

Understanding Copyright Markets

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Three Goals

- ◆ State the problem of market definition in copyright
- ◆ Market Structure and Copyright Law
- ◆ Derive implications for market definition

Problem of Market Definition

- ❖ Fair use and “rights of first entry”
- ❖ Derivative works
- ❖ Distribution rights
- ❖ Copyright misuse
- ❖ Copyrightable subject matter

Antitrust market definition

Smallest set of products that satisfy the “small but significant and nontransitory” price increase test

Antitrust vs. Copyright market definition

◆ Institutional differences

- Agency decision making versus judicial decision making
- Problem of distinguishing copying, adapting, and distributing
- Precision and heuristics

◆ Economic differences

- Price competition versus non-price competition
- Public goods
- Price discrimination

Copyright Markets

- ◆ Market definition question is one of scope of copyright owner's entitlement

- ◆ Optimal variety of works
 - Difficult tradeoff between variety and quantity (ex: textbooks, CD's)
 - Basis for justifying non-transformative uses

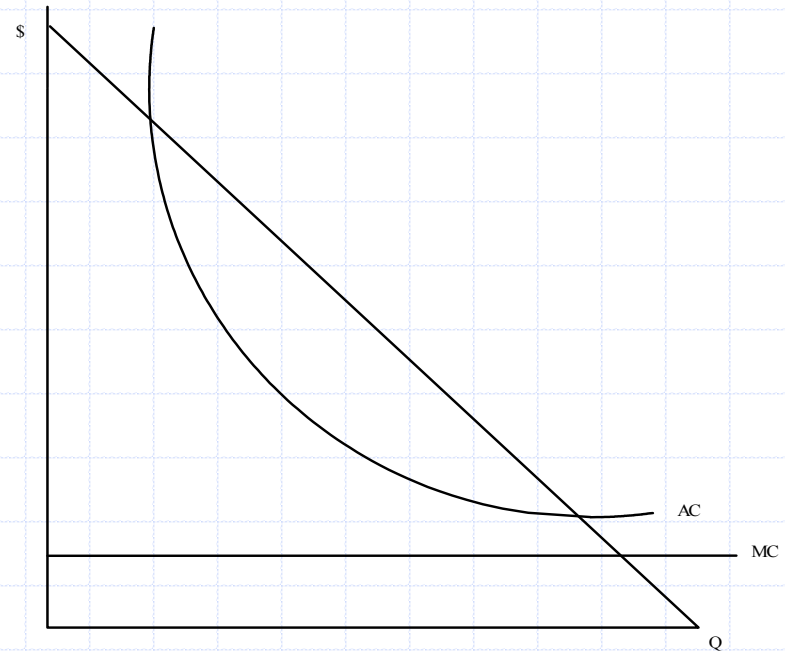
- ◆ Big Question is one of entry
 - Licensed entry
 - Free entry

Possible Copyright Markets

- ◆ Entitlement structure will determine copyright markets
 - Separability Assumption not appropriate
- ◆ Two examples of possible arrangements:
 - Purely privatized copyright markets
 - Mixed public goods and utilization

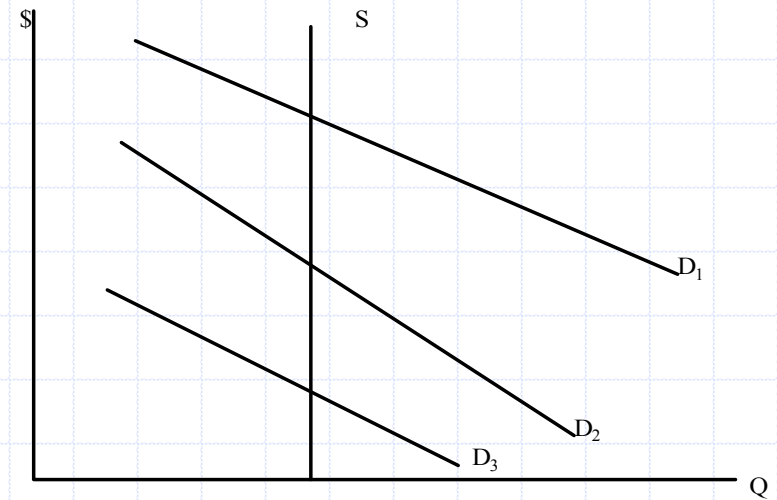
Purely privatized copyright markets

- ◆ DMCA-style legal entitlements combined with technological protections



Limited Public Good and Utilization

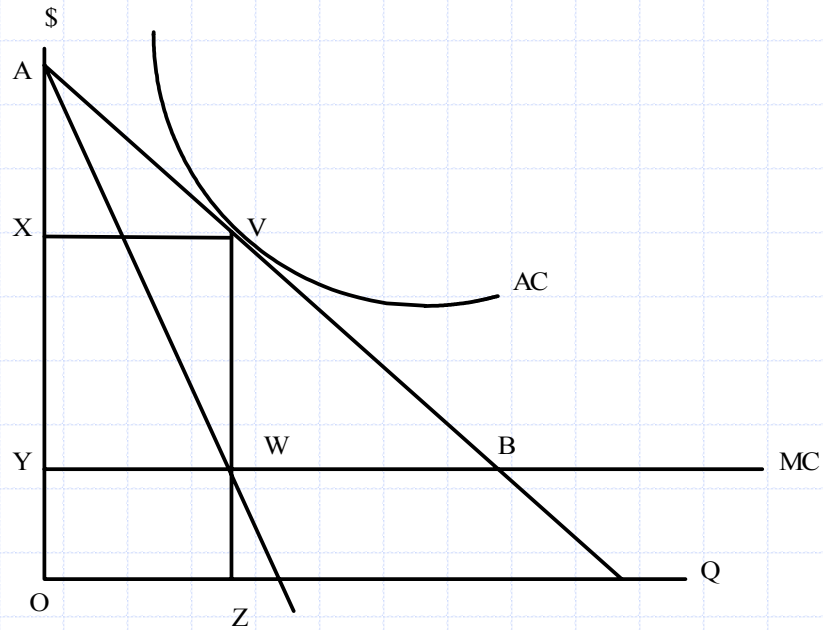
Price discrimination
with sharing



Monopolistic Competition

- ◆ Actual copyright markets are somewhere in between these two extremes
- ◆ Multiple firms producing different works
 - Note definition of work to include new uses of existing works as a different work
- ◆ Question becomes one of how entry through licensing affects the number of permitted new works

Monopolistic Competition Model



Consumer surplus: AXV
Producer surplus: XZYV
Deadweight loss: VWB

When Will a Copyright Owner Permit a New Work?

- ◆ A new work will affect demand for the old work with resulting effect on producer surplus
- ◆ A new work will also generate consumer & producer surplus in the new market which the copyright owner will try to appropriate through licensing fees (L)
- ◆ Copyright owner will permit new work if
$$\Delta PS_0 + L > 0$$

Is it Socially Desirable to have a new work?

New work is socially desirable if

$$CS_N + PS_N + \Delta CS_O + \Delta PS_O > 0$$

Note that copyright owner will license new work if

$$\Delta PS_O + L > 0$$

First Implication

Entry through licensing is not necessarily socially desirable

Copyright owner may license either too many or too few new works

Numerical Example One: Too few new works

- ◆ $CS_O = 10$; $PS_O = 15$
- ◆ $CS_N = 10$; $PS_N = 3$; $\Delta CS_O = -5$; $\Delta PS_O = -5$
- ◆ Since total $CS+PS$ increases by 3, new work should be allowed
- ◆ But the copyright owner in the original will not license it unless he can obtain more than 5 units in licensing fees.

Numerical Example Two: Too many new works

◆ $CS_O = 10$; $PS_O = 15$

◆ $CS_N = 3$; $PS_N = 6$; $\Delta CS_O = -5$; $\Delta PS_O = -5$

◆ New work is not socially desirable.

◆ Copyright owner might still license new work if he can capture the full 6 units of PS.

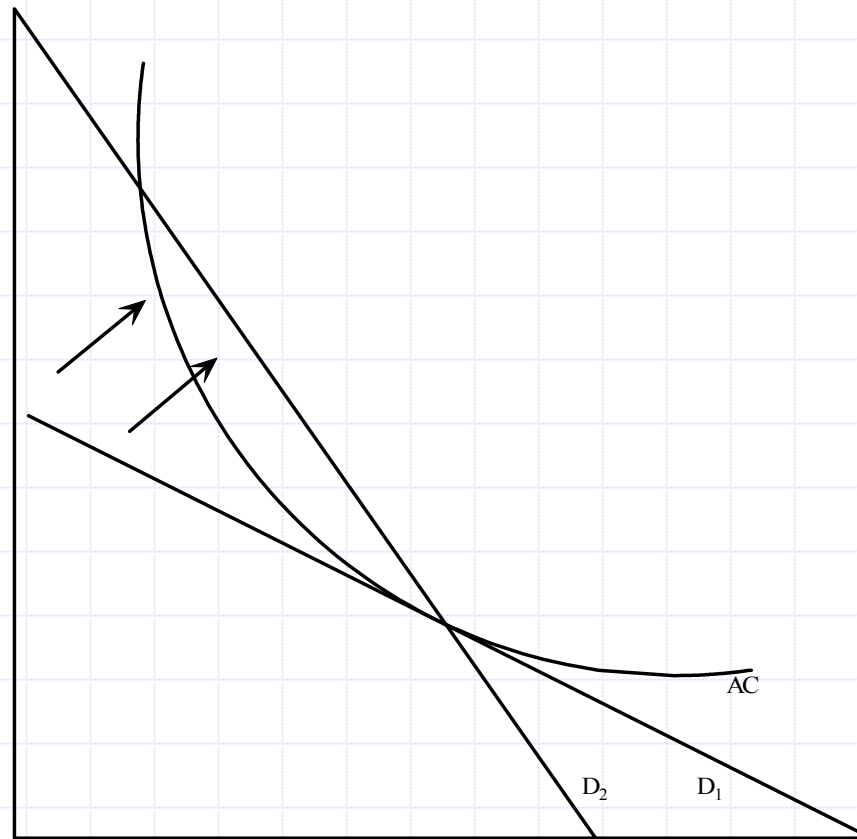
Why might licensed entry not be efficient?

- ◆ Ability of copyright owner to capture CS and PS in new market (appropriability effect)
- ◆ Effect of new works on PS in existing markets (trade diversion effect)

Appropriability effect

- ◆ Since copyright owner cannot capture all the surplus from new uses, licensing will result in *too few new works*
 - Problem is that $L < CS_N + PS_N$
- ◆ Measuring AE: Analogous to transaction cost analysis of fair use: Are there impediments to licensing that limit the ability of the copyright owner to capture the surplus in the new market?

Understanding Trade diversion: the case of complements



Trade diversion effect

- ◆ This effect captures competition between old and new works.
 - Complements: increases PS in market for old work
 - Substitutes: decreases PS in market for old work

Decomposing the effects

Case One: Too Few New works

$$CS_N + PS_N + \Delta CS_O + \Delta PS_O > 0$$

but

$$\Delta PS_O + L < 0$$

Case arises when works are substitutes
and $AE > TDE$

Decomposing the effects

Case Two : Too Many New Works

$$CS_N + PS_N + \Delta CS_O + \Delta PS_O < 0$$

but

$$\Delta PS_O + L > 0$$

Case arises either when

(1) Works are substitutes and $AE < TDE$

OR

(2) Works are complements and decrease in CS_O is greater than surplus in new market (copyright owner is “cannibalizing old market”)

Why aren't these effects internalized through licensing?

- ◆ Information costs
- ◆ Internalizing two externalities with one instrument
 - Copyright owner would need to appropriate all surplus and meter quantity
- ◆ Persistence of deadweight loss

Implications for copyright doctrine-I

- ◆ Difficulty of separating assignment of entitlements from definition of market
- ◆ Monopolistic competition model as benchmark
- ◆ Licensed entry in general may not be socially optimal
- ◆ Licensed entry can result in too few or too many new works

Implications for copyright doctrine -II

- ◆ In situations where licensing would lead to too few new works, define market narrowly to permit more unlicensed entry.
- ◆ In situations where licensing would lead to too many new works, limit copyright owner's rights by permitting non-transformative copying or deny copyright protection altogether.

Implications for copyright doctrine-III

- ◆ Substantial non-infringing use test
 - Entails comparing CS_N , PS_N , & ΔPS_O
 - Focus should be on likelihood that copyright owner will license use
- ◆ Derivative work
 - Both categorical and expectations approaches lacking
 - Compare with fair use: who has burden?

Implications for copyright doctrine-IV

- ◆ Scope of first sale doctrine
 - Distinguishing between production and distribution of work
 - Problem of cannibalizing old market

Applications to copyright cases

◆ Case One: too few new works

- Sony & American Geophysical: substitutes and $AE > TDE$. Market should be defined narrowly.

◆ Case two: too many new works

- Case of substitutes
 - ◆ Command hierarchies
 - ◆ Legal codes and standards
- Case of complements and cannibalizing old market
 - ◆ Fair use for out of print works
 - ◆ Treatment of parodies

Back to the starting point: Napster and Rights of First Entry

- ◆ Right of first entry makes little economic (as well as little legal) sense
- ◆ Market definition should rest on whether copyright owner would have licensed a socially desirable use
- ◆ Problem is one of how to characterize Napster as creating substitutes or complements to existing CD's