<sup>29</sup> It is this expansion of rights of copyright proprietors, and the response of certain users to this expansion, that has intensified the fair use debate.<sup>30</sup>

Technological exclusion mechanisms cannot currently enable copyright proprietors and users to internalize all externalities created by technological developments in the media. Such technological exclusion mechanisms would be the most "efficient" (in terms of obtaining specific payment and value information from each consumer) and possibly the lowest-cost method of capturing the value lost to the copyright proprietor of these externalities.<sup>31</sup> Though less "efficient," legal exclusion mechanisms have

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29. See Patterson, *Free Speech, Copyright and Fair Use*, 40 *Vand. L. Rev.* 53, 55 (1987); see also Litman, *supra*, at 883-87 (describing other 1976 expansions of the Copyright Act). Just like the stationers several centuries ago attempted to obtain the copyright over works in the public domain, see Patterson, *supra*, at 25-28, some copyright proprietors are now using technology to reimpose copyright over works in the public domain, including companies obtaining new copyrights for colorized versions of libraries of films in the public domain. See 36 *Pat. Trademark & Copyright J.* (BNA) 493 (Sept. 15, 1988).

30. See Litman, *supra*, at 886-87 (fair use doctrine became the "central source of flexibility" in the expansive statute).

31. See Davis & Whinston, *supra*, at 367.

been proposed and are being used where technological exclusion mechanisms are impractical.

The greatest difficulty of using legal exclusion mechanisms in the absence of a supporting technological exclusion mechanism is the existence of transaction costs.<sup>32</sup> Consequently, much effort has been spent attempting to reduce the relevant transaction costs or to generate income by taxing analogous transactions having a lower transaction cost. The three major alternatives are collective rights societies, compulsory licenses and hardware taxes.

Collective rights societies, such as ASCAP and the Copyright Clearance Center, enable copyright proprietors to reduce transaction costs by designating a central agent to enforce their rights.<sup>33</sup> The collective rights society locates potential licensees,

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32. See Brennan, *Harper & Row v. The Nation, Inc.*: Copyrightability and Fair Use, 33 J. Copyr. Soc'y 368, 380 (1986). Transaction costs include information costs, the cost of determining and locating the parties, contracting costs, the cost of reaching the bargain, and enforcement costs, the cost of ensuring that each party lives up to the bargain. See Lee, *An Economic Analysis of Compulsory Licensing in Copyright Law*, 5 W. New Engl. L. Rev. 203, 214 (1982) [hereinafter "Compulsory Licensing Economics"]. All of these costs are important in this context. See also Gordon, *supra*, at 1618-21, 1628-31 (high transaction costs can create market failures that can justify fair use, if cumulative injury to the copyright owner is not great).

33. See Goldstein, *supra*, at 210-11.

bargains with them, and monitors enforcement<sup>34</sup>, which allows copyright proprietors to share information, contracting and policing costs. The collective rights societies generally but not always further reduce contracting costs by offering licensees a blanket license covering use by the licensee of all the works handled by the collective rights society.<sup>35</sup> The tradeoff for the copyright proprietor is that in most cases, his income is not based upon a fee for every use, but upon a statistical determination of the frequency of the use of his work.<sup>36</sup> Thus, depending on the statistical process used, the copyright proprietor could receive more or less than he would if each use were individually monitored (for example, if each use were monitored with a technological exclusion mechanism).<sup>37</sup> Additionally, the administrative cost of the collective rights society must be divided among that society's members as well.<sup>38</sup> Because the funds are

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34. See Brabec, *Music that Sells*, in 1987 *Entertainment Publishing and the Arts Handbook* 341, 353 (Throne & Viera, eds. 1987).

35. *Id.*

36. *Id.* at 354-60.

37. See *Id.* at 367.

38. See Breyer, *supra*, at 317, 332 (arguing that administrative costs are high).

channeled through a central organization representing competing producers of copyrighted works, a potential exists for anticompetitive tying of such works.<sup>39</sup> Additionally, collective rights societies can effectively pursue only institutional users, particularly businesses, due to the sizable monitoring costs involved.<sup>40</sup>

Compulsory licenses are licenses at a governmentally set rate.<sup>41</sup> They slightly reduce information and policing costs, and virtually eliminate contracting costs, except in the case in which a user seeks to pay less than the statutory rate.<sup>42</sup> Because the rates are set relatively infrequently, however, they tend to become rate ceilings.<sup>43</sup> In addition, compulsory licenses are generally imposed to avoid an anticompetitive pooling of copyrights. However, they are generally viewed as not effective at this goal, with antitrust seen as more appropriate.<sup>44</sup> Compulsory

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39. However, courts have generally permitted such licenses. See *Id.* at 361-62.

40. Adelstein & Peretz, *supra*, at 230.

41. Compulsory Licensing Economics, *supra*, at 204-05.

42. *Id.* at 210-25.

43. See Brennan, *supra*, at 381.

44. Compulsory Licensing Economics, *supra* at 218-21, 225-26.

licenses also raise the issue of equitable distribution of income from the licenses. Currently, income from compulsory licenses in the U.S. is divided and paid by the Copyright Royalty Tribunal. Although the CRT is an independent government agency, the potential for unduly concentrated economic power, or worse, close governmental oversight and censorship, exists.<sup>45</sup>

Fair use is a compulsory license at a zero price.<sup>46</sup> It is imposed for reasons other than economic regulation, and creates problems slightly different from other compulsory licenses. First, fair use is an all-or-nothing compulsory license, because courts seek to avoid creating licensing schemes with a variety of fees based on willingness to pay.<sup>47</sup> Second, courts often balance a defendant's "nonmonetizable" interest against the plaintiff's copyright interest.<sup>48</sup> A defendant's nonmonetizable interest is usually a positive externality, i.e., a benefit to the community at large for which the defendant is unable

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45. See *Id.* at 221.

46. Brennan, *supra*, at 378.

47. See *Williams & Wilkins v. United States*, 487 F.2d 1345 (Ct. Cl. 1973).

48. Gordon, *supra*, at 1636-37 & n.199.

to charge the value of the benefit conferred.<sup>49</sup> Such a balancing in effect could require the copyright holder to underwrite directly the defendant's positive externalities.<sup>50</sup> The response is commonly that without such a balancing the defendant could no longer create the benefit, and that government cannot afford to subsidize the activity. Such a response also commonly assumes, however, that all consumers have the same ability and willingness to pay, and that compulsory licenses should be granted at a uniform price.<sup>51</sup> Part II explains that this need not, and should not, be the case in fair use determinations.

Targeted taxes have been proposed in the U.S. and are in place in Europe, in an attempt by copyright owners to capture some of the value lost in the negative externalities created by unauthorized taping of copyrighted works. The taxes are either in the form of taxes on recording equipment or on blank tape, although it has been suggested that a tax on blank tape is more responsive to varying levels of taping activity. Copyright proprietors sued a manufacturer of videocassette

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49. Gordon, *supra*, at 1630-32.

50. Gordon, *supra*, at 1632.

51. See Goldstein, *supra*, at 208-09 (making such an assumption).

recorders in the Betamax case on the ground of contributory infringement, i.e., aiding consumers make illegal copies, which was essentially an attempt to impose a tax on recording equipment through a finding of contributory copyright infringement by the manufacturer of the recorders.<sup>52</sup> Such taxation systems distort incentives among consumers and among copyright proprietors.<sup>53</sup> When levied on consumers, the taxes will reach some consumers who will not be violating any copyrights,<sup>54</sup> either because the works being copied are in the public domain, can be copied as a legitimate fair use, or because the consumer created the work or owns or has permission to copy the work. This fact has been recognized in cases regarding contributory infringement as an exemption from liability for substantial non-infringing uses. Alternatively, a general tax could be imposed.<sup>55</sup> Either type of tax distorts incentives for copyright proprietors, because the

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52. 464 U.S. 417 (1984).

53. See Breyer, *supra*, at 336 n.224.

54. See Breyer, *supra*, at 336 n.224.

55. Compare Breyer, *supra*, at 336 n.224 (a targeted tax will reduce spillover benefits created by copying, is difficult to administer fairly, and will increase transaction costs) with Samuelson, *Aspects of Public Expenditure Theories*, *Rev. Econ. & Stat.* 332, 335-36 (Nov. 1958) (user fees are preferable to general taxes, but users will attempt to hide their true levels of demand).

income from such a tax creates a central fund, producing the problem of economic centralization, difficulty of administration<sup>56</sup> and potential political control<sup>57</sup> as seen above with regard to collective rights societies and compulsory licenses.

### 3. Comparing Technological Exclusion Mechanisms to Legal Exclusion Mechanisms

From the above discussion, it is not clear whether technological exclusion mechanisms or legal exclusion mechanisms are preferable. As mentioned above, a legal exclusion mechanism cannot function without some type of supporting technological exclusion mechanism.<sup>58</sup> Technological exclusion mechanisms could be developed to completely "lock out" all infringing uses without a need for copyright law at all, thereby creating an electronic analog to the "natural copyright" held in earlier times by the owner of a theater or cinema.<sup>59</sup> But such a "natural

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56. See Note, Toward a Unified Theory of Copyright Infringement for an Advanced Technological Era, 96 Harv. L. Rev. 450, 461 n.60 (1982).

57. See Breyer, *supra*, at 336 n.224.

58. See Adelstein & Peretz, *supra*, at 214.

59. See *supra* note 21.

copyright," especially after such a long period of freely flowing books, magazines, records and tapes, is contrary to the free flow of ideas and information envisioned by the First Amendment, and the potential it creates for private control (and only one step beyond, government control and censorship) prevents it from being a comprehensive solution.

Likewise, the methods for reducing transaction costs as part of a legal exclusion mechanism are only a partial solution, if they are a solution at all. Just as with the technological exclusion mechanisms, such methods can put too much power in the hands of copyright owners and the government. Unlike the technological exclusion mechanisms, such methods explicitly concentrate economic power and create the possibility for inefficiency<sup>60</sup> and abuse in distributing the funds, so that well-known creators will be rewarded not only for their contribution, but for the contributions of obscure creators, and for political control of funding.

Regardless of the objections raised above, both technological and legal exclusion mechanisms, without more, are insufficient to balance properly the creator's incentive with public access, and neither leads to the

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60. See Davis & Whinston, *supra*, at 362 (giving example).

production of an efficient level of copyrighted works.<sup>61</sup> Perhaps even more significantly, an emphasis on exclusion mechanisms has tended to shift the focus to the shortcomings of exclusion mechanisms and from there either to excessive private control<sup>62</sup> or to an almost inexorable need for government subsidy.<sup>63</sup> This Article attempts to shift the emphasis away from exclusion mechanisms, and to

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61. See Samuelson, *supra*, at 334-36 (focus should be on declining cost characteristics of public goods rather than on exclusion mechanisms).

62. See Adelstein & Peretz, *supra*, at 233-34 (proposes elimination of all fair uses, except when the owner has the purpose of suppressing information).

63. See, e.g., Brennan, *supra*, at 380, 388-89; Hurt & Schuchman, *The Economic Rationale for Copyright*, 56 *Am. Econ. Rev. (Papers & Proc.)* 421, 424, 426 (1966); Breyer, *supra*, at 307-08 (considering possibility of government financing but refusing to rely exclusively on it). This conclusion arises from the unusual economic nature of public goods, discussed *supra* notes 5-8 and accompanying text, in which average total costs decline as the number of consumers rises but the marginal cost of serving another consumer is zero. As Kahn observes, the consequence in such declining cost situations is "a flat contradiction between two fundamental rules [of economic efficiency]: one, that the price to all buyers be equated with marginal costs, and two, that total revenues cover total costs. (If marginal cost is less than average total cost per unit, and prices are set at the former level, total revenues will be less than total costs.) Some economists have resolved this conflict by preferring the first to the second principle. If following the rule of equating price to marginal cost means that total revenues fall short of total costs, their solution would be to make up the difference out of taxpayer financed subsidies. Governments have in fact adopted this solution with respect to numerous 'public goods' ...." 1 A. Kahn, *supra*, at 130.

the conditions underlying the efficient production of copyrighted works as public goods.

#### B. Conditions for the Efficient Production and Dissemination of Copyrighted Works

In a competitive market, the efficient level of production is achieved by producing goods so that the price of the good is equal to its marginal cost of production.<sup>64</sup> However, producing the efficient level of a public good creates a special case, because of the public good's characteristic that one person's consumption does not reduce the potential consumption by others, i.e., that the marginal cost of providing the good to another consumer is zero. Because the marginal cost of providing another good is zero, but the good would not be produced if all consumers paid nothing, each consumer should at most pay no more than his or her value of the good for a public good to be produced efficiently.<sup>65</sup> Restated slightly differently, price discrimination is necessary in order for a public good

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64. 1 Kahn, *supra*, at 65-66.

65. See Lee, *supra*, at 404 & n.2. Legal commentators have tended not to observe this requirement. See, e.g., Goldstein, *supra*, at 209 (assuming uniform pricing but different intensities of demand).

to be provided efficiently by a competitive private market.<sup>66</sup> This condition is separate from the possibility of exclusion that enables the good to be provided at all by a private market.<sup>67</sup>

Price discrimination occurs when the prices paid by consumers are not related to differences in costs in dealing with consumers.<sup>68</sup> Price discrimination is often viewed with disfavor, and is prohibited by law.<sup>69</sup> The

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66. See Besen, *supra*, at 4-5; Demsetz, *supra*, at 304.

67. It is "wrong to think that the essence of the [public good] phenomenon is inherent in the fact that the broadcaster is not able to refuse the services to whatever individuals he pleases. ... [B]y use of unscramblers, it is technically possible to limit the consumptions of a particular broadcast to any specified group of individuals. You might ... be tempted to say: A descrambler enables us to convert a public good into a private good; and by permitting its use, we can sidestep the vexing problems of collective expenditure, instead relying on the free pricing mechanism. Such an argument would be wrong." Samuelson, *supra*, at 335.

68. Cooper, Price Discrimination Law and Economic Efficiency, 75 Mich. L. Rev. 962, 963 (1977). If costs of providing goods differ, then no price discrimination occurs where consumers are charged varying prices to reflect this difference. Price discrimination may occur where such consumers are charged the same price, however. See Blakeney, Price Discrimination Laws: An Economic Perspective, 19 Duquesne L. Rev. 479, 487 (1981).

69. See Robinson Patman Act, 15 U.S.C.A. section 13(a) (1973) (prohibiting discrimination in price between customers of commodities of like grade and quality). The Robinson Patman Act does not apply to services, see H. Schneiderman & B. Leverich, Price Discrimination in Perspective 37-38 (2d ed. 1987), with which this Article  
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economic impact of price discrimination, however, is unclear.<sup>70</sup> Commentators have suggested that the unique

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69.(...continued)  
is partially concerned, although the borderline between goods and services is unclear, see *Kennedy Theater Ticket Serv. v. Ticketron, Inc.*, 342 F. Supp. 922, 926-27 (E.D. Pa. 1972) (theater ticket is not a "commodity" under the Act). For example, the Act does not apply to cable television service. See *Rankin County Cablevision v. Pearl R. Valley Water Supply Dist.*, Slip Op., No. J97-0428(L) (S.D. Miss. June 21, 1988). And, it does not apply to temporal price discrimination. See *Schneiderman & Leverich, supra*, at 38. Certain types of price discrimination among services, however, are regulated as part of specific industry regulation. See, e.g., 47 U.S.C.A. section 543(f) (West Supp. 1988) (enabling cable franchising authorities to prohibit discrimination among certain classes of cable subscribers); 47 C.F.R. section 73.642(3)(4)(ii) (1984) (prohibiting unreasonable price discrimination among subscribers to over-the-air subscription television). Other types of price discrimination, see *infra* notes 105-13 and accompanying text (bundling), may be prohibited as unlawful tying under the antitrust laws due to the presumption of market power arising from a copyright, but recent cases have eroded this presumption. See Note, *The Presumption of Economic Power for Patented and Copyrighted Products in Tying Arrangements*, 85 Colum. L. Rev. 1140, 1140-41, 1146-49 (1985) [hereinafter "Tying Note"].

70. See 1 Kahn, *supra*, at 133 & n.18. The Robinson Patman Act was passed primarily as a means to prevent large chain stores with greater buying power from overpowering smaller stores. See H. Schneiderman & B. Leverich, *supra*, at 5. The Act has a problematic economic effect when applied in other circumstances. See Cooper, *supra*, at 962-63, 982. Although price discrimination generally results in reduced output as to consumers with inelastic demand and increased output as to consumers with elastic demand, product will be made available to customers who would not have purchased under the profit maximizing single price, and if costs decline in the relevant range of output, price discrimination can result in lower prices to all consumers or enable the production

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cost characteristics of public goods justify price discrimination with respect to them.<sup>71</sup> Price discrimination, because consumers must pay on the basis of benefits received rather than cost, in fact resembles taxation,<sup>72</sup> but a taxation imposed by the private sector rather than by the government.

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70. (...continued)  
of goods that could not be produced in its absence.  
Cooper, *supra*, at 965.

71. Kahn finds a "special justification" for price discrimination in situations of decreasing cost, where price cannot be equated to marginal cost and also cover total costs. 1 Kahn, *supra*, at 132 n.17. In other words, unlike the economists he describes *supra* note 63, Kahn would select rule two, that total revenues cover total costs, in preference over rule one, that the price to all buyers be equated with marginal costs. A principled legal argument for preferring one of these economic rules over the other arises from the substantial First Amendment interest in ensuring sources of information apart from the government. *Associated Press v. United States*, 326 U.S. 1, 20 (1944). A preference for rule two, which leads to price discrimination and private provision of copyrighted works (public goods), and away from public subsidy, fulfills such First Amendment interests and results in a First Amendment policy consistent with the marketplace as called for by *Associated Press*. For the foregoing reasons, this Article assumes that the Robinson Patman Act is not applicable, or if it does apply in certain cases, that it should be amended to provide an exemption consistent with Kahn's "special justification," and likewise that the presumption of economic power of a copyright in a tying case, see *supra* note 69, should be limited to actual abuses of market power under a rule of reason. See *Tying Note*, *supra*, at 1156 & n.98.

72. See 1 Kahn, *supra*, at 133.

Although the textbook case of price discrimination is "perfect" price discrimination, in which each consumer pays a different price according to his or her valuation of the good, for a public good to be efficiently produced, the price discrimination need not be "perfect"; separating consumers into several groups with approximately similar levels of demand may be sufficient.<sup>73</sup> Price discrimination is possible only when the following conditions exist: (1) the seller has some market power,<sup>74</sup> (2) consumers in the market have differing elasticities of demand, (3) the seller is able to segregate consumers according to their elasticity of demand, and (4) arbitrage is not possible.<sup>75</sup> Arbitrage is the ability of consumers facing a low price to resell to consumers facing a higher price, thus reducing

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73. See Lee, *supra*, at 405.

74. The monopoly power discussed in the text should be distinguished from that of a classical monopolist. First, price discrimination in this context, unlike the textbook example of monopoly pricing at a single price, does not result in reduced total output. Second, the "monopoly" power giving rise to the discrimination advocated in this Article is the limited "monopoly" arising only from a single copyrighted work. See Tying Note, *supra*, at 1149-52. A substantial monopoly problem could arise if multiple copyrighted works, especially from different copyright owners, were tied together. See *U.S. v. Paramount Pictures*, 334 U.S. 131 (1948).

75. See L. Philips, *The Economics of Price Discrimination* 16 (1983).

the profitability of the seller's attempt to charge the higher price.<sup>76</sup> It is important to note for the discussion that follows that arbitrage is easier for goods than services and thus price discrimination is more difficult to achieve with goods than services.<sup>77</sup>

Price discrimination can be achieved in several different ways: directly among consumers, across time, and by bundling. Bundling can be achieved, among other ways, by bundling goods of the same type,<sup>78</sup> by bundling a private good with a public good,<sup>79</sup> and by bundling variable amounts of "quality" with a good.<sup>80</sup> All these types of price discrimination have developed and are used often in copyright-related industries.

Note, however, that price discrimination has its own costs, which must be weighed against its benefits. Key

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76. Id.

77. See Note, Product Market Definition for Video Programming, 86 Colum. L. Rev. 1210, 1220-21 & n.69. When the product is a public good, the nature of the exclusion mechanism determines whether arbitrage is possible; for example, theater tickets can be arbitrated but cable television subscriptions cannot. Id. at 1221 n.69.

78. However, in certain circumstances such bundling may constitute illegal tying.

79. See Besen, *supra*, at 19-20.

80. See Adams & Yellen, Commodity Bundling and the Burden of Monopoly, 90 Q.J. Econ. 475, 475 (1976).

questions are whether the losses imposed by price discrimination are offset by efficiency gains, and which methods of price discrimination impose fewer losses. Different price discrimination methods have different social costs, apart from the administrative cost of implementing each method. In some cases social costs may be offset by social gains.

Direct Consumer Discrimination. This is the most familiar type of price discrimination, in which consumers are sorted by their actual intensity of demand, or more usually, by characteristics that serve as proxies for intensity of demand, such as income, residence, or age.<sup>81</sup> For example, scholarly journals exercise price discrimination directly among users by charging libraries more than individual subscribers.<sup>82</sup> However, this is the least desirable type of discrimination, because consumers generally cannot select which consumption class they will occupy. Instead, the producer or, worse, a court will

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81. See R. Posner, *Cable Television, The Problems of Local Monopoly 2* (Rand Memorandum No. RM-6309FF, 1970).

82. See Dyl, *A Note on Price Discrimination by Academic Journals*, 53 *Lib. Q.* 161 (1983).

determine how discriminatory prices shall be allocated<sup>83</sup> and the level of the prices.

Temporal price discrimination. This type of discrimination occurs when consumers are charged different prices for the same product at different times.<sup>84</sup> This is perhaps the most prevalent form of price discrimination in the copyright industries;<sup>85</sup> it is most fully developed in the motion picture industry.<sup>86</sup> A motion picture typically will be released sequentially over a multiyear period to

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83. In some fair use cases, it can be difficult to distinguish price discrimination from price differentials based on the likelihood of copying. Such price differentials may not constitute price discrimination at all, but merely rather an additional fee for copying. Higher fees charged to libraries after the Williams & Wilkins decision may be viewed as an additional fee for the right to copy, but only if other institutions likely to copy, such as corporations or the government, were charged similar higher fees.

84. See Note, 86 Colum. L. Rev. 1210, 1221 (1986). This assumes that the product's characteristics do not change over time. Id. at 1221 n.72.

85. Temporal price discrimination, even of goods, is not prohibited by the Robinson Patman Act. See supra note 69; see also *Morning Pioneer, Inc. v. Bismarck Tribune Co.*, 342 F. Supp. 1138, 1141 (D.N.D. 1972), aff'd 493 F.2d 383 (8th Cir.), cert. denied, 419 U.S. 836 (1974) (newspaper delivered to two cities at different times with slightly different content not considered commodities of like grade and quality).

86. See *Universal City Studios, Inc. v. Sony Corp.*, 480 F. Supp. 429, 433-34 (C.D. Cal. 1979) (describing in detail the release schedule of programming produced by Universal City Studios).

theaters, then via pay television such as cable television and videocassettes, then to advertiser-supported network television, and finally in syndication to independent television stations.<sup>87</sup> Because the price for each exhibition drops at each stage of the distribution, this distribution scheme is a form of temporal price discrimination.<sup>88</sup>

Note that new media have been added to the distribution schedule at points in the temporal release schedule designed to maximize profit, rather than replacing any of the existing media.<sup>89</sup> Note also, that in the motion picture industry, the earlier releases in the schedule are to media with stronger technological exclusion mechanisms.<sup>90</sup> One of the major problems with newer media, particularly the VCR, is that one medium has the capacity to cannibalize demand for the other media.<sup>91</sup> In the case in which a goods-based medium cannibalizes a service-based medium, consumers will

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87. See Waterman, *Prerecorded Home Video and the Distribution of Theatrical Feature Films*, in *Video Media Competition* 229-30 (E. Noam ed. 1985).

88. *Id.* at 231.

89. *Id.* at 231, 233-34.

90. *Id.* at 233-34.

91. *Id.* at 234.

in effect have the ability to use arbitrage as a means to counteract the temporal price discrimination system.<sup>92</sup>

Temporal price discrimination is also a feature of the book publishing industry,<sup>93</sup> because, even though a hardcover book costs slightly more to produce, it is priced at a much higher level than the paperback copy of the same book.<sup>94</sup> A popular book can be produced first as a hardcover book, then as a trade paperback and finally as a mass market pocket-sized paperback;<sup>95</sup> finally, the excess hardcovers will be sold as "remainders" for less than the mass-market paperback's cover price. The price falls and the break-even print run rises (except for the remainder edition, which is based on the original hardcover print run) as each different edition is produced.<sup>96</sup>

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92. See Note, 86 Colum. L. Rev. 1210, 1229 n.136.

93. See, e.g., Breyer, *supra*, at 314 n.130; Besen, *supra*, at 23. Breyer assumes the existence of temporal price discrimination in his reliance on "preemptive publication" by publishers as an alternative to copyright protection. See Breyer, *supra*, at 299-300.

94. See H. Bailey, *The Art and Science of Book Publishing* 140-41 (1970).

95. See *Id.* at 140.

96. See *Id.* at 136-39.

In fact, the entire subsidiary rights marketing of a major work could be considered as a series of releases arranged with temporal price discrimination in mind, and taking advantage of the different economies of various media involved.<sup>97</sup>

Temporal price discrimination enables consumers to "self-select" the price they will pay depending upon how long they are willing to wait,<sup>98</sup> but creates losses in the form of wasted waiting time by consumers.<sup>99</sup> Waiting time for a good under a temporal price discrimination regime is analogous to waiting in a line for such a good. In both cases, the waiting time constitutes part of the price paid.<sup>100</sup> Such a waiting time creates a loss to society because the "waiting price" paid by consumers accrues to no one, but is merely dissipated as consumers wait.<sup>101</sup>

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97. Cf. U.S. Congress, Office of Technology Assessment, Intellectual Property Rights in an Age of Electronics and Information 162-63 (1986)[hereinafter "OTA Report"]. In the long run, every work, when it loses copyright protection and passes into the public domain, is subject to a rough type of temporal price discrimination.

98. L. Philips, *supra*, at 15.

99. See Barzel, A Theory of Rationing by Waiting, 17 J. L. & Econ. 73, 80 (1979).

100. *Id.* at 75-79.

101. *Id.* at 80 & n.10 (viewing waiting time as a transaction cost).

Although consumers have some ability to choose how long they will wait, and thus reduce the "waiting price" that they pay, in the aggregate the waiting time remains a loss to society.<sup>102</sup>

It is important to identify those cases in which temporal price discrimination is not a factor. For example, "classics," textbooks and certain factual works may not be released in this manner, because demand for them (e.g., as required textbooks) may be relatively inelastic.<sup>103</sup> For those works, competition with used books may be a factor, and frequent revisions of the work are a common response to such competition.<sup>104</sup>

Bundling of Rights. Bundling can be a form of tying, which occurs when two different products are sold together for less than the sum of their individual prices.<sup>105</sup> It is a form of price discrimination because purchasers of

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102. Barzel, *supra*, at 80, 84. Such losses may be more important for factual works than works of other kinds, because there may be a multiplier loss through the economy as producers wait to produce other items using the factual work and thereby delay otherwise useful production. However, the idea-expression dichotomy, which is more significant for factual works, may offset this problem to some extent.

103. See H. Bailey, *supra*, at 142; Breyer, *supra*, at 315, 325.

104. See Besen, *supra*, at 29.

105. See Adams & Yellen, *supra*, at 475, 478.

the individual products and purchasers of the bundle pay different prices per individual product.<sup>106</sup> Thus, purchasers of individual products are deprived of the consumer surplus that they could have gained by purchasing at the bundle price.<sup>107</sup>

When rights are available only in a bundle, bundling of several copyrighted works creates risks of tying and creation of undue market power, and though often attempted, is equally often suppressed.<sup>108</sup> Nevertheless, many copyrighted works, such as magazines, anthologies and even record albums, consist of bundles of rights.<sup>109</sup> Encouraging unbundling of such smaller bundles can reduce some of the market power problems of price discrimination, can increase the income to copyright holders and promote the production of a more efficient level of copyrighted works.<sup>110</sup> Such bundling may cause development of too many

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106. Adams & Yellen, *supra*, at 488-89.

107. Adams & Yellen, *supra*, at 488.

108. See *United States v. Paramount Pictures*, 334 U.S. 131 (1948) (block booking of motion pictures enjoined).

109. Cf. OTA Report, *supra*, at 164.

110. One problem created by photocopying machines, videocassette recorders, and similar devices is that they enable consumers to unbundle rights directly, see OTA Report, *supra*, at 164 n.23; encouraging producers to provide such unbundling directly may reduce such illicit  
(continued...)

bundle alternatives, but in a phase of technological development of the media, this may actually create a benefit by encouraging research and development of media and methods for bundling.<sup>111</sup> As long as consumers have the option of choosing between bundled and unbundled goods, they can self-select their consumption class as in the case of temporal price discrimination,<sup>112</sup> making such schemes preferable to the unfairness of direct consumer discrimination. And, bundling has none of the losses caused by waiting in temporal price discrimination schemes.<sup>113</sup>

Quality Bundling. Levels of "quality" can also be bundled with goods and services. For example, first class, business class and coach are examples of quality being bundled with essentially the same good, a seat on an

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110.(...continued)

unbundling. Additionally, such bundled "rights" need not be limited to copyright rights. Other valuable rights, such as trademark rights, can be bundled with copyrighted works (making the original bearing the trademark an item of value in its own right). See Adams & Yellen, *supra*, at 475. Such rights can be unbundled as well, and, in the form of merchandising rights, are creating new sources of income to the creators of copyrighted works that should not be ignored.

111. See Adelstein & Peretz, *supra*, at 214-17.

112. See Adams and Yellen, *supra*, at 490, 497.

113. See *supra* notes 98-102 and accompanying text.

airplane.<sup>114</sup> Another example is the bundling of quality and luxury with automobiles.<sup>115</sup> Surprisingly, except for the book industry, in which the quality and longevity of the paper and binding of a book is reduced as a book is printed in hard cover, trade paperback and mass market paperback editions,<sup>116</sup> the bundling of quality with copyrighted works is relatively rare.<sup>117</sup> However, the potential for this type of bundling in other media is growing.

As long as consumers have a choice among various bundles, quality bundling, like rights bundling, does not create the unfairness of direct consumer discrimination or the losses caused by waiting under temporal price discrimination schemes.<sup>118</sup> Quality bundling is limited by the number of groups of purchasers with different tastes and the uniformity of their demand,<sup>119</sup> and can impose

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114. See L. Philips, *supra*, at 12.

115. Adams & Yellen, *supra*, at 475.

116. See H. Bailey, *supra*, at 140-42.

117. See also Breyer, *supra*, at 300-01 (discussing low-cost "fighting editions" sold by publishers as retaliation for competition from other publishers who published the same uncopyrighted work).

118. See *supra* notes 98-102 and accompanying text.

119. See Lee, *supra*, at 407, 415.

costs, however, if too much variation in quality develops.<sup>120</sup> Development of quality variations probably will develop concurrently with technological development of the media however, and thus the cost of an overabundance of quality variations may be offset by technological progress and development of new media or new capabilities in existing media.<sup>121</sup>

Bundling--Public Goods with Private Goods. Such bundles combine the sale of a public good with a private good, i.e., a good for which exclusion is possible and opportunities for joint consumption are reduced.<sup>122</sup> Besen gives the examples of selling computer software (a public good) in conjunction with consumer training and support services, such as a call-in advice service (a private good), and provision by public television stations of detailed program guides (a private good) of the stations' programming (a public good) only to contributors.<sup>123</sup> Note also that advertiser-supported programming is a type of

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120. See Tyerman, A Reply to Professor Breyer, 18 U.C.L.A. L. Rev. 1100, 1114 (1971).

121. Adelstein & Peretz, *supra*, at 214-17.

122. Besen, *supra*, at 19.

123. *Id.*

bundling,<sup>124</sup> and is especially important where exclusion of non-purchasers is difficult.<sup>125</sup> For this strategy to work, the supplier must be able to sell the bundle at a price greater than the cost of producing the private good, so that the difference can pay for the public good, and the supplier must have some advantage in providing the private good.<sup>126</sup>

Copyrighted works can also be bundled with goods embodying other types of rights not subject to such types of fair use, such as trademark rights. For example, a copyright proprietor could market a book as an authorized "official" version,<sup>127</sup> or apply a trademark to a record album to make it a collectible object in its own right. The increasing reliance on merchandising rights created by copyright and trademark rights to support the production of copyrighted works is an example in which revenues are combined, although the items involved are not necessarily sold together.

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124. Demsetz, *supra*, at 306.

125. Besen, *supra*, at 16.

126. See *id.*

127. Hurt & Schuchman, *supra*, at 428-29 (J.R.R. Tolkien authorized only one version of *The Lord of the Rings* to compete with public domain versions).

However, this type of bundling scheme raises a greater problem of potential tying and abuses of market power. This is a problem particularly when the seller monopolizes the market for a private good that is bundled with a public good; the inefficiency caused by noncompetitive pricing could outweigh the efficiency gains in supplying the public good in this manner.

Hybrid Discrimination. The social costs imposed by the preceding price discrimination measures may be reduced in part by combinations of those methods. For example, the market for literary rights combines temporal price discrimination and quality bundling, as readers of trade books generally must wait (temporal price discrimination) to purchase cheaper, but more cheaply bound (quality bundling) books.<sup>128</sup>

In general, in terms of cost to society, rights bundling (when it does not rise to the level of tying), quality bundling and bundling with private goods seem preferable to direct user discrimination and temporal price discrimination, because (a) consumers can self-select which consumption group to which they will

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128. See H. Bailey, *supra*, at 139-40.

belong,<sup>129</sup> (b) no waiting losses are imposed, and (c) any losses caused by a superabundance of unbundled rights or quality should be offset by technological innovation in the media. Tying problems can be avoided by encouraging the availability of the bundle and its constituent components or of a variety of bundle alternatives.<sup>130</sup> If this is not possible, then hybrid discrimination is the next best choice.

Additionally, price discrimination affects not only allocative efficiency, the type of efficiency with which this Article has been concerned so far, but the distribution of wealth or income as well.<sup>131</sup> The methods of price discrimination described above capture the consumer surplus of the group with the most intense demand (i.e., most inelastic demand) and pay it to the copyright owner in return for the owner's grant of use of the copyrighted work to those consumers with less intense desires (i.e., those with elastic demand).<sup>132</sup> Although

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129. Adams & Yellen, *supra*, at 490. This reduces transaction costs, as well, because the seller need not expend resources in separating consumers into groups. See L. Philips, *supra*, at 15.

130. See Adams & Yellen, *supra*, at 497.

131. See J. Stiglitz, *The Economics of the Public Sector* 115-17.

132. See Cooper, *supra*, at 965-66.

there is an intuitive appeal in equating the group having intense demand with the rich and the group having low demand with the poor, such an approach confuses demand with ability to pay. Also, it is not necessarily true in practice. For example, persons in the middle or lower-middle classes, as a group, can have a higher demand for cable television than the rich, if only for the fact that they can afford fewer alternative entertainments.<sup>133</sup> Thus, the price discrimination schemes described above do not necessarily operate progressively or regressively in the manner of an income tax.

However, when consumers have the ability to self-select the consumption group to which they will belong, the problem of distributional effects is reduced.<sup>134</sup> In all cases other than the case of direct user discrimination, consumers have this ability to select the group to which they will belong.<sup>135</sup> Thus, for income distribution reasons as well as considerations of allocative efficiency, direct

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133. See, e.g., Collins, Reagan & Abel, *Predicting Cable Subscribership*, 27 *J. Broadcasting* 177, 180-82 (1983).

134. Adams & Yellen, *supra*, at 490.

135. See *supra* notes 98, 112 and 129, and accompanying text.

user discrimination should be avoided in favor of the other methods, and again, a hybrid of discriminatory methods may be preferable.

### C. Cases in which Price Discrimination does not Apply

In two situations, the price discrimination analysis described above cannot be applied. The first situation involves goods or services where the preconditions for price discrimination are not met. The second involves situations in which holdout problems or non-market considerations impede market transactions altogether.

#### 1. Situations in which Conditions for Price Discrimination are Not Met

As described above, four conditions must be met for price discrimination to be possible. If one or more of these conditions do not occur, then price discrimination will be limited or impossible. In such cases, it will be difficult to grant fair use to one group of consumers by attempting to charge another group a higher price.

The most common case concerns markets in which consumers have approximately the same intensity of demand, and that intensity remains approximately constant over

time. In such a case, price discrimination would not be possible.<sup>136</sup>

For certain works, there may be a limit to the amount of price discrimination that can be achieved. The consumers with intense demands simply may not want to or be able to pay a higher discriminatory price.<sup>137</sup> If this happens, the solution may be to offer a greater selection of discriminatory prices at which the good is sold.<sup>138</sup>

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136. See *supra* text at notes 73-74.

137. For a related but more complicated treatment concerning the proper upper limits of price discrimination, see 1 Kahn, *supra*, at 142-50.

138. See L. Philips, *supra*, at 14-16. In other words, if offering a work at, say, three prices (high, intermediate and low) does not produce an adequate return, instead of raising the high price, the work could be offered, for example, at the high and low prices and at four prices in between (rather than just at the one intermediate price).

## 2. Situations in which Other Considerations Preclude Market Transactions

These situations concern strategic bargaining and non-market considerations, most often an "anti-dissemination motive,"<sup>139</sup> whether for personal reasons,<sup>140</sup> political reasons,<sup>141</sup> or anticompetitive reasons.<sup>142</sup> They are beyond the scope of this Article.

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139. See Gordon, *supra*, at 1632-35.

140. See *Rosemont Enterprises, Inc. v. Random House, Inc.*, 366 F.2d 303 (2d Cir. 1966), cert. denied, 385 U.S. 1009 (1967).

141. See *Keep Thomson Governor Comm. v. Citizens for Gallen Comm.*, 457 F. Supp. 957 (D.N.H. 1978); cf. *Legitech, Inc. v. Keiper*, 766 F.2d 728, 735-36 (2d Cir. 1985) (court implies that state sponsored legislative information service denied subscription to private service out of fear that private service would combine text of legislation with voting histories of assemblymen).

142. See, e.g., *Triangle Publications, Inc. v. Knight-Ridder Newspapers, Inc.*, 626 F.2d 1171, 1177-78 (5th Cir. 1980) (upholding fair use when use would not harm plaintiff's individual copyright, but would enable defendant to compete in general more effectively with plaintiff). For example, cases involving parodies of copyrighted works, in which the parody would not directly compete with the copyrighted work. See Gordon, *supra*, at 1633 & n.180.

## II. FAIR USE CASES AND THE EFFICIENT PRODUCTION OF PUBLIC GOODS

Fair use concerns the right to use a copyrighted work for certain limited purposes without compensation to the copyright owner. Cases involving the fair use defense to copyright infringement have been widely criticized for being contradictory and incoherent.<sup>143</sup> In considering the public goods aspect of copyrighted works, legal commentators have tended to concentrate on the non-exclusion condition<sup>144</sup> (which is the prerequisite for provision of a public good by a private market) and ignore the further condition of marginal cost discriminatory pricing (which is the prerequisite for efficient provision of a public good). The courts, in evaluating harm to the copyright proprietor by fair use, have concentrated too heavily on lost sales, and have considered marginal cost discrimina-

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143. See generally Goldstein, *supra* (criticizing Williams & Wilkins case). The ad hoc nature of fair use was apparently promoted deliberately by copyright owners to prevent courts from establishing firm exceptions that particular uses were fair. Litman, *supra*, at 887.

144. See, e.g., Goldstein, *supra*, at 206-07; Brennan, *supra*, at 380.

tory pricing only as an apparent afterthought,<sup>145</sup> but have not explicitly adopted it as a principle for deciding fair use cases. This ignorance is not surprising, given the current all-or-nothing rule for fair use,<sup>146</sup> and the limited scope of each copyright infringement case, which generally would give the court no self-evident opportunity to apply the efficiency condition to the entire distribution system of copyrighted works. Nonetheless, when the outcomes of the fair use cases are considered as a group, the cases do provide cumulative support for marginal cost discriminatory pricing, and thus are consistent with the model of efficiency described in Part I.

#### A. Temporal Price Discrimination and the Fair Use Cases

Fair use concerns a right to use a copyrighted work without compensation to the owner of the copyright. In effect, a case holding that a use is a "fair use" grants a zero-price compulsory license to the alleged infringer.<sup>147</sup> Although the Copyright Act specifies other

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145. See Gordon at 1649 n.269.

146. See 3 M. Nimmer, Nimmer on Copyright section 13.05[E][4][e] (1988).

147. See Brennan, *supra*, at 378.

factors to be used in deciding whether to grant fair use,<sup>148</sup> and the factors specified in the statute are not exclusive,<sup>149</sup> certain of these factors are particularly important when considering the effect of the fair use cases upon economic efficiency: (a) "the effect of the use upon the potential market for or value of the copyrighted work,"<sup>150</sup> (b) "the nature of the copyrighted work,"<sup>151</sup> and (c) the balancing by the courts of the benefits of the alleged infringer's use against the value lost by the copyright owner.<sup>152</sup>

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148. Such factors are "the purpose and character of the use," 17 U.S.C.A. section 107(1) (1983) and "the amount and substantiality of the portion used in relation to the copyrighted work as a whole," 17 U.S.C.A. section 107(3) (1983).

149. Harper & Row, Publishers, Inc. v. Nation Enterprises, 471 U.S. 539, 549 (1985).

150. 17 U.S.C. section 107(4) (1983). This is the most important fair use factor. 3 Nimmer, Nimmer on Copyright section 13.05[A][4] (1988).

151. 17 U.S.C. section 107(2) (1983).

152. See Gordon, *supra*, at 1615-22. However, this balancing has its limits. "[T]o propose that fair use be imposed whenever the 'social value [of dissemination] outweighs any detriment to the artist,' would be to propose depriving copyright owners of their right to property precisely when they encounter those users who could afford to pay for it." 471 U.S. at 559 (footnote omitted)(quoting Gordon, *supra*, at 1615). The price discrimination analysis of this Article is consistent with this limitation, by advocating that fair use be limited to uses corresponding to low intensities (highly elastic) demand. Other uses by consumers with more intense (inelastic) demand are more likely to take place through market transactions. Gordon, *supra*, at 1615.

Considering for a moment these factors alone, the court's balancing of the values of a copyrighted work in a particular case suggest the court's view of the value of the copyrighted work at the particular stage of the work's temporal release schedule. A finding of fair use is an "all-or-nothing" decision. That is, because a finding of fair use precludes a finding of infringement and thus of damages, a court in a fair use case under the current unsettled state of the law cannot directly impose a system of discriminatory compulsory license fees.<sup>153</sup> Even if this is so, however, the outcomes of fair use cases can encourage the establishment of discriminatory pricing systems indirectly in two ways. First, fair use can be granted or withheld in situations (a) in which lesser or greater amounts of a work are copied,<sup>154</sup> and (b) in which

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153. But see *infra* notes 182-83, 222-26 and accompanying text (arguing that such a system could be imposed).

154. See 17 U.S.C.A. section 107(3); cf. *Salinger v. Random House*, 811 F.2d 90, 97 (2d Cir. 1987) (discussing "scope" of fair use as amount of material that can be copied). The scope of the use must also take into account the quality or importance of the material used. *Harper & Row, Publishers, Inc. v. Nation Enterprises*, 471 U.S. 539, 564-65 (1985); *Roy Export Co. Establishment v. Columbia Broadcasting System, Inc.*, 503 F. Supp. 1137, 1145 (S.D.N.Y. 1980), *aff'd*, 672 F.2d 1095 (2d Cir.), *cert. denied*, 459 U.S. 826 (1982).

the use is commercial or not.<sup>155</sup> That is, fair use could be granted for increasingly larger amounts of the work depending on the length of time that the work had been available, or on the value of the use (with fair use being granted for greater amounts of the work for noncommercial uses than commercial uses). Such a varying amount of material would in effect constitute a discriminatory fee, because the amount of material available at the zero price would vary. Such varying amounts of zero price uses would affect license fees, because uses above the corresponding amount held to be fair use would still be subject to a licensing fee, which should vary corresponding to the different amounts of the work subject to fair use. Second, a grant of fair use, even if not as complicated as that just described, could force the copyright proprietor to adopt a discriminatory pricing scheme in order to pay his or her average total costs.<sup>156</sup> In light of the first alternative above, because fair use has been granted more

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155. See 17 U.S.C.A. section 107(1) (1983). The Court stated in *Betamax* that every commercial use is presumptively unfair. 464 U.S. at 451.

156. See *infra* notes 184-86 and accompanying text. Cf. Goldstein, *supra*, at 212 (when a certain class of users is too expensive to police or privacy interests are jeopardized, "costs will instead be bunched and imposed on the institution that is nearest to the uncontrolled user and, at the same time, is itself controllable.")

extensively with regard to works closer to the end of their temporal release schedule, where demand is likely to be less intense, the fair use cases considered as a group are consistent with a declining price over time, and thus with temporal price discrimination. Additionally, the behavior of some copyright proprietors has been consistent with the second alternative, and limited price discrimination schemes have been adopted.<sup>157</sup> The following paragraphs describe how these two alternatives have worked out in the fair use cases.

Before Publication. Fair use has been denied for uses before publication, even where the amount of material used is relatively small and even where a strong public policy argument could have been made in favor of the use. In Harper & Row, Publishers, Inc. v. Nation Enterprises, the Supreme Court overruled a holding of a fair use of several quotations from an unpublished biography of Gerald Ford, claiming that "substantial" damage to the author and to "the marketability of first serialization rights in general" could occur.<sup>158</sup> A later case, Salinger v. Random House, Inc., went even further, restricting even close paraphrasing of an author's personal letters before

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157. See supra notes 85-97 and accompanying text.

158. 471 U.S. at 553, 569.

publication, and explicitly recognized the future first publication value of the letters.<sup>159</sup>

Soon after Publication. Fair use cases involving uses near the time of publication are relatively rare. In Marvin Worth Productions v. Superior Films Corp., the court held that the defendants' use of copyrighted material in a motion picture to be exhibited contemporaneously with plaintiff's film was not a fair use of plaintiff's copyrights.<sup>160</sup> Several cases analogous to copyright apply similar principles. Although not a copyright case, the well-known case International News Service v. Associated Press, is an analogous example of a court denying use of a work soon after publication.<sup>161</sup> In Legi-tech, Inc. v. Keiper, the Second Circuit granted the defendant,

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159. See 811 F.2d 90, 99 (2d Cir. 1987). Of course, Salinger could be distinguished from the Nation case on the grounds that the owner of the copyright had not sought publication and that publication of the letters would invade the author's personal privacy. However, the Nation Court explicitly rejected the claim of fair use even where the author was seeking publication and presumably had therefore waived any privacy interests. See 471 U.S. at 554-55.

160. 319 F. Supp. 1269, 1274 (S.D.N.Y. 1970). See also New Boston Television, Inc. v. Ent. Sports Prog. Network, Inc., 215 U.S.P.Q. 755 (D. Mass. 1981) (taping of excerpts and rebroadcast of plaintiff's sports programs held an infringement, in light of evidence that plaintiff had previously offered defendant a license for such use).

161. 248 U.S. 215 (1918) (imposing a temporal delay upon a competing newspaper's use of uncopyrighted news).

an information provider, with access to the computerized legislation information provided by the plaintiff state agency, but only upon payment of the plaintiff's lost revenues.<sup>162</sup> Although the case was not a fair use case, compulsory access comparable to a right of fair use was granted, and the court explicitly referred to an economic rationale often invoked in fair use determinations: the need to exclude free riders to preserve the economic incentive for creation.<sup>163</sup> The court held that the grant of access by the defendant was contingent upon its payment of "the true cost" to the plaintiff of the revenue the plaintiff would lose as a consequence of the Defendant's resale of the work.<sup>164</sup> Where a competitor seeks to use a copyrighted work soon after publication, the courts have relied on the idea-expression dichotomy to ensure adequate dissemination of ideas.<sup>165</sup>

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162. 766 F.2d 728 (2d Cir. 1985).

163. *Id.* at 735.

164. *Id.* at 736.

165. See *infra* notes 204-05 and accompanying text; *New Boston Television, Inc. v. Ent. Sports Prog. Network, Inc.*, 215 U.S.P.Q. 755, 757 (D. Mass. 1981); see also *Marvin Worth Productions v. Superior Films Corp.*, 319 F. Supp. 1269, 1275 (S.D.N.Y. 1970) (similar reasoning in entertainment context).

End of Release Schedule. The Betamax case can be interpreted as a case granting fair use at the end of a product's life-cycle.<sup>166</sup> In Betamax, consumer videotaping of entire televised programs for replay at a later time, i.e., complete copying of a work for non-productive uses, was held to be a fair use.<sup>167</sup> Likewise, widespread, institutionalized photocopying of scientific journals (with no reprints available from the publisher), which is a use at the end of the product's temporal life-cycle, was held to be a fair use by the Court of Claims in Williams & Wilkins.<sup>168</sup> Another analogous case held that there was no liability for small-scale reception of advertiser-supported broadcasts in a retail setting.<sup>169</sup> The claim for access to a computer service in Legi-tech also was decided in light of the timing of the works' release schedule, as the court noted that the value of the information at issue was quite time sensitive, and could be worth little only days after its release.

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166. 464 U.S. 417 (1983).

167. 464 U.S. at 450-51, 456.

168. 487 F.2d 1345 (Ct. Cl. 1973).

169. Twentieth Century Music Corp. v. Aiken, 422 U.S. 151 (1975).

170. 766 F.2d at 733.

As seen in the foregoing cases, the temporal release schedule is important for considering the fair use of the copyrighted work. Because the cases are more likely to grant fair use toward the end of the product's temporal release schedule, they are consistent with a system of temporal price discrimination, in which consumers valuing the product less must wait to obtain it, but can obtain it at a low price (zero) nonetheless.<sup>171</sup> No cases regarding uses enabling arbitrage that impair or defeat the temporal price discrimination scheme have been litigated, but such uses should be allowed only in exceptional cases.<sup>172</sup>

Subsequent Subsidiary Uses. The cases are less consistent regarding subsequent subsidiary rights uses of a work beyond the use in the first medium of publication,<sup>173</sup> but fair use of an original work can affect the market for

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171. See supra notes 84-88 and accompanying text. News has a shorter release schedule, and so fair use is more applicable to it than to entertainment. See *Betamax*, 464 U.S. at 455 n.40; see also *Pacific & Southern Co., Inc. v. Duncan*, 744 F.2d 1490, 1497 n.12 (interpreting *Betamax* in terms of duration of secondary markets).

172. See, e.g., *Betamax*, 464 U.S. 449-50 (suggesting that home videotaping of motion pictures from pay television channels on cable might not be considered fair use). Such videotaping could reduce the market for works earlier in the temporal release schedule, and can eliminate the efficiency of the temporal price discrimination approach.

173. Gordon, supra, at 1640 & n. 219. Nimmer advocates broad protection of the copyright owner's interest in  
(continued...)

derivative works.<sup>174</sup> The Nation case contains dicta stating that the fair use inquiry "must take account not only of harm to the original but also of harm to the market for derivative works."<sup>175</sup> For example, photocopying of journal articles several years after the journal has been distributed to subscribers should be a fair use with regard to the market for the original journal subscription market, but could be an unfair use with regard to the markets for back issues of the journal or article reprints.<sup>176</sup> Courts have had to speculate on the likelihood that such subsidiary rights markets would develop or that the copyright owner would exploit such rights.<sup>177</sup> In Williams & Wilkins, the court determined that no subsidiary rights

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173. (...continued)  
subsidiary rights markets. 3 Nimmer, Nimmer on Copyright section 13.05[B] (1988).

174. See Marvin Worth Prod. v. Superior Films Corp., 319 F. Supp. 1269, 1275 (S.D.N.Y. 1970) (citing Nimmer for example of an unfair use in a medium different from that of the original work).

175. 471 U.S. at 568; see also Meeropol v. Nizer, 560 F.2d 1061 (2d Cir. 1977), cert. denied, 434 U.S. 1013 (1978).

176. See Williams & Wilkins, 487 F.2d at 1355-57 & n.17.

177. See, e.g., Salinger, 811 F.2d at 99 (estimating market for subsidiary rights even though author disavowed intention to exploit them).

market would be forthcoming;<sup>178</sup> in Pacific and Southern Co., Inc. v. Duncan, another court stated that the fact that the copyright owner did not market its works was irrelevant, because the statute protects potential uses, but the facts of the case were that the owner had conducted informal, modest sales of derivative works (videotapes of local news broadcasts that had previously been aired).<sup>179</sup> In Meeropol v. Nizer, the court left the question of the potential subsidiary rights market to the jury, where the copyrighted works at issue had been out of print for 20 years.<sup>180</sup>

Additionally, the inquiry is further complicated by considerations of bundling and repackaging of rights in subsidiary rights markets. For example, a journal or magazine can be considered a bundle of articles, which may be unbundled and sold separately as reprints.<sup>181</sup> If the copyright owner refuses to unbundle certain rights, a finding of fair use as to individual unbundled rights may

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178. 487 F.2d at 1360.

179. 744 F.2d 1490, 1493, 1496 (11th Cir. 1984), cert. denied, 471 U.S. 1004 (1985).

180. 560 F.2d 1061, 1070 (2d Cir. 1977).

181. Cf. OTA Report, *supra*, at 164; see also Duncan, 744 F.2d at 1496-97 & nn.9-11 (infringer was selling unbundled copies of individual programs of plaintiff's broadcasts).

be appropriate, even though copying of the entire work would not be a fair use.

Courts will need to define the difference between primary and subsidiary uses more explicitly, and determine, for each type of copyrighted work, the likelihood that a subsidiary rights market will develop. If the difference is left too unclear and likelihood of exploitation allowed to be too modest, then the possibility of subsidiary rights exploitation could be used as a sham to prevent fair use. An alternative to the all-or-nothing grant of fair use when potential but unexploited subsidiary rights are a consideration is to grant fair use, at some non-zero price, until the copyright owner actually developed the market for the

subsidiary right.<sup>182</sup> Although determining the non-zero price would be difficult, it is not impossible.<sup>183</sup>

#### B. Fair Use and Other Types of Price Discrimination

Other types of price discrimination, including discrimination directly among consumers and bundling, are used less frequently, but have been discussed in some of the fair use cases. Additionally, some of these types of discrimination are prohibited by law and are objectionable for reasons to be discussed later.

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182. See 3 M. Nimmer, Nimmer on Copyright section 13.05[E][4][e] & n.135.1 (1988)(citing *Universal City Studios, Inc. v. Sony Corp.*, 659 F.2d 963, 976 n.18(9th Cir. 1981)); but see *Williams & Wilkins*, 487 F.2d at 1360 & n.25 (no power to institute compulsory licensing system under 1909 Copyright Act, as opposed to antitrust statutes). Such a determination would nevertheless deprive the copyright owner of the ability to determine with whom and when the owner will exploit the right, however, see *Compulsory Licensing Economics*, supra, at 204-05, and should be limited to situations (a) in which the copyrighted work may not be available at all in the future, but see *Duncan*, 744 F.2d 1490 (denying use even though copyrighted videotapes were erased seven days after broadcast), or (b) in which subsidiary rights are somewhat standardized and do not generally involve negotiations by the parties (for example, reprints of a journal article).

183. See *Legi-tech*, 766 F.2d at 736 (Defendant to pay information owner's foregone revenue); but see *Brennan*, supra, at 379-80 (rate regulation unnecessary and undesirable in competitive markets for copyright).

## 1. Discrimination among Consumers

Williams & Wilkins is the paradigm case in which a court explicitly recognized that discriminatory prices among consumers could be one alternative to an extensive holding in favor of the copyright owner.<sup>184</sup> However, the court did not mandate such a system, merely recognizing that such a system could develop in response to its grant of fair use.<sup>185</sup> In fact, discriminatory pricing systems, in which subscription fees were higher to libraries than to individual subscribers, were instituted after the decision, and are apparently common among scholarly journals.<sup>186</sup> In other areas of the publishing and information industries, where the information is provided through a service, direct consumer discrimination is often prohibited.<sup>187</sup>

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184. 487 F.2d 1345 (Ct. Cl. 1973).

185. See 487 F.2d at 1360 n.26; see also Goldstein, *supra*, at 210 (after decision, the publisher introduced a dual pricing scheme, in which a higher rate was charged for a subscription plus a blanket right to copy and a lower rate was charged for a subscription only). Such differential rates may or may not be discriminatory based upon the level of fees charged.

186. See, e.g., Dyl, *supra* (empirical study).

187. These prohibitions arise from laws other than the Robinson Patman Act. See *supra* note 69.

## 2. Bundling

Courts have recognized the efficacy of various discriminatory methods of bundling and unbundling rights, but have tended to ignore other types of bundling.

Rights Bundling. Commodity bundling of rights has been encouraged in the courts. Williams & Wilkins recognized that a market for article reprints would be one solution to the problem of library photocopying, but discounted the possibility that such a market would develop.<sup>188</sup> The court would apparently have granted greater protection to the copyright holder if article reprints (unbundled) or single back issues (somewhat unbundled) had been available as well as journal subscriptions (bundled). Duncan's denial of fair use can be interpreted on the grounds that, although a formal market had not yet been created, an informal market for unbundled rights had been developed.<sup>189</sup> Regarding cable programming, bundling of program channels (called "tiering") is an apparently

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188. 487 F.2d at 1356-57, 1360.

189. 744 F.2d at 1493.

accepted practice.<sup>190</sup> In the audio field, the availability of the same music on singles (unbundled) and LPs (bundled) achieves the same effect.<sup>191</sup> Slightly further afield, the courts have upheld blanket licenses of music rights from different performers.<sup>192</sup>

Quality Bundling. This type of bundling has received little, if any, attention from courts and regulators. It should receive greater attention, especially because a reliance by copyright owners upon quality bundling for

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190. See 47 U.S.C.A. section 545(d) (allowing retiering by cable operators).

191. The record industry is currently developing several compact disk formats, with various playing times, all to be compatible with the same playing equipment. A multiplicity of such formats could enhance the alternatives for bundling and unbundling. Conversely, one popular activity of individuals who tape at home has been to compile their own "dance tapes" consisting of a group of songs by various artists. That is, consumers take unbundled music and create their own bundles. If the antitrust problems of tying or collusion by competitors could be avoided, copyright owners could potentially profit by creating standard or custom bundles such as these.

192. See *BMI v. CBS*, 441 U.S. 1 (1978) (blanket licenses held not a per se restraint). Although the requirement of a separate license has been imposed to solve the antitrust problem of tying of individual licenses, see *Columbia Broadcasting Sys., Inc. v. Am. Soc'y of Composers*, 620 F.2d 930 (2d Cir. 1986), it does not eliminate the possibility of discriminatory bundling based upon price differentials between the blanket license and the individual licenses, see 2 M. Nimmer, *Nimmer on Copyright* section 8.19 n.6 (1988) (discussing existence of such an ASCAP license).

revenue can encourage technological innovation.<sup>193</sup> For example, the sale of the same music on traditional LP's as well as Digital Audio Disks (CD's), and the development of several television media with differing quality levels (for example, traditional broadcast television and High Definition Television), makes quality bundling a possibility in those media.<sup>194</sup>

Bundling with Private Goods. This bundling alternative has also received little explicit attention. Recent cases can be interpreted as allowing the broader availability of fair use when bundling with a private good occurs. In Betamax<sup>195</sup> and Aiken,<sup>196</sup> many of the copyright licensees were able to bundle their programs with a private good, advertising time, and fair use was permitted. However, fair use was not granted where similar copyright licensees (publicly funded stations) could not bundle

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193. See also Adelstein & Peretz, *supra*, at 214 (exclusion technologies and property rules cause each other to develop concurrently).

194. See 28 Television Digest at 1-4, 12-13 (Sept. 5, 1988).

195. 464 U.S. 417, 446 & n.28.

196. 422 U.S. 151, 163 (1975); Lloyd & Mayeda, Copyright Fair Use, the First Amendment and New Communications Technologies: The Impact of Betamax, 38 Fed. Com. L. J. 59, 89 & n.152 (1986). Although technically not a fair use case, Aiken has frequently been interpreted as resting on fair use principles. See *id.*

the programming with advertising.<sup>197</sup> For many types of copyrighted works, it provides copyright proprietors with a type of self-help, particularly against unauthorized copying by consumers.<sup>198</sup> It is unlikely to stop pirating by competitors, but in situations in which the private good embodies trademark rights, the additional penalties under the Lanham Act<sup>199</sup> could perhaps deter some piracy. However, in considering such situations, courts should be careful to ensure that a claim against unlawful piracy is not merely a disguised claim against legitimate and beneficial competition in the private good.

#### C. Cases in which Price Discrimination does not Apply

Part I discussed two situations in which the price discrimination analysis cannot be applied. The first situation, in which the conditions for price discrimination are not met, most commonly concerns markets

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197. See Crooks, 542 F. Supp. 1156, 1173-74; LLOYD & MAYEDA, *supra*, at 89 n.152.

198. See Besen, *supra*, at 19; see also Tying Note, *supra*, at 1156 (arguing that tying arrangements of software are a "cost-effective" means of metering use of copyrighted products, and would require "more discriminating treatment of tie-ins" than the per se rule against such tie-ins currently allows).

199. 15 U.S.C.A. sections 1051-1127 (1983).

in which consumers have approximately the same intensity of demand, and in which their demand remains approximately constant over time. Encyclopedia Britannica Educ. Corp. v. Crooks presents such a case.<sup>200</sup> Unlike markets for entertainment or news, in which the intensity of demand drops over time, the market for educational films in Crooks remained constant over time,<sup>201</sup> perhaps because the ultimate audience (the students) was constantly refreshed with a new class each year. Additionally, even if some teachers and students had a higher intensity of demand, because the programming was recorded from a government supported broadcasting station, the copyright owner had no alternative source to obtain payment for the extra demand.<sup>202</sup> Thus, the refusal to grant fair use in Crooks is consistent with the price discrimination analysis above.<sup>203</sup>

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200. 542 F. Supp. 1156 (W.D.N.Y. 1982).

201. Crooks, 542 F. Supp. at 1169-71 & n.12. The court corrected for declines in sales it attributed to unauthorized copying. *Id.* at 1170 n.12.

202. Crooks, 542 F. Supp. at 1173-74.

203. See also Marcus v. Rowley, 695 F.2d 1171 (9th Cir. 1983) (use by one teacher of approximately 46% of another teacher's instruction book held not a fair use); cf. 3 Nimmer, Nimmer on Copyright section 13.05[B] (fair use should not be available if plaintiff's and defendant's works serve the same function for consumers).

This approach suggests that a general denial of fair use for long-lived works, such as factual works or "classics," would be justified on efficiency grounds because demand for such works should more often be constant than is the case for works of entertainment, fashion or news. It is with factual works, however, where the fundamental dichotomy of protection of expression and fair use of ideas embodied in such expression has received its fullest development.<sup>204</sup> In many, but not all, cases use of ideas alone is sufficient for access to copyrighted works of this type,<sup>205</sup> and one would expect fair use of the expression itself to be granted more sparingly than in cases concerning entertainment. Classics present a more difficult problem,<sup>206</sup> related to subsidiary rights. However, the fair use of the ideas and the availability of the work in its original form in the public domain should ensure public access to some form of the work. The

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204. See *Harper & Row, Publishers, Inc. v. Nation Enterprises*, 471 U.S. 539, 563 (1985).

205. See *Triangle Publications, Inc. v. Knight-Ridder Newspapers, Inc.*, 626 F.2d 1171, 1179-82 (5th Cir. 1980) (Brown, C.J., concurring). In some cases, such as photographs of the My Lai massacre, the idea and expression are inseparably fused. See 1 M. Nimmer, *Nimmer on Copyright* section 1.10[C][2] (1988).

206. Breyer, *supra*, at 326.

character of the use involved (particularly scholarly uses) may be a more important factor in this case.<sup>207</sup>

The problem of an upper limit to the amount of price discrimination that can be achieved has been explicitly reached in cases only rarely. However, courts in such situations have usually recognized this only as an argument against allowing fair use, to be applied to an all-or-nothing decision. Thus, they have not recognized the alternative, an increase in the number of discriminatory prices at which the good is sold.<sup>208</sup>

For cases in the second situation discussed in Part I, in which market transactions are precluded, the solution is generally based on non-economic grounds, such as First Amendment grounds. Depending upon the motive involved, and especially in cases in which the copyright proprietor seeks not to exploit the work, the denial of fair use would contravene one of the underlying policies of the Copyright Clause, which is to stimulate the dissemination of authors' works,<sup>209</sup> as well as of the First Amendment. To be consistent with the efficiency analysis above, a court presented with such a case should deny an injunction

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207. Id.

208. See *supra* note 138 and accompanying text.

209. See Patterson, *supra*, at 5.

against copying, but should, instead of granting a blanket fair use, grant a compulsory license at a discriminatory price.<sup>210</sup> In a case analogous to copyright and reasoning on essential copyright principles, one court has granted such relief.<sup>211</sup>

### III. THE BENEFITS OF A MIXED SYSTEM OF INCENTIVES AND CONTROL

The copyright law contains an essential balancing of incentives and control--control granted to authors so far as to give them incentives to create and disseminate works, but limitations on such control beyond that needed for incentives. As discussed in Part I, dissemination of copyrighted works through services has the potential to give the author extensive control, which, although it would create perhaps the most "efficient" and direct method of ensuring that authors were rewarded, could easily be

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210. See 3 M. Nimmer, *supra*, at section 13.05[E][4][e]; cf. *Belushi v. Woodward*, 598 F. Supp. 36 (D.D.C. 1984) (declining to enjoin publication of book containing infringement of copyrighted photograph because damages would be adequate and free expression would otherwise be unnecessarily hampered).

211. See *Legi-tech, Inc. v. Keiper*, 766 F.2d 728 (2d Cir. 1985).

extended to give the government undue political control and give the author undue economic control over uses not provided for in the Copyright Act.<sup>212</sup>

Dissemination of copyrighted works through goods can counteract this potential for excessive control.<sup>213</sup> However, due to the development of new technologies, dissemination through goods has the potential to destroy incentives as well.<sup>214</sup> And many of the most difficult recent copyright problems have arisen at the interface--literally<sup>215</sup>--of media based on services and media based on goods.

The price discrimination methods described in Part II are a response to the control problems created by distribution through services and the incentive problems created by distribution by means of goods. Price discrimination can maintain profitability and incentive to

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212. See *supra* notes 17-23 and accompanying text.

213. See, e.g., Groskaufmanis, *What Films We May Watch: Videotape Distribution and the First Amendment*, 136 U. Penn. L. Rev. 1263, 1264, 1285-88, 1298-1300 (1988) (discussing political uses of videotapes).

214. See Waterman, *supra*, at 234, 242 n.5.

215. See Betamax, 464 U.S. 417.

creators in the presence of incomplete control.<sup>216</sup> It is compatible with a market in which service-based and goods-based media co-exist, in which incentives are preserved but some "loose spots" of unmonitored use can persist. Such a mixed system is not perfect, as it generates conflict among right-holders and right-users, helps to preserve confusion where goods and services come into contact, and cannot eliminate the potential for inequity (for example, if law-abiding consumers subsidize copyright pirates). But it aims for a workable measure of freedom, efficiency and equity, in which not all uses are monitored by the market or by the state and pricing reflects the variation in demand by consumers.

No simple solutions exist, because, as described above, all impose costs. For example, a tax on blank tape has been proposed as a simple solution to the problem of unauthorized taping. Yet it creates the distortions of

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216. See, e.g., Waterman, *supra*, at 238 ("Along with pay-TV, home video is part of a process by which more efficient program pricing is shifting a vast pool of consumer surplus away from the viewers of advertiser-supported broadcast television to the producers and distributors of that programming" causing a surge in production, and presumably, increased incentives for copyright owners.) Breyer suggests that governmental funding is necessary in many cases to ensure adequate production of copyrighted works, but oddly enough, his examples assume the possibility of temporal price discrimination. See Breyer, *supra*, at 299-304; *supra* note 93; see also Hurt & Schuchman, *supra*, at 427 (same).

demand and production described in Part I, and responds only to the non-exclusion requirement of the public goods problem--which, as discussed, is the superficial part of the problem. If such a tax were to be enacted at all, it should respond to the more fundamental requirement that the consumer should pay no more than his or her value for the good, because the marginal cost of providing a public good to another consumer is zero.<sup>217</sup> Examining such a tax in light of the price discrimination analysis set forth in Part II, such a tax should correlate with the intensity of demand, which a tax on each tape only partly achieves.<sup>218</sup> Alternatively, the level of such a tax could also depend upon the quality or longevity of the recording medium purchased.<sup>219</sup> Or, the tax could be set at a relatively

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217. In technical terms, this result arises from the fact that average total costs decline as the number of consumers increases, while marginal costs remain constant at zero.

218. A tax on blank tape sales does not fully measure all demand and cannot distinguish between the intensity of demand to use one copyrighted work repeatedly versus several works less frequently. For example, a consumer (e.g., a library) could make one copy of a work, and use it repeatedly, or make several copies of a work and use them less frequently. The tape tax measures the intensity of demand less inaccurately in the second case, but inaccurately nonetheless.

219. That is, the tax would impose a surcharge much like the quality bundling described supra notes 114-21 and accompanying text.

low level to capture the demand of individuals and supplemented by direct collection efforts of a collective rights society (such as ASCAP) to capture the demand of institutions.<sup>220</sup> Once the price discrimination approach is accepted, however, one must ask why the discriminatory taxing scheme should be followed at all, if the price discrimination methods described in Part II could reach essentially the same result.<sup>221</sup>

Even without such a tax, discriminatory pricing principles can be applied to fair use cases. First, although past cases taken as a group are for the most part consistent with discriminatory pricing, this consideration can be applied more explicitly and consistently in the future. The amount of the work subject to fair use can be varied systematically, consistent with

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220. Such a tax would resemble the multipart tariffs adopted in the pricing of telephone services as a means to reconcile efficient pricing with the goals of universal service and distributional equity. See 1 Kahn at xxxi-xxxii, 152.

221. See also Cirace, *supra*, at 671, 680 (concluding that given some copyright owners' ability to engage in temporal price discrimination, a targeted tax would overcompensate them). However, the targeted taxing scheme could be appropriate where the limits of price discrimination are reached. See *supra* notes 137-38 and accompanying text. Note that if the costs of the tax were higher than the cost of implementing comprehensive technological exclusion mechanisms, manufacturers might opt for comprehensive technological exclusion mechanisms, creating a potential for excessive government and private control. See *supra* notes 17-23 and accompanying text.

discriminatory pricing.<sup>222</sup> Decisions granting fair use can weigh the possibility that discriminatory pricing schemes, including ones described above but not widely recognized in the courts, could develop, and consider the social costs of each type. Such a perspective would better enable a court to determine whether the harm to the copyright owner caused by fair use defeats author incentives.<sup>223</sup>

Legislatively, the fair use doctrine could perhaps lead to the more efficient production and dissemination of

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222. See *supra* notes 153-57 and accompanying text.

223. This Article's analysis is consistent with Gordon's approach, in which fair use should be granted in the presence of market failure (e.g., when transaction costs of granting use exceed that value of such use of a copyright), see Gordon, *supra*, at 1618-19, provided that author incentives are not substantially impaired, see *id.* at 1615-21. It assumes that the social costs of curing market failure (by means of technological and legal exclusion mechanisms) are too high, see *supra* notes 17-23 and accompanying text, and thus is consistent with Gordon's justification of fair use on the basis of market failure. Author incentives are preserved by implementing discriminatory prices and limiting fair use to cases of less intense (i.e., elastic) demand. See 3 Nimmer, Nimmer on Copyright section 13.05[A] n.26.1 (1988) (adding this interpretation to Gordon's article); Harper & Row, 471 U.S. at 566 n.9. This Article's analysis is also consistent with Nimmer's "functional test" for fair use of whether a work "meet[s] the same demand on the same market" as a prior work, see 3 Nimmer, Nimmer on Copyright section 13.05[B] & n. 46 (1988) (quoting *Berlin v. E.C. Publications, Inc.*, 219 F. Supp. 911, 914 (S.D.N.Y. 1963)), but provides a more explicit definition of "same demand" and "same market."

copyrighted works by the adoption in the copyright statute of certain "fair" uses at non-zero prices.<sup>224</sup> Finally, the approach suggested by this Article could perhaps be applied with some modification to the determination of the proper damages in copyright infringement cases, which up to now has been based upon calculations of profits not necessarily related to the public goods characteristics of copyrighted works,<sup>225</sup> but over which courts have considerable discretion in many instances.<sup>226</sup>

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224. This approach dates back to the first copyright statute. See A. Latman, R. Gorman, & J. Ginsburg, *Copyright for the Eighties*, at 1-4 (2d ed. 1985); see also Breyer, *supra*, at 328 (discussing provision of English law, now repealed, providing for compulsory license for works during last 25 years of their copyright); but cf. *Compulsory Licensing Economics*, *supra*, at 216-21 (arguing that compulsory licensing has the net effect of raising transaction costs, thereby reducing economic efficiency).

225. See *supra* notes 4-8, 64-67 and accompanying text.

226. See, e.g., 17 U.S.C.A. section 504(c) (1983) (granting discretion over award of statutory damages).

## CONCLUSION

In considering the fair uses of copyrighted works, too much emphasis has been placed on the exclusion of non-paying consumers and not enough attention has been given to the cost characteristics of copyrighted works as public goods. Because the marginal cost of providing a public good to another consumer in many cases is zero, consumers for such goods should be charged prices no more and no less than their intensities of demand. Copyrighted works will be produced more efficiently if copyright owners are allowed to charge different prices to different consumers, to match their differing intensities of demand. Price discrimination can occur by discriminating directly among consumers, by charging different prices over time, or by bundling copyrighted works with various levels of quality or with other rights or private goods. Because all methods of discrimination other than direct consumer discrimination enable consumers to self-select the price each consumer will pay, those methods are preferable to direct consumer discrimination. A combination of several types of discrimination would reduce any peculiar costs imposed by any single type of price discrimination. The courts could adopt such a discriminatory system to

encourage the creation and dissemination of copyrighted works, either by selective grants of fair use in a wider variety of cases or by allowing certain fair uses to take place only in return for a non-zero compulsory license fee.

#### About Harry Boadwee

Harry Boadwee is a corporate and technology lawyer with over 20 years of experience. He represents U.S. and international businesses in negotiation of strategic alliances, technology and content transactions and licensing; and advises on internet and e-commerce law and offerings of new technology products and services. He is admitted to practice in California and New York.

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