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Copyright Without Creators

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**Center in Law, Economics and Organization
Research Papers Series No. C13-7**

Legal Studies Research Paper Series No. 13-7

April 4, 2013

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Copyright is typically justified by the rationale that profits induce authors and other artists to invest resources in cultural production. This rationale is vulnerable to the objection that some artists have intrinsic incentives to invest in cultural production and do not require significant capital to do so. Even accepting this objection, copyright is justified by an alternative rationale: it supports the profit-motivated intermediaries that bear the high costs and risks involved in evaluating, distributing and marketing content in mass-cultural markets. This “authorless” rationale is consistent with the intermediated structure of mature mass-cultural markets and accounts for long-standing features of copyright law that have conventionally been dismissed as mere transfers from consumers to media interests. The digital transformation of mass cultural markets, which has been accompanied in some media by a decline in production and distribution costs but no change or even an increase in screening and marketing costs, challenges and clarifies the intermediary-based rationale for copyright. Even in digitized content markets, copyright plays a critical role by enabling intermediaries to select freely from the full range of transactional structures for most efficiently bearing the costs and risks of screening, producing, distributing and marketing content to a mass audience.

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“. . . [T]he author owes all rights to his exploiters, and by no means to his own futile appeals for justice, though these have always been made the pretext for the legislation which has established him as a person of property.”

--- Bernard Shaw (1932)¹

It seems virtually self-evident that copyright is designed to provide a profit incentive that elicits creative production by authors and other artists. This commonly-stated proposition obscures the core function of copyright law. Contrary to standard characterizations in legal casebooks and treatises, appellate court opinions, and scholarly commentary, copyright is best conceived not as a system for incentivizing creation by authors and other artists; rather, it is best conceived as a system for incentivizing investment by the *intermediaries* responsible for undertaking the capital-intensive tasks required to deliver a creative work from an individual artist to a mass audience.² In short: copyright is not for creators; it is for intermediaries.³ This neglected function provides a compelling explanation for long-standing core features of copyright law that otherwise

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¹ *A Letter to the Author from Bernard Shaw*, in G.H. THRING, *THE MARKETING OF LITERARY PROPERTY: BOOK AND SERIAL RIGHTS* (1933), at xv-xix.

² I am certainly not the first to identify the role played by copyright in supporting distributors' incentives, but to my knowledge it has never been fully elaborated as the primary justification for copyright without reference to authorial incentives. For earlier brief discussions, see BENJAMIN KAPLAN, *AN UNHURRIED VIEW OF COPYRIGHT* 8-9, 75 (1967); Paul Goldstein, *Copyright*, 38 J. COPYRIGHT SOC'Y OF THE U.S.A. 109, 110, 112-113 (1990-1991). Two recent contributions provide more extensive analysis of the connection between copyright and distribution incentive but conclude that copyright cannot be justified on that basis. See Mark Nadel, *How Current Copyright Law Discourages Creative Output: The Overlooked Impact of Marketing*, BERK. TECH. L. J. (2004); Derek E. Bambauer, *Faulty Math: The Economics of Legalizing The Grey Album*, ALA. L. REV. 345 (2008). Another recent contribution recognizes copyright's role in supporting distributors but argues that it is now obsolete due to technological changes. See Raymond Shih Ray Ku, *The Creative Destruction of Copyright: Napster and the New Economics of Digital Technology*, 69 U. CHI. L. REV. 263 (2002). A related line of argument identifies large media interests as the primary beneficiary and proponent of copyright law but relies on that observation to argue that copyright law has been distorted so as to advance those private interests at the expense of the public good. See *infra* note 10. Unlike any of these prior contributions, I argue that (i) copyright can be justified on the basis of distributors' (or more broadly, intermediaries') incentives, (ii) intermediaries are not obsolete in digital content markets; and (iii) intermediaries' interests are not inherently misaligned with the public interest.

³ In the scholarly literature on copyright, the term “publishers” is often used to denote both literary publishers and a broader range of distribution intermediaries. I use the generic term “intermediaries” to cover the full range of screening, publishing, distribution and marketing entities in creative goods markets. Note further that I use the term “artists” interchangeably with “creators” or “authors” to denote individuals who are the source of creative inputs.

resist explanation and are commonly attributed to the nefarious influence of large media interests. The reason is simple. To generate, package, deliver and market a creative good to a mass audience necessitates both creative activities—the predominant focus of copyright scholarship and jurisprudence—and a host of non-creative activities—the predominant focus of actual participants in creative goods markets. While scholars may debate whether artists always require significant capital or an expectation of profit to engage in creative activity, it is clear that the individuals and entities that produce, distribute and market creative goods on a mass scale do require significant capital and are primarily if not exclusively motivated by profit. Hence, in the absence of some other equivalent and no-less-costly mechanism, intellectual property rights are required to generate the premia that incentivize the latter group, even if it were recognized that those rights would sometimes be excessive if only required to incentivize the former group.

Copyright scholarship has long expressed skepticism with respect to the social value of its subject of inquiry.⁴ In particular, copyright scholarship has expressed skepticism that copyright is necessary to induce participation in activities that deliver non-pecuniary benefits or do not require extensive capital investment. If making art is intrinsically satisfying and not especially costly, then copyright reduces to a rent-seeking exercise that transfers wealth from the public to private interests without any incremental gain in creative output.⁵ That skeptical view stands in contrast with the view historically adopted by much of the cast of content originators and distributors that participate in mass-cultural markets, ranging from large distribution entities to smaller production entities to prominent individual artists, writers and other creators.⁶ Prevailing academic

⁴ For perhaps the original and best statement of copyright skepticism, see Arnold Plant, *The economic aspects of copyright in books*, *ECONOMICA* (May 1934), reprinted in ARNOLD PLANT, *SELECTED ECONOMIC ESSAYS AND ADDRESSES* (1974). For widely-cited modern examples, see Stephen Breyer, *The Uneasy Case for Copyright*, 84 *HARV. L. REV.* 281 (1970); LAWRENCE LESSIG, *FREE CULTURE: HOW BIG MEDIA USES TECHNOLOGY AND THE LAW TO LOCK DOWN CULTURE AND CONTROL CREATIVITY* (2004).

⁵ See, e.g., Diane Leenheer Zimmerman, *Copyrights as Incentives: Did We Just Imagine That?*, 12 *THEORETICAL INQUIRIES IN LAW* 29 (2011). For related views on the non-economic motivations for creative efforts and the correspondingly limited justification for copyright, see YOCHAI BENKLER, *THE WEALTH OF NETWORKS: HOW SOCIAL PRODUCTION TRANSFORMS MARKETS AND FREEDOM* Chs. 3–4 (2006); James Boyle, *The Second Enclosure Movement and the Construction of the Public Domain*, 66 *LAW & CONTEMP. PROBS.* 33, 45–46 (2003).

⁶ For examples of authorial support for copyright, see *Letter to the Author from Bernard Shaw*, *supra* note __; William Wordsworth, *A plea for authors*, in *SONNETS* (London 1838). On American and English authors who lobbied for the extension of U.S. copyright to foreign authors, see B. Zorina Khan,

analysis claims to know better than the market: it dismisses the view that copyright is critical as a thinly-disguised campaign to extract rents from consumers. An intermediary-based view suggests that, at least historically, those entities' self-interest in profit-maximization is compatible with the public's interest in incentivizing, and expanding access to, creative output, as compared to any other feasible property-rights arrangement. In particular, an intermediary-based view suggests that the progressive expansion of the subject matter, term, assignability, divisibility and scope of copyright entitlements—developments that have been subject to repeated criticism from the academy—maximize intermediaries' incentives to invest in cultivating and disseminating creative works that are costly and risky to evaluate, produce, edit, market and distribute on a mass scale.

The conventional skeptical view overlooks the peculiar economics of creative markets, and in particular the mundane but critical *non*-creative components of creative markets, which have received little attention in scholarly writing on copyright.⁷ Funding creative expression and then distributing it on a mass basis for commercial purposes is a difficult endeavor fraught with high cost and risk. In particular, any entity seeking to earn a positive return on the mass distribution of creative goods must overcome three formidable obstacles: (i) commercial outcomes in creative markets are extremely skewed and unpredictable; (ii) even successful releases depreciate rapidly in value; and (iii) given elements (i) and (ii), coupled with the difficulty in collateralizing intangible assets, accessing external capital to fund creative projects is difficult. These challenges explain the critical role historically played by large intermediaries—the movie studio, the record label, the book publisher—in every mature mass-cultural market. Functionally, those intermediaries act as financing and insurance entities that spread the costs and risks of capital-intensive cultural production by funding and holding a large portfolio of creative properties, which generates cash flow to offset losses on failed projects and fund future projects. These intermediaries' much-maligned scale and scope support the financing

Does Copyright Piracy Pay? The Effects of U.S. International Copyright Laws on the Market for Books, 1790-1920, Nat'l Bureau Econ. Res., Working Paper No. 10271 (2004).

⁷ For exceptions, see Nadel, *supra* note __; Bambauer, *supra* note __; Mark Schultz, *Live Performance, Copyright and the Future of the Music Business*, RICHMOND L. REV. (2009) [hereinafter Schultz, *Live Performance*]. For briefer discussion, see Ku, *supra* note __. For discussion with respect to ownership and employment issues, see Michael D. Birnhack, *Who Owns Bratz? The Integration of Copyright and Employment Law*, 20 FORDHAM INTELL. PROP., MEDIA & ENT. L. J. 95 (2009).

and risk-diversification functions that facilitate funding cultural production and distribution without tax-funded transfers or philanthropic patronage.

Historically copyright has been a vital input to this infrastructure. Without it, publishers, record labels and movie studios would have difficulty capturing returns on the occasional “big hit” and cultivating revenue streams from a rich library of older successes. The blockbuster gains earned on a film such as *Titanic* (worldwide gross revenues of \$1.84 billion), Michael Jackson’s *Thriller* album (over 30 million albums sold domestically) or J.K. Rowling’s *Harry Potter* book series (450 million copies sold worldwide)⁸, and the cash flow generated by a library of thousands of past releases, are a precondition for achieving the risk-diversification and financing efficiencies that support mass-cultural markets without state or philanthropic support. The free-riding threat to this funding and insurance mechanism is obvious. Imitators would lie in wait for the big hit, reaping profits on a single creative work without bearing the costs and risks involved in that work and the far greater number of terminated or losing projects that the originator had funded and developed. The successful operation of mass cultural markets does not only benefit dominant intermediaries but confers socially valuable benefits on other deserving stakeholders. Specifically, it provides a production and distribution infrastructure for the artists who supply creative inputs to those intermediaries and delivers access to a rich pool of creative goods for end-users. The result has been an increase in access by readers, listeners and viewers to creative works, and an increase in access by authors, musicians and filmmakers to those audiences, that is unrivaled by any prior time in human history.

Even if it were accepted that secure copyright has provided critical support for the infrastructure behind mature mass-cultural markets of the 19th century and 20th centuries, there is no intrinsic reason to believe that that proposition holds true for the digitized mass-cultural markets of the 21st century and beyond. It might be thought that the intermediary-based account only provides a historical account of the valuable role played

⁸ On *Titanic*, see THE-NUMBERS.COM, *Box Office Data, Movie Stars, Idle Speculation – Titanic*, <http://www.the-numbers.com/movies/1997/TITAN.php> (last visited Nov. 12, 2012); on *Thriller*, see RIAA, *RIAA’s Gold & Platinum Program*, http://www.riaa.com/goldandplatinumdata.php?table=SEARCH_RESULTS&title=thriller&format=ALBUM&go=Search&perPage=50 (search “Thriller”) (last visited Nov. 12, 2012); on *Harry Potter*, see: BBC, *Rowling ‘makes £5 every second’* (2008), <http://news.bbc.co.uk/2/hi/entertainment/7649962.stm>.

by copyright in a “pre-digital” period during which it was costly to acquire the skills and equipment required to produce and distribute content on a mass scale. By implication, the intermediary-based case for copyright would appear to falter in an environment in which those costs have fallen significantly and artists can reach users without an intermediary. Closer scrutiny paints a more complex picture that preserves a fundamental role for intermediaries—and, by implication, copyright—even in contemporary mass-cultural markets. Contrary to popular views, the decline of copyright enforcement in digitized content markets does not result in frictionless disintermediated markets in which the artist interacts directly with the audience. Rather, the decline in legal protections has resulted in *re*-intermediated markets. In particular, the viable point of intermediation has shifted from intermediaries that specialize in the stand-alone delivery of priced creative content to intermediaries that specialize in the delivery of unpriced creative content that is *bundled* with a complementary asset—principally, services and hardware—to which access can be controlled. That shift in transactional form is not merely aesthetic. It inherently imposes a potential social welfare loss insofar as that shift is *compelled* by the inability to access the full range of transactional forms in environments that operate under weak copyright protections against unauthorized use. Under strong copyright, all forms of intermediation—both bundled and unbundled—are available and, absent competitive distortions, the market efficiently selects from those forms; by contrast, under weak or zero copyright, the set of intermediation options is limited to bundled production and delivery mechanisms, which may not coincide with the most efficient form of producing and delivering creative content on a mass scale. Whether or not that risk materializes in any particular market, and whether that risk then translates into a net welfare loss, is a matter for case-specific empirical inquiry.

Organization is as follows. In Part I, I describe the traditional author-based approach to copyright and the traditional critique of that approach. In Part II, I identify the key costs and risks of creative markets and the manner in which intermediaries bear those costs and risks. In Part III, I set forth an intermediary-based approach to copyright and use it to account for key features of copyright law. In Part IV, I discuss how the digitization of content markets clarifies the intermediary-based case for copyright.

I. Copyright for Creators

I will start by reviewing two points of reference: (i) the standard author-based view of copyright, and (ii) the standard critique of the author-based view of copyright.

A. The Standard Rationale

The conventional justification for copyright is well-known: copyright supplies a property-rights solution to a free-rider problem. Without some means of excluding unconsented users, any artist anticipates being unable to recoup his or her investment in the face of imitation. By anticipation, the artist reallocates resources to other activities and creative output falls. That market failure is resolved by a property entitlement that deters unconsented usage and enables the artist to extract a premium. As Lord Macaulay famously stated in a 19th-century English parliamentary debate, copyright is “a tax on readers for the purpose of giving a bounty to users”⁹—that is, a necessary tax without which creative output would decline.

B. The Standard Critique

The logic behind the author-based view of copyright runs into some difficulties when assessed empirically. In short: it is not clear that Lord Macaulay’s “tax” is strictly necessary. There are two potentially vulnerable points.

1. Art is Cheap

The author-based view assumes that production costs are considerable and therefore a significant premium is required to induce artists to bear those costs. However, the costs of creation in some media are not especially great. A writer or composer requires a pen and paper, or today a moderately-priced laptop; an artist requires a canvas and paint; a musician requires a musical instrument; and so forth. That places in doubt the necessity for copyright—or, at least, the expansive version of it found in the copyright statute and associated case law—as an instrument to incentivize creative production. To be clear, this objection is far from fully persuasive. Most obviously, while the immediate

⁹ See Lord Macaulay, *A Modest Plea for the Property of Copyright*, London, 1774, Rpt. *The Literary Property Debate: Eight Tracts 1774-1775* (ed. Stephen Parks 1974), cited in MARK ROSE, *AUTHORS AND OWNERS: THE INVENTION OF COPYRIGHT* 105-06 (1993).

out-of-pocket costs of producing an individual creative work may not be especially great, the total costs of producing that work can be exorbitant, taking into account the extensive training required to acquire the skills necessary to produce certain kinds of art and the opportunity costs incurred by any artist, who could often be pursuing other more immediately profitable activities.

2. *Artists are Romantic*

The author-based view assumes that authors and other artists conform to a rationally self-interested model of human behavior. That model jars with the popular notion of the romantic artist, which posits that individuals often engage in artistic activity for intrinsic non-profit-motivated reasons, in which case the necessity for strong copyright, and the associated premium, becomes unclear.¹⁰ That objection too is far from fully persuasive. There exists ample evidence that artists are motivated at least in part by economic considerations¹¹ and even apparently “romantic” behavior can be explained on the basis of a chronic overestimate of, rather than indifference to, the chance of commercial success.¹² Most persuasively, artists respond to changes in profit opportunities much as would be expected by economic rationality. In Victorian England, the popularity of poetry in the publishing market prompted large volumes of poetry submissions to publishing companies.¹³ In the 1920s, the most talented songwriters suddenly moved *en masse* from working for Broadway in New York to working for

¹⁰ See *supra* note 5. A related critique argues that the “romantic author” is a social construction that has been used strategically to support copyright protections that protect publishers’ interests. See, e.g., LYMAN RAY PATTERSON, COPYRIGHT IN HISTORICAL PERSPECTIVE 143, 147 (1968); Peter Jaszi & Martha Woodmansee, *Introduction*, in CONSTRUCTION OF AUTHORSHIP 6 (eds. Peter Jaszi & Martha Woodmansee 1994). My argument is consistent with this strategic view of the authorial figure but draws the normative conclusion that promoting publishers’ interests is often consistent with, or at least not necessarily inconsistent with, the social interest.

¹¹ See BRUNO S. FREY & WERNER W. POMMERHNE, MUSES AND MARKETS: EXPLORATIONS IN THE ECONOMICS OF THE ARTS 11 (1989). For examples of artists motivated by commercial objectives, see TYLER COWEN, IN PRAISE OF COMMERCIAL CULTURE 18-19 (1998); RICHARD E. CAVES, CREATIVE INDUSTRIES: CONTRACTS BETWEEN ART AND COMMERCE 43 (2002).

¹² That is: artists are not irrationally indifferent to commercial success; rather, they irrationally overestimate the chances of achieving commercial success. For the leading statement of this argument, see RUTH TOWSE, CREATIVITY, INCENTIVE AND REWARD: AN ECONOMIC ANALYSIS OF COPYRIGHT (2001).

¹³ See LEE ERICKSON, THE ECONOMY OF LITERARY FORM: ENGLISH LITERATURE AND THE INDUSTRIALIZATION OF PUBLISHING (1800-1850) 51-52 (1996).

Hollywood in Los Angeles, for the unsurprising reason that the studios offered better terms.¹⁴ The list can go on. Nonetheless, even if we adopt a more nuanced and realistic view that artists are motivated by a mix of profit and non-profit-based objectives¹⁵, the conventional case for copyright (or, at least, strong forms of it) still stands in some doubt.

II. Understanding the Economics of Creative Markets

Both advocates for, and opponents of, the author-based incentive case for copyright usually analyze a stylized environment that misses some of the most basic economic characteristics of the process by which creative goods are produced and distributed in mass-cultural markets. Those models typically envision a single act of authorial creation, which then generates a creative work that is immediately available for consumption by the end-user. That is a gross simplification: myriad and formidable tasks are required to deliver any creative input from the upstream point of creation to the downstream point of end-usage. That oversight means that even utilitarian strands of copyright scholarship typically use an economic model that bears little resemblance to the mass-cultural markets in which copyright has its primary real-world impact. In this Part, I correct this oversight. We cannot fairly assess the case for copyright until we understand the economic characteristics that are peculiar to mass-cultural markets.

A. The Total Costs of Creative Production

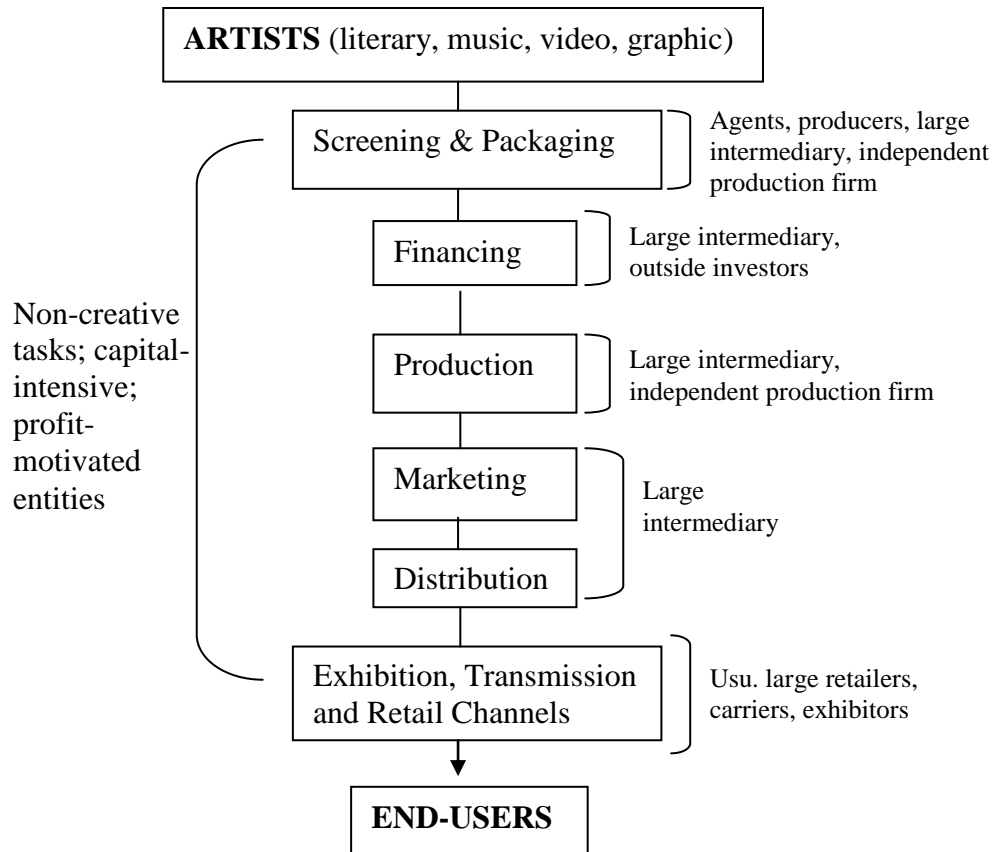
The standard economic argument for copyright is vulnerable because creation costs would often seem to be low and artists would often appear to be motivated in part by non-monetary considerations. But this simple model is incomplete. Even accepting the romantic assumption of the intrinsically motivated artist, it overlooks all the *non-creative* tasks that must be undertaken to deliver a creative product to a mass market and earn a return on it. These tasks are far more capital-intensive than the initial act of creation, requires skills, equipment and infrastructure that are not easily accessible, and

¹⁴ See RUSSELL SANJEK, FROM PRINT TO PLASTIC: PUBLISHING AND PROMOTING AMERICA'S POPULAR MUSIC (1900-1980) 16 (pub. 1983).

¹⁵ On artists' mixed utility functions, see Richard E. Caves, *Organization of Arts and Entertainment Industries*, in HANDBOOK OF THE ECONOMICS OF ARTS AND CULTURE 536 (Vol. 1, eds. Victor A. Ginsburgh & David Throsby 2000).

are undertaken by entities that are primarily motivated by monetary considerations. The diagram below sets forth these tasks and indicates the types of entities that typically undertake these tasks in mass-cultural markets.

Figure I: The Creative Supply Chain



1. *Screening and Packaging Costs*

Precisely because out-of-pocket creation costs are often not significant, and creative activity confers some intrinsic utility on the creator independent of any expected profit, creative output is abundant.¹⁶ For the same reason, however, the average quality—at least as measured by the objective criterion of commercial value—of creative output is low. Search and evaluation costs required to sort out high-value from low-value

¹⁶ For similar views, see HAROLD L. VOGEL, ENTERTAINMENT INDUSTRY ECONOMICS 44 (8th ed. 2011).

output would be infeasible for almost any individual user to bear. Total output that reaches cultural markets, which far exceeds the volume of output submitted to intermediaries for distribution into those markets, is immense. In 2011, approximately 347,178 books, 610 feature films, and 76,875 albums were released in the U.S. domestic market.¹⁷ The *accumulated* pool of creative content facing any user is even more daunting. Gracenote, the most comprehensive digital database of musical tracks, holds over 100 million musical tracks from more than 400,000 artists.¹⁸ To efficiently search and evaluate this vast pool of creative works, cultural markets are typically populated by specialized agents—for example, talent agents, literary agents or record and film producers—that develop skills in, and are willing to bear the costs of, doing so. These agents also often take on a “packaging” role: that is, assembling multiple creative and human capital assets into a final “package” such as a Broadway show, a Hollywood movie, or a record album.¹⁹ Identifying those inputs, assembling them into a single package, and negotiating the terms on which each contributor’s input is integrated into the package, is a time-intensive, skill-intensive and capital-intensive activity for which market rates of compensation must be paid.

¹⁷ On books, see BOWKER, *Publishing Market Shows Steady Title Growth in 2011 Fueled Largely by Self-Publishing Sector* (2012), www.bowker.com/en-US/aboutus/press_room/2012/pr_06052012.shtml; on films, see MOTION PICTURE ASS’N OF AMERICA, INC., *THEATRICAL MARKET STATISTICS*, at 16 (2011), www.mpa.org/resources/5bec4ac9-a95e-443b-987b-bff6fb5455a9.pdf; on albums, see THE NIELSEN CO., *The Nielsen Company & Billboard’s 2011 Music Industry Report*, BUSINESSWIRE.COM (2012), www.businesswire.com/news/home/20120105005547/en/Nielsen-Company-Billboard’s-2011-Music-Industry-Report.

¹⁸ See “Gracenote Global Media Database”, avail. at http://www.gracenote.com/products/global_media_database/.

¹⁹ For extensive discussion, see CAVES, *supra* note ____.

2. *Production, Marketing and Distribution Costs*

The remaining tasks required to deliver a creative good to market typically entail the largest capital expenditures. I will examine these costs in three primary industries: film, music and book publishing.

a. *Film*. It may be a relatively low-cost activity to produce a screenplay but it is a more capital-intensive activity to edit the screenplay, assemble a cast and technical crew to produce a film based on the screenplay, hire technical staff to edit the film, produce prints of the film, distribute the film to exhibitors and other distribution channels (TV, home video), and market the film to millions of viewers in those distribution channels. As of 2007 (the last year in which the Motion Picture Association of America collected this information from its members), the total average budget for a feature film release was almost \$107 million, of which \$32 billion was constituted by marketing and advertising costs.²⁰ Today blockbuster feature films commonly have budgets in excess of \$200 million.²¹ Note that those figures do not include the non-project-specific overhead costs incurred by a studio to maintain an infrastructure that can disseminate content across tens of foreign markets and all types of media around the world at short notice.²²

b. *Music*. The costs required to fund a new artist's album include recording costs, promotional costs, and the "signing advance" given to the artist prior to production. These costs are substantial, with marketing expenses being the single greatest expense as a share of industry revenue (26.3% in 2012).²³ Based on information collected by the

²⁰ MOTION PICTURE ASSOCIATION OF AMERICA (2007)

²¹ For example: *Avengers*, released in 2012, had a reported budget of \$220 million; *John Carter*, released in 2012, had a reported budget of approximately \$250 million; *The Dark Knight*, released in 2012, had a reported budget of \$230 million. See Andrew Stewart, '*Avengers*' Takes Aim at All-Time Record, VARIETY (2012), www.variety.com/article/VR1118053509 (quoting The Avengers' budget at \$220 million); Ben Fritz & Amy Kaufman, *The Dark Knight Rises' Tracking Is Huge*, LOS ANGELES TIMES (2012), <http://www.latimes.com/entertainment/envelope/cotown/la-et-ct-dark-knight-rises-tracking-avengers-20120716.0,4678609.story>; Mark Graser, *Disney to Finally Unleash 'John Carter'*, VARIETY (2012), www.variety.com/article/VR1118051102 (quoting John Carter's budget at around \$250 million).

²² For discussion, see JEFFREY C. ULIN, THE BUSINESS OF MEDIA DISTRIBUTION 8-9 (2010).

²³ See IBIS WORLD, MAJOR LABEL MUSIC PRODUCTION.

International Federation of the Phonographic Industry (“IFPI”), these costs break down as follows on average in the case of a new artist: (i) \$200,000 cash advance; (ii) \$200,000 in recording costs; (iii) \$200,000 for music videos; (iv) \$100,000 to support a promotional tour; and (v) \$300,000 in other promotional expenses, which sum to \$1,000,000.²⁴ In the case of a superstar artist, who can demand greater production quality and marketing efforts, the total rises on average to \$4,650,000.²⁵ Much of the marketing efforts are directed to securing radio play, which remains the most important factor in securing an audience for an artist’s work and ultimately generating sales through physical or digital purchases.²⁶ Additionally, assuming there is distribution into the physical market, some entity must bear the significant costs of manufacturing (in industry jargon, “pressing”), warehousing, and distributing CDs to thousands of retailers.²⁷ Following industry custom, the distributors bear the risk of product failure since unsold items are usually returned to the label at full credit to the retailer²⁸ (which historically occurs on average about 20% of the time).²⁹

c. *Books.* The costs of writing and printing a trade book³⁰ can be relatively low (depending in part on the size of the initial printing). But the development, marketing

²⁴ See IFPI, INVESTING IN MUSIC: HOW MUSIC COMPANIES DISCOVER, DEVELOP & PROMOTE TALENT 9 (2011). See also VOGEL, *supra* note __, at 261 (stating that marketing costs can rise to \$100,000 for a standard release and exceed \$500,000 for a major artist).

²⁵ See IFPI, *supra* note __, at 9.

²⁶ There is virtually complete agreement among commentators on this point, even in a digitized environment. See M. WILLIAM KRASILOVSKY & SIDNEY SHEMEL, THE BUSINESS OF MUSIC 22 (10th ed. 2010); KRISTIN THOMAS (FUTURE OF MUSIC COALITION), AN ANALYSIS OF RADIO PLAYLISTS IN A POST-FCC CONSENT DECREE WORLD 9 (2009); VOGEL, *supra* note __, AT 163; CAVES, *supra* note __, at 149; GORDON, *supra* note __, at 143; HULL ET AL., *supra* note __, at 268. For a partially dissenting view that the internet is now the most important source used by younger listeners to learn about new music, see Joel Waldfogel, *Bye, Bye Miss American Pie? The Supply of New Recorded Music since Napster* (Working Paper 2011) [hereinafter Waldfogel, *Bye, Bye*]; Joel Waldfogel, *And the Bands Played On: Digital Disintermediation and the Quality of New Recorded Music* (Working Paper 2012) [hereinafter Waldfogel, *Digital Disintermediation*].

²⁷ See HULL ET AL., *supra* note __, at 64. These costs are significant: for every dollar spent on wages, a major label spends \$40.37 in capital equipment. See IBIS WORLD, MAJOR LABEL MUSIC PRODUCTION.

²⁸ See HULL ET AL., *supra* note __, at 70.

²⁹ See HULL ET AL., *supra* note __, at 281.

³⁰ A “trade book” is any hardcover or paperback book produced for sale in general bookstores, including both adult and juvenile titles.

and distribution costs are not, which require that a publisher maintain a large infrastructure for printing, warehousing and transporting physical copies.³¹ At the development stage, publishers must pay significant non-refundable advances to secure the services of a celebrity or well-regarded author, who often does not generate sales in excess of those advances.³² To elicit interest from booksellers, leading book publishers have historically devoted extensive resources to maintaining a large sales force and promoting books at national and regional book shows.³³ A full campaign to promote a new book through advertising, sales representatives, author appearances and securing book reviews and other press coverage can run between \$500,000 and \$750,000.³⁴ As in the music industry, the publisher usually bears the risk of product failure, given industry custom allowing booksellers to return to the publisher all unsold books at full credit³⁵ (which, on average, occurs 36% of the time for hardcovers and 25% of the time for paperbacks³⁶).

3. *Financing Costs*

All the activities mentioned above must be financed by the intermediary out of some combination of internal and external capital. External financing can be a difficult proposition in cultural markets. The difficulty is two-fold: (i) there is little objective basis on which a production or distribution entity can commit to any certain expected rate of return or provide any reasonable assurance against project failure; and (ii) there are few tangible assets that could be offered as collateral to secure outside financing. Illustrating these difficulties, independent film production companies often can only secure financing through a complex combination of secured receivables transactions (“foreign presales” that sell an interest in future expected income from theatrical

³¹ See Greco, *supra* note __, at 207 (stating that publishers “spend an inordinate amount of time and money marketing books to a variety of channels”). On distribution costs in book publishing, see ROBERT G. PICARD, *THE ECONOMICS AND FINANCING OF MEDIA COMPANIES* 61 (2d ed. 2011).

³² See CAVES, *supra* note __, at 143-44.

³³ See GRECO, *supra* note __, at 177-84, 193.

³⁴ See CAVES, *supra* note __, at 150-51.

³⁵ See CAVES, *supra* note __, at 149.

³⁶ See BOOK AND PUBLISHING FACTS, *THE WRITERS NEWS*, avail. at <http://www.thewritersnews.com/bookfacts.htm>.

exhibition or video sales in specific foreign territories) and high-cost loans from specialized lenders to fill the funding gap until release.³⁷ The cost and complexity of those transactions inherently favor financing creative production through internal capital.

B. Production Risk

Virtually any creative goods market is a “hits market”: that is, the vast majority of products released are flops that result in a significant to complete loss while a small portion are hits that result in hefty profits, but, even in that case, usually do so only over a limited seasonal period. The film, music and book publishing markets usually follow approximately the rule that 80% of releases earn 20% of profits.³⁸ As a result, most film, music and literary releases fail to earn a net profit for the entity that funds and distributes it. The most extensive empirical study of film releases finds that, for the period 1984-1996, only 22% of feature film releases (in the U.S. and Canada) were profitable; among the minority of profitable movies, 35% earned 80% of total profits; and, in the aggregate, 6.3% of all movies earned 80% of total profits.³⁹ The same skewed ratios characterize the distribution of commercial outcomes in musical⁴⁰ and literary releases.⁴¹ As these data indicate, cultural markets are gambler’s markets that result in a loss most of the time and a fantastic gain a small portion of the time. Neither industry nor academia has identified any reliable principle or metric by which to separate hits from flops prior to release into the market. Economists of creative markets call this the “nobody knows”

³⁷ See VOGEL, *supra* note __, at 121, 155-56.

³⁸ On film, see ARTHUR DE VANY, *HOLLYWOOD ECONOMICS: HOW EXTREME UNCERTAINTY SHAPES THE FILM INDUSTRY* (2004); on music, see R. SERGE DENISOFF, *TARNISHED GOLD: THE RECORD INDUSTRY REVISITED 4* (1986) (stating that, as of the mid-1980s, estimates were that roughly 80% of albums and 85% of singles fail to cover costs).

³⁹ See De Vany, Arthur S. and W. David Walls, *Motion picture profit, the stable Paretian hypothesis, and the curse of the superstar*, 28 J. ECON. DYNAMICS & CONTROL 1035-57 (2004).

⁴⁰ Based on Nielsen/Soundscan reports, out of 44,000 new albums released in 2008, the top 100 titles (equivalent to .2% of all releases) constituted 50% of total sales and the top 700 (equivalent to 1.5% of all releases) constituted 80% of total sales. Out of that same pool, 81% sold fewer than 1,000 titles. See C. MICHAEL BRAE, *MUSIC DISTRIBUTION: SELLING MUSIC IN THE NEW ENTERTAINMENT MARKETPLACE* (2d ed. 2009).

⁴¹ In 1986, out of a total population of approximately 25,000 new hardbound trade titles, there were less than 200 best-sellers, which generated an estimated nearly \$1 billion in sales out of a total of \$1.7 billion. Put differently: less than 1% of all trade books published in 1986 accounted for almost 60% of total sales. See Stan J. Liebowitz & Stephen E. Margolis, *Seventeen Famous Economists Weigh in on Copyright: The Role of Theory, Empirics and Network Effects*, 18 Harv. J. L. & Tech. 435 (2003).

principle.⁴² It was well-known in the 19th century, at which time an English publisher lamented: “Four books out of five which are published do not pay their expenses . . . The most experienced person can do no more than guess whether a book by an unknown author will succeed or fail.”⁴³ Any investor who elects to fund a commercial creative production is adopting a low risk of extremely high returns and a high risk of a complete loss. Critically, that means that, for all but the most risk-loving entities, an investment in any *single* creative production is economically irrational—that is, it promises a return that is less than normal expected profits.⁴⁴ No wonder investors in Hollywood are called the “dumb money”.⁴⁵

C. Consumption Risk

Just as an investor in a creative production faces a high risk of production failure, a consumer who “invests” in a creative good faces a high risk of *consumption* failure. This derives from the fact that creative goods are experience goods—meaning, the value of the good is only revealed after consumption.⁴⁶ To address this dilemma, intermediaries in cultural markets make an extensive investment in marketing, advertising and other promotional efforts to overcome consumers’ rational wariness concerning the quality of any new release.

1. *Imitative Consumption*

Let’s distinguish between two types of consumers: (i) the naïve consumer who believes she has no independent means of assessing the value of a creative good, and (ii)

⁴² See, e.g., Caves, *supra* note __, at 536; Arthur De Vany, *The Movies*, in HANDBOOK OF THE ECONOMICS OF ARTS AND CULTURE 619-20 (eds. Victor A. Ginsburgh & David Throsby, Vol. 1, 2006); ARTHUR DE VANY, *HOLLYWOOD ECONOMICS: HOW EXTREME UNCERTAINTY SHAPES THE FILM INDUSTRY* (2004).

⁴³ See PLANT, *supra* note __, at 72, *citing* EDINBURGH REVIEW (Oct. 1878).

⁴⁴ For evidence concerning investments in Broadway productions, see Caves, *supra* note __, at 119.

⁴⁵ See Dorothy Pomerantz, *Larry Ellison’s Son is Hollywood’s Latest Dumb Money*, Forbes.com, Aug. 17, 2010 (stating that “dumb money is the term Hollywood uses for people from outside the industry trying to finance movies because they are often fleeced”).

⁴⁶ Since the value of the good is not objectively verifiable, this dilemma cannot be resolved by a warranty contract that would refund payment subject to consumer satisfaction (obviously, that contract would never result in a payment being owed by consumers, who would always claim to be dissatisfied).

the sophisticated consumer who believes she has such means. The sophisticated consumer might be a critic, a trend-setter or some other type of connoisseur. The interaction between these two consumer types drives the “bandwagon effects” often observed in cultural markets: the most sophisticated consumer group sets a consumption trend, which may be imitated by somewhat less sophisticated consumers, until the new fashion disseminates to the broadest and most naïve portions of the total consumer pool.⁴⁷ While most familiar in the fashion world, these types of bandwagon effects have been identified in the case of record sales⁴⁸ and film releases.⁴⁹ The prospect of inducing a bandwagon effect drives distributors of creative goods to spend effort in eliciting adoption of a new creative good by sophisticated consumers, who may then trigger adoption by the far broader class of naïve consumers. This imperative to “demonstrate” the value of any new cultural good explains the critical role played by marketing agents as well as independent third-party certifiers such as critics, best-seller lists in publishing, the “charts” in popular music, and awards ceremonies in all markets (Oscar’s in film, Grammy’s in music, Pulitzer’s in publishing, etc.).⁵⁰

2. *The Star Vehicle*

The “star” actor, director or other talent is a constant feature since the inception of mass-cultural markets. While cultural explanations abound, there is a simple economic explanation for the star’s persistence in mass-cultural markets. Suppose a consumer has no information with respect to the quality of two new movies, *A* and *B*. Suppose that movie *A*’s cast includes several stars who have previously appeared in high-quality films and movie *B*’s cast includes no stars. So long as the consumer associates the presence of a star with an increased likelihood of film quality, she will select movie *A*. The consumer could use the star as a proxy for film quality on various grounds: (i) the presence of a star

⁴⁷ For similar views, see Caves, *supra* note ___, at 178-80, 185-86. For application of this model to the fashion market, see Jonathan M. Barnett, *Shopping for Gucci on Canal Street: Reflections on Status Consumption, Intellectual Property and the Incentive Thesis*, 91 VA. L. REV. 1381 (2005).

⁴⁸ See Kee H. Chung & Raymond A.K. Cox, *A Stochastic Model of Superstardom: An Application of the Yule Distribution*, 76 REV. ECON. & STAT. 771 (1994).

⁴⁹ See Arthur De Vany & W. David Walls, *Bose-Einstein Dynamics and Adaptive Contracting in the Motion Picture Industry*, 439 ECON. J. 1493 (1996).

⁵⁰ For extensive discussion, see Caves, *supra* note ___, at 189-200.

indicates a greater likelihood of film quality; (ii) the presence of a highly-compensated star indicates a strong belief by the studio in film quality; or (iii) the presence of a star with a large stock of reputational capital indicates a strong belief by the star in film quality. Whatever the underlying set of supporting beliefs, consumers' use of the star as a proxy for the quality of the underlying creative good⁵¹ has a critical implication: it requires that the producer or distributor spend effort in acquiring the expensive services of star talent as a signal of project quality. This is a significant cost and, in the case of a major feature film, one of the largest items on the project budget—typically, approximately \$60 million (roughly *one-third* of the budget) in the case of a major feature film release.⁵²

D. Why Creative Markets Are Always Intermediated

The high costs and risks of creative production account for a structural regularity of mature cultural markets: namely, a concentrated group of leading intermediaries that accumulate large portfolios of creative goods and dominate the financing and distribution of those goods.⁵³ Conventional wisdom tends to ascribe this outcome to entry barriers or interfirm collusion. This skeptical view misunderstands the role played by the large intermediary. The large intermediary performs three functions that are critical to the efficient operation of mass-cultural markets. First, economies of scale and learning in production, marketing and distribution favor locating creative production in entities that repeatedly undertake the non-creative tasks required to deliver a creative good to market, do so over a large volume of releases, and have bargaining leverage to obtain favorable

⁵¹ The extent to which the presence of a star actually improves the likelihood of a successful release remains unresolved. Using a sample of 2000 films released from 1984 to 1996, Prof. De Vany finds that, on average, a star significantly increases a movie's higher least revenue (that is, a star constrains the lower tail portion of the revenue distribution) and slightly increases a movie's chance of making a profit, in each case relative to a movie without a star. See DE VANY, *supra* note __, at §§ 4.3.2, 4.5.1, 4.5.2. This is consistent with other findings in the empirical literature showing that actors positively impact opening performance (see Anita Elberse, *The Power of Stars: Do Star Actors Drive the Success of Movies?* 71 J. MARKETING 102, 120 (2007)), as well as popular observations in Hollywood that "stars help the movie to open".

⁵² See Movie Budget Records, Apr. 21, 2010, avail. at <http://www.the-numbers.com/movies/records/budgets.php>.

⁵³ See Caves, *Organization of Arts*, *supra* note __, at 555-56.

terms in dealing with third-party suppliers of required services or other inputs.⁵⁴ Second, holding a broad portfolio of creative properties improves the likelihood of a positive net aggregate return by setting off the losses on many flops against the gains on a few hits. By contrast, an artist holds an undiversified portfolio of creative properties.⁵⁵ It is instructive to note that, prior to the development of mass markets for book publishing, authors were often required to secure subscriptions in advance of a print run, suggesting that no intermediary was sufficiently large or diversified to assume the risk of commercial failure.⁵⁶ Third, large entities that generate internal cash flow from the hits within a copyright portfolio can finance future creative productions at a lower cost relative to any source of external capital, which is challenged by the informational uncertainty inherent to creative projects.⁵⁷ Intermediaries that successfully execute these three functions are richly rewarded and, at the same time, generate revenues that sustain professional artists who otherwise lack personal wealth to engage in artistic production on a full-time basis and deliver a rich array of cultural products to millions of users. For purposes of illustrating these arguments in greater detail, I will examine three paradigm cultural intermediaries: the movie studio, the record label and the book publisher.

A. The Movie Studio

From the inception of the Hollywood film industry, large studios have occupied a central position in the industry's production and distribution infrastructure. In 2011, six major studios (Warner Bros., Disney, Twentieth-Century Fox, Sony, Paramount and Universal) accounted for an estimated 90% of gross domestic box office revenues⁵⁸; in 1939, five major studios and three smaller studios accounted for 85% of the feature films

⁵⁴ For a fuller discussion, see CAVES, *supra* note ___, at 157-160.

⁵⁵ For similar observations, see WILLIAM M. LANDES & RICHARD A. POSNER, *THE ECONOMIC STRUCTURE OF INTELLECTUAL PROPERTY LAW* 38 (2003).

⁵⁶ See ERICKSON, *supra* note ___. For evidence that U.S. publishing suffered from a lack of capital and risk-bearing capacities, see WILLIAM CHARVAT, *LITERARY PUBLISHING IN AMERICA 1790-1850* (1959), at 42-43.

⁵⁷ On self-financing in publishing, see Caves, *supra* note ___, at 151.

⁵⁸ See VOGEL, *supra* note ___, at 48.

released that year.⁵⁹ The persistence of the large studio, and its supporting portfolio of film properties, is not accidental. The scale and scope of the Hollywood studio supports its ability to fund the costs of film production through internally-generated cash flow or external financings secured by the studio's intellectual property portfolio, to generate economies of scale in distribution and marketing, and to hedge against the risk of failure on any individual project.⁶⁰ Additionally, the major studios are subsidiaries or divisions of larger parent organizations, which can further diversify the risk of project failure through a portfolio of entertainment-related and non-entertainment-related assets. This combined cost-spreading, financing and risk-diversification function reached its apex during the studio system (roughly, the late 1920s through the late 1940s), at which time the studios were fully integrated from talent (under long-term contract) through theatrical exhibition. While the studios are no longer active in exhibition and do not typically enter into long-term contracts with talent, they continue to dominate distribution and fund a portfolio of projects that diversify the risk of failure on any single project. Independent production companies sometimes achieve critical success but few persist for the long-term, typically rely on studios for production financing and distribution services, and ultimately either fail or are acquired by a major studio as a permanent division.⁶¹

B. The Record Label

From the 1930s through the present, a handful of major music companies have usually dominated the sound recording market.⁶² In 1948, the top eight firms accounted for 95%, and the top four firms accounted for 81%, of all releases that placed in the "weekly top 10" *Billboard* singles charts, although these figures had declined, respectively, to 58% and 34% by 1959 (a consequence of the "rock and roll

⁵⁹ See MAE D. HUETTIG, *ECONOMIC CONTROL OF THE MOTION PICTURE INDUSTRY: A STUDY IN INDUSTRIAL ORGANISATION* 87 (1944).

⁶⁰ This hedging effect is reflected literally by cross-collateralization clauses in producers' contracts, which sometimes specify that a producer is only entitled to a share of the profits once the film's revenues have been allocated to cover both the costs of that particular film as well as a certain portion of the costs attributed to other films. See Vogel, *supra* note __, at 123.

⁶¹ See SELZ ET AL. 2009, §§1:8; 2:3; VOGEL, *supra* note __, at 97.

⁶² See THE MUSIC BUSINESS, *supra* note __, at 171-72.

revolution”⁶³).⁶⁴ During the 1960s and 1970s, the industry re-consolidated so that, as of 1980, the top four firms accounted for 76.5% of the *Billboard* “Top 100” album charts; as of 1998, the Big Four (Warner Music, Sony Music, EMI and Universal) controlled 89.4% of the album charts; and, as of 2008, the Big Four controlled 70.3%.⁶⁵ Since the merger between Universal and the recorded-music division of EMI, consummated in September 2012 (but pending regulatory approval)⁶⁶, the remaining “Big Three” now control 89% of revenues from recorded music in the U.S. market⁶⁷ and are responsible for the promotion and distribution of nearly every major recording artist.⁶⁸ Like the movie studio, the record label enjoys scale economies, risk-diversification, and unique expertise in production, marketing and distribution⁶⁹ and is usually an affiliate of a larger parent organization that offers economies of scope and internal financing capacities. Even well-financed but smaller competitors have had difficulty breaking into the inner circle of the music oligopoly, either failing or, if successful, being acquired by one of the dominant labels⁷⁰ or contracting with the label for marketing and distribution services. The largest record labels also have publishing affiliates (which together account for 65% of the music publishing business⁷¹), which own large portfolios of composition rights (a separate

⁶³ See C. MICHAEL BRAE, *MUSIC DISTRIBUTION: SELLING MUSIC IN THE NEW ENTERTAINMENT MARKETPLACE* (2d ed. 2009).

⁶⁴ See R.A. Peterson and D.G. Berger, *Cycles in symbol production: The case of popular music*, 40 *AMER. SOC. REV.* 158, 160 (1975). For discussion, see PETER TSCHMUCK, *CREATIVITY AND INNOVATION IN THE MUSIC INDUSTRY* 104, 109 (2d ed. 2012),

⁶⁵ See *THE MUSIC BUSINESS*, *supra* note __, at 171.

⁶⁶ See Ben Sisario, *Universal Closes on EMI Deal, Becoming, By Far, the Biggest of the Three*, *N.Y. Times*, Sept. 28, 2012, avail. at <http://mediadecoder.blogs.nytimes.com/2012/09/28/universal-closes-on-emi-deal-becoming-by-far-biggest-of-remaining-big-three/>. Note that Sony acquired EMI’s publishing division, thereby becoming the largest holder of copyrighted musical tracks in the world.

⁶⁷ Author’s calculations based on year-end 2011 data, see The Nielsen Company & Billboard’s 2011 Music Industry Report, *BusinessWire.com*, Jan. 5, 2012, avail. at <http://www.businesswire.com/news/home/20120105005547/en/Nielsen-Company-Billboard%E2%80%99s-2011-Music-Industry-Report>.

⁶⁸ See KRASILOVSKY ET AL., *supra* note __, at 277; BENJAMIN M. COMPAINE & DOUGLAS GOMERY, *WHO OWNS THE MEDIA? COMPETITION AND CONCENTRATION IN THE MASS MEDIA INDUSTRY* 340, 344 (2000).

⁶⁹ See COMPAINE & GOMERY, *supra* note __, at 327. For further discussion, see Fortes, *supra* note __, at 12-13. On record labels’ ability to pool risk, see Schultz, *Live Performance*, *supra* note __.

⁷⁰ See COMPAINE & GOMERY, *supra* note __, at 341-43.

⁷¹ See HULL ET AL., *supra* note __, at 114.

entitlement from sound recording rights under U.S. copyright law⁷²) that generate further cash flow to finance future production.

C. The Book Publisher

Historically the book publishing industry has not exhibited the same concentration levels observed in other creative markets, although concentration has still been significant.⁷³ Since the early 1960s, consolidation has accelerated so that, as of 2006, the six largest U.S. trade book publishers accounted for almost 90% of total sales and the top four accounted for almost 75% of that total.⁷⁴ Today that leading group has been reduced to five large publishing houses (each of which is part of a larger media conglomerate).⁷⁵ As in the film and music industries, publishers maintain a large inventory of previously released works (the “backlist”).⁷⁶ While the costs of publishing a book are relatively small depending on the size of the print run, the scale and cash reserves of a large publishing operation, including its even larger corporate parent, assist in supporting the capital-intensive marketing and distribution efforts required to produce a best-seller. Those efforts include: the capital required to bear the cost and risk of an initial large printing, which provides a signal of confidence to the market in generating initial sales⁷⁷; the large and non-refundable cash advances required to attract best-selling authors; and the efforts made to secure attractive display space or other favorable terms from a limited group of national retail booksellers.⁷⁸

⁷² 17 U.S.C. §§ 106(4), (6), 114 (2006).

⁷³ For the period 1925-1930, 10% of all publishers were the source of 48-50% of titles released each year. *See* O.H. CHENEY, *ECONOMIC SURVEY OF THE BOOK INDUSTRY 1930-31* (1931), at 163-64.

⁷⁴ *See* ANNET ARIS & JACQUES BUGHIN, *MANAGING MEDIA COMPANIES* 85 Tbl. 5.1 (2009) (using data from *Publishers Weekly*).

⁷⁵ This reflects the pending merger of Penguin and Random House publishing divisions into an entity jointly held by Bertelsmann and Pearson. The other four firms are: HarperCollins (part of News Corporation), Macmillan (owned by Georg von Holtzbrinck), Hachette (part of Lagardere), and Simon & Schuster (part of CBS). *See* Eric Pfanner & Amy Chozick, *Random House and Penguin Merger Creates Global Giant*, *N.Y. Times*, Oct. 29, 2012.

⁷⁶ *See* ALBERT N. GRECO, *THE BOOK PUBLISHING INDUSTRY* 201 (2005).

⁷⁷ *See* Whiteside, *supra* note ___, at 59-60.

⁷⁸ *See* COMPAINE & GOMERY, *supra* note ___, at 82

III. Copyright Without Creators

The traditional critique argues that copyright law adopts an inappropriate behavioral model that does not take into account the non-profit-motivated incentives of some or even most artists. While evidence for the “romantic artist” proposition is tenuous, I will provisionally accept it and show that there nonetheless remains a robust economic case for copyright as an instrument for supporting the development of mass-cultural markets. (*A fortiori* the “true” case for copyright is even stronger if a more nuanced behavioral model were adopted that attributed some profit-seeking motivation to artists.) Assuming artists require no monetary inducement to invest in creative production, it still is the case that copyright supports investment by intermediaries who supply critical services to fund and commercialize creative works on a mass scale.

A. Theory

The intermediary-based theory of copyright follows in its simplest form the following logical sequence.⁷⁹ Intermediaries incur significant capital costs and risks in funding cultural production and distribution on a mass basis. Intermediaries are clearly profit-motivated. Without the ability to secure supracompetitive profits on the few “hits” among a portfolio constituted mostly by losses, the intermediary will decline to fund those costs and bear those risks and will shift some or all of its resources to other activities. Without the intermediary, a fatal gap arises in mass-cultural markets. There is no entity willing or able to fund the capital-intensive non-creative tasks required to deliver a creative good to market and to insure against the high risk of failure on any individual project. Even if it were conceded that artists require no profit incentive and incur limited capital costs, the conventional incentive case for copyright remains robust.

⁷⁹ Other commentators have set forth elements of this theory but have usually treated it briefly or dismissively. For references, see *supra* note 2. Two recent contributions on copyright’s role in the music industry take a more sympathetic view, see Brian R. Day, *In Defense of Copyright: Creativity, Record Labels and the Future of Music*, 21 SETON HALL J. SPORTS & ENT. L. (2011); Schulz, *Live Performance*, *supra* note __.

B. Re-Understanding Copyright Law

The intermediary-based theory of copyright might seem to run directly counter to the explicitly-stated objectives as well as the history of the copyright system.⁸⁰ The founding documents of the modern statutory forms of English and U.S. copyright—respectively, the Statute of Anne enacted in 1710⁸¹ and the Intellectual Property Clause of the U.S. Constitution enacted in 1787—explicitly provide for legal protections for “Authors” and, in the case of the Statute of Anne, explicitly shift those legal protections from a publishing monopoly (the Stationers’ Company) to authors.⁸² If we “back-date” the modern copyright system to the charter granted to the Stationers’ Company in 1557 (effectively, a form of collective copyright), then this tension between history and theory diminishes. In a certain sense, however, none of this matters. A basic lesson of Coasean analysis is that, subject to transaction-cost constraints, the initial distribution of property rights is immaterial from an efficiency perspective.⁸³ Whatever the initial allocation, property rights will ultimately migrate through contractual and other private agreements to the most highly-valuing users. So too with copyright. So long as copyrights are freely assignable, the fact that copyright *initially* vests in an individual author (or a publisher, for that matter) will have little effect on the ultimate allocation of those copyrights, subject to transaction-cost constraints.⁸⁴ Given the risk-diversification and internal-financing imperatives that characterize mass-cultural markets, it would be expected that authors would transfer some if not all of their interest in their copyrights to intermediaries who are best-positioned to finance the non-creative tasks required to realize the commercial value of the underlying creative works and to insure against the high risk of project failure. Even assuming a romantic author who is

⁸⁰ On the history of the concept of authorship in copyright law, see Oren Bracha, *The Ideology of Authorship Revisited: Authors, Markets and Liberal Values in Early American Copyright*, 118 Yale L. J. (2008).

⁸¹ Statute of Anne, 8 Anne C. 19 (1710).

⁸² As noted previously, a line of argument in copyright scholarship views the putative “authorial” origins of copyright as a rhetorical ruse designed to establish an intellectual property system that favors the interests of large media interests, to the detriment of society as a whole.

⁸³ See Ronald Coase, *The Problem of Social Cost*, 3 J. L. & Econ. 1 (1960).

⁸⁴ For similar thoughts, see Hardy, *infra* note ___, at 183-85; Birnhack, *supra* note ___, at 133-34.

solely interested in fame or broad distribution, we would expect that any such transfer of rights would be demanded by a distribution intermediary, who would be unwilling to incur the costs of cultivating and disseminating creative works without having “tied up” all ownership rights in the various elements making up the creative work. That is of course the case: musicians contract with record labels, screenwriters contract with studios, authors contract with publishers, and so on. The result: the large intermediaries that cultivate and promote creative works on a mass scale usually hold full or partial interests in the copyrights relating to those works.

Notwithstanding the author-based rhetoric that dominates copyright jurisprudence and scholarship, the intermediary-based theory of copyright delivers explanations for certain features of copyright law that otherwise resist adequate explanation from a public-interest perspective. Given that inexplicability, there is a strong consensus among copyright scholars that those features lack any social justification and simply reflect the disproportionate influence of large media interests on the legislative and judicial processes through which the copyright system is modified (and usually expanded) from time to time. But the case is not as clear as is commonly portrayed. At a minimum, there is a plausible optimistic interpretation of copyright history: an increasing expansion of the copyright system starting in the mid-19th century secured intermediaries’ ability to insure against the vagaries, and self-finance the costs, of mass-cultural production and distribution. Even the most holder-friendly elements of the copyright regime can be reasonably justified from a social point of view as a necessary tool for inducing intermediaries to perform the non-creative functions without which a mass-cultural market cannot achieve the broad access to a mass market sought by artists and the broad access to cultural output sought by users. It is true that these same elements enable intermediaries to earn rents over and above the variable costs required to deliver a single creative work into the market. But those rents only count as a “true” social cost provided there is some less socially-costly mechanism to induce those intermediaries or some other entity to fulfill the same financing, production and distribution functions that support then-existing levels of creative output and the dissemination of that output. Mature mass-cultural markets overcome the high risk, and bear the high costs, of mass-cultural production through a portfolio-diversification and

self-financing strategy secured by robust copyright. The result is not just the generation of rents for the intermediaries who hold and manage these “copyright estates”, which rewards them (and, of course, may sometimes *overreward* them) for bearing those risks and costs, but a screening, production and distribution infrastructure that has cultivated and disseminated cultural products to an extent never previously imaginable.

1. Subject Matter

As shown below, the U.S. copyright system has been extended over time to an increasingly large number of media: musical compositions in 1831, dramatic works in 1856, motion pictures in 1912, and so forth. From an intermediary-based perspective, this often-maligned expansionary trend appears presumptively to be an efficient development. Any capital-intensive technology of mass cultural production or distribution requires that some entity bear the costs and risks of producing and distributing cultural content, subject to the endemic risk of commercial failure. It would therefore be expected that the intermediary’s private interest in influencing the state to expand copyright to cover a novel production or distribution technology and the public’s interest in financing and bearing the costs and risks of producing and distributing content through that technology at the lowest cost possible would go hand in hand. Maximizing the intermediary’s incentives to finance, and insure against the risk of, cultural production and distribution on a mass scale promotes artists’ ability to disseminate cultural output as well as the public’s access to that output.

Table I: Historical Expansion of Federal Copyright

Year	Extension
1831	Musical compositions ⁸⁵
1856	Dramatic works ⁸⁶
1865	Photographs ⁸⁷
1870	Paintings, statues, certain designs ⁸⁸
1909	Phonorecords (subject to compulsory license) ⁸⁹
1912	Motion pictures ⁹⁰
1972	Sound recordings ⁹¹

To argue that the expansion of copyrightable subject matter operates to the advantage of both intermediaries and end-users is a counterintuitive proposition. Surely any such expansion of property rights is a zero-sum event that expands copyright holders' pricing power to the detriment of users who now have limited access to the underlying body of cultural works. While that is certainly a possible outcome, it is not a necessary outcome: the *net* access effects of any increase in copyright protection depend (among other things) on the availability in any given market of alternative cost-equivalent means by which to regulate access to the underlying pool of creative works. Whenever copyright is the least-cost means of appropriating returns on the generation and distribution of creative output, it can result in both more output and more access to an expanded pool of creative works. A little-known but well-documented historical episode illustrates this contingency. In major Western European markets, musical compositions were unprotected by copyright until the early 18th century in England and as late as the

⁸⁵ ACT OF FEB. 3, 1831, CH. 16, SEC. 1, 4 STAT. 436, 436.

⁸⁶ ACT OF AUG. 18, 1856, CH. 169, 11 STAT. 138, 138-39.

⁸⁷ ACT OF MAR. 3, 1865, CH. 126, §1, 13 STAT. 540, 540.

⁸⁸ ACT OF JULY 8, 1870, CH. 230, §86, 16 STAT. 198, 212.

⁸⁹ ACT OF MAR. 4, 1909, CH. 320, §1(E), PUB. L. NO. 60-349, 35 STAT. 1075, 1075-76.

"Phonorecord" refers to any physical object in which a musical work is embodied (e.g., LP, CD).

⁹⁰ THE TOWNSEND AMENDMENT OF 1912, CH. 356, §5(L), PUB. L. NO. 62-303, 37 STAT. 488, 488.

⁹¹ SOUND RECORDING AMENDMENT OF 1971, PUB. L. NO. 92-140, 85 STAT. 391 (1971). Note that, prior to this amendment, sound recordings were sometimes protected under state common law copyright.

early 19th century in Germany and Austria, then centers of classical music composition.⁹² Concurrently with those changes in copyright protection, composers shifted their allocation of time and labor in a manner that increased public access to musical works. Prior to the extension of copyright, leading composers had tended to focus on operatic production for a small elite population. This cultural choice had an economic rationale. Unlike musical compositions that could be (and were) freely copied⁹³, a live performance is an inherently excludable good to which composers could regulate access and extract a premium. Following the extension of copyright to musical compositions, composers could move safely into the broader market and (as befits a profit-maximizing artist) shifted their efforts to the production of chamber music that could be sold as sheet music by music publishers to the far broader population of consumers who played music at home.⁹⁴ The result: extending copyright to a particular class of creative works altered the allocation of creative labor in a manner that dramatically improved access, thereby yielding both efficiency and distributive gains. While expanding property rights happened to promote the economic interests of composers and the sheet-music publishers, it resulted in an almost certain net welfare improvement for the broader listening public.

2. Duration

The long, and periodically extended, term of copyright has been the object of much critique by virtually the full gamut of copyright scholars. Currently that term is set at the life of the author plus 70 years for any work created after January 1, 1998.⁹⁵ Legal scholars and economists have persuasively argued that, using a discounted present-value analysis, the current term cannot have any plausible marginal incentive effect on creative production as compared to a significantly shorter term.⁹⁶ But this critique does not

⁹² See F.M. SCHERER, *QUARTER NOTES AND BANK NOTES: THE ECONOMICS OF MUSIC COMPOSITION IN THE EIGHTEENTH AND NINETEENTH CENTURIES* (2004).

⁹³ See *id.*

⁹⁴ See *id.*

⁹⁵ 17 U.S.C. § 302 (2006).

⁹⁶ See, e.g., BRIEF OF GEORGE A. AKERLOF ET AL. AS AMICI CURIAE IN SUPPORT OF PETITIONER (2002).

address the “hit market” characteristics of a creative goods market and the portfolio strategy that is required to sustain big-budget investment under a low probability of project-specific success. Recall the predicament of an intermediary who accumulates a diversified portfolio of creative properties: it must generate sufficient returns on a small number of successful releases in order to cover the complete to near-complete losses on a much larger number of unsuccessful releases. Among those hits, there is an even smaller population of releases that are “classics” for which demand persists beyond a single season.⁹⁷ Classics (or, in industry terms, the “backlist”) can play a valuable role in a risk-diversification strategy by delivering a reliable income stream that can be used to fund new creative projects, cultivate related projects inspired by classic releases, and offset the losses on new unrelated projects. Given that fact, any extension of copyright protection—even the widely-maligned retroactive extensions of copyright upheld by the Supreme Court in 2002 in *Eldred v. Ashcroft*⁹⁸ and again in 2012 in *Golan v. Holder*⁹⁹—inherently reduces intermediaries’ cost of capital, thereby improving intermediaries’ capacity to fund, distribute and market new creative projects. This is not to say that these extensions of the copyright regime necessarily result in a net welfare improvement, but it is not an inherently implausible contingency as has been almost universally alleged.¹⁰⁰ While a long duration has little justification if construed as a mechanism for inducing marginal investments by a single author in preparing a *single* artistic work, it can be plausibly justified if construed as a mechanism for inducing investment by an intermediary in accumulating, and cultivating, a *portfolio* of artistic works from multiple sources to insure against project failure and generate cash flows that fund future production and distribution of cultural works.

⁹⁷ The paucity of classics is reflected in part by the fact that, when renewals were required to maintain the term of a copyright, only a small percentage of works were renewed despite a low fee. See EDWARD RAPPAPORT, COPYRIGHT TERM EXTENSION: ESTIMATING THE ECONOMIC VALUES, CONGRESSIONAL RESEARCH SERVICE REPORT 98-144E (1998).

⁹⁸ 537 U.S. 186 (2003) (upholding constitutionality of Congressional extension of copyright protection, which operated both prospectively and, with respect to certain works, retroactively).

⁹⁹ 565 U.S. (2012) (upholding the constitutionality of Section 514 of the Uruguay Round Agreements Act, an international treaty as a result of which Congress restored copyright protection to works that had previously fallen into the public domain as a matter of U.S. copyright law).

¹⁰⁰ For exceptions, see Liebowitz & Margolis, *supra* note __; William Landes & Richard Posner, *Indefinitely Renewable Copyright*, U. Chicago L. Rev. (2002).

3. Derivative Rights

The costs and risks of cultural production can be mitigated both temporally, by extending the term, and spatially, by expanding the cultural territory over which a property right extends. Spatial risk-diversification is enabled most directly by Section 106(2) of the Copyright Act, which entitles the copyright owner to claim infringement with respect to derivative works “based upon” the copyrighted work. The derivative works provision gives copyright holders a potentially wide territory over which to assert their copyright, including abridgements and sequels as well as a loosely defined body of adaptations of the original work. The derivative right is probably a close runner-up to the extended term for the most vilified feature in the U.S. copyright system. As critics like to observe, there was no derivative right in the early period of modern copyright, both in the U.K. and the U.S.: second-movers could freely produce translations, abridgements and adaptations of copyright-protected works. Hence, in 1853, the publisher of Harrier Beecher Stowe’s *Uncle Tom’s Cabin*, one of the first bestsellers, was unable to use its copyright to block an unauthorized German translation.¹⁰¹ At around the same time, however, courts had been crafting a common-law derivative right¹⁰², which was later codified by amendments to the copyright regime in 1870¹⁰³ and, most dramatically, in 1909¹⁰⁴, followed by clarifying language added in 1976.¹⁰⁵

Following an author-based view of copyright, these extensions of the copyright holder’s exclusive territory seem to result in excessive windfalls to lucky authors and prompt queries such as: did J.K. Rowling really write the original Harry Potter novel because she foresaw the ability to license the Harry Potter property to Warner Bros. for a film, to Disney for a Harry Potter amusement park ride, and to Mattel for Harry Potter

¹⁰¹ Stowe v. Thomas, 23 F. Cas. 201 (C.C.E.D. Pa. 1853).

¹⁰² See, e.g., Folsom v. Marsh, 9 F. Cas. 342 (C.C.D. Mass. 1841) (extending copyright to abridgement); Woolsey v. Judd, 11 How. Pr. 49 (N.Y. Super. Ct. 1855); Grigsby v. Breckinridge, 65 Ky. 480 (App. Ct. 1867).

¹⁰³ Act of July 8, 1870, ch. 230, §86, 16 Stat. 198, 212 (extending copyright to dramatizations and translations); Act of Mar. 3, 1891, ch. 565, 26 Stat. 1106 (clarifying that copyright extends to dramatizations).

¹⁰⁴ Copyright Act of 1909, c. 320, §1(b), 35 Stat. 1075.

¹⁰⁵ 17 U.S.C. § 106(2) (2006). For further discussion, see Pamela Samuelson, *The Quest for a Sound Conception of Copyright’s Derivative Work Right* (Working Paper 2012).

action figures?¹⁰⁶ No, she almost certainly did not. If that is the case, then the derivative right is an unjustified transfer of rents from consumers to authors that could be scaled back or eliminated consistent with copyright's underlying incentive function. But the relevant question is: did the publishers of the Harry Potter novel, the makers of the Harry Potter movie, and the merchandisers of the Harry Potter action figures foresee those possibilities? Of course, those intermediaries clearly did foresee those extensions and would not have funded those capital-intensive undertakings without the ability to secure exclusivity over those extensions of the original work. From that perspective, it makes perfect sense that derivative rights would expand in tandem with the historical expansion of markets for the mass distribution of creative content. The 1909 Act (extending amendments made in 1870), situated right at the inception of modern mass cultural markets, allocated to the copyright holder the right to control a wide gamut of cultural applications: translations, dramatizations of nondramatic works, novelizations of dramatic works, and arrangements of musical works, among others.¹⁰⁷ As capital requirements and financial risk increase, intermediaries demand derivative rights to spread creative risk and amortize production and distribution costs by applying any successful creative work in various media and extending it in sequels and other variations, each of which contributes to the aggregate revenue stream flowing from the occasional successful release and thereby mitigates the risks and costs associated with an intermediary's entire cultural portfolio.¹⁰⁸ Contrary to commonly-expressed views that

¹⁰⁶ This type of objection is pursued at length in Shyamkrishna Balganash, *Foreseeability and Copyright Incentives*, 122 HARV. L. REV. 1569, 1589-1591 (2009).

¹⁰⁷ 17 U.S.C. §1(b) (repealed 1976).

¹⁰⁸ Prof. Mark Nadel argues that the derivative right, and the associated expansion in expected profits on a blockbuster hit, induces copyright holders to favor popular works over more "economically marginal" works. See Nadel, *supra* note __. There are three vulnerabilities in this argument. First, it is unclear why reducing total expected returns (by weakening copyright) would lead producers to favor "economically marginal" works. The opposite would seem to be the case given that producers would then favor the lowest-risk projects that appeal to the broadest population; conversely, expanding expected returns (by increasing copyright) provides producers with additional profits that can be invested in higher-risk "artistic" projects that appeal to niche audiences. For similar views, see Goldstein, *supra* note __, at 113. Second, the winner-take-all nature of mass-cultural markets would persist even in the absence of copyright, given that it is largely attributable to low-cost reproduction technologies (which undermine the commercial value of all "runner-up" artists) and the evaluation difficulties inherent to experience goods (which induce consumers to use stars as a proxy for quality). Third, available evidence does not support the view that concentration suppresses cultural diversity. See Peter J. Alexander, *Entropy and Popular Culture: Product Diversity in the Popular Music Recording Industry*, 61 AMER. SOC. REV. 171 (1996) (finding that moderately concentrated creative markets exhibit greater product diversity relative to both more and less

the derivative right overrewards creators and stifles innovation¹⁰⁹, it provides an incentive for profit-motivated intermediaries to undertake the costs and risks of developing, marketing and distributing a large, diversified and failure-prone pool of original and follow-on products.

4. Corporate Ownership

The copyright regime deviates most sharply from an author-based view of copyright, and is most consistent with an intermediary-based view of copyright, in its ownership provisions.¹¹⁰ In particular, the copyright act provides that ownership of a copyright *initially* vests in an individual author (or authors)¹¹¹ but then qualifies it in three respects that facilitate the assertion and transfer of ownership interests in copyright by corporate (or other “non-author”) entities. There are three avenues by which a corporate entity can assert ownership over a copyright: (i) in the case of an author who is acting within “the scope of employment”, the employer-firm is deemed to be the author; (ii) in the case of a work that is prepared by an independent contractor for a client-firm and falls into certain enumerated categories, the firm is deemed to be the author so long as the author recognizes that fact in writing (a so-called “work-made-for-hire” acknowledgement); or (iii) the firm is the assignee if the individual author assigns his or her copyright interest to the firm.¹¹² Following an author-based view of copyright, these provisions might be (and have been) viewed as evidence of the distortionary influence of media interests that “unfairly” enable intermediaries to wrest control from artists and

concentrated markets); *Product variety and market structure: A new measure and a simple test*, 32 J. ECON. BEHAV. & ORG. 207 (1997) (same); see also Paul D. Lopes, *Innovation and Diversity in the Popular Music Industry, 1969 to 1990*, 57 Amer. Soc. Rev. 56 (1992) (finding no relationship between market concentration and product diversity in the popular music market).

¹⁰⁹ See Nadel, *supra* note __; Balganes, *supra* note __, at 1590-91.

¹¹⁰ For similar observations, see Bracha, *supra* note __, at 248-49; Mark Lemley, *Romantic Authorship and the Rhetoric of Property* (Book Review), 75 Tex. L. Rev. 873, 882-83 (1996).

¹¹¹ 17 U.S.C. § 201(a).

¹¹² 17 U.S.C. s. 201. Note, however, that an assignment cannot transfer full ownership to the assignee; under copyright law, the assignment terminates 35 years after the date of assignment (the “reversion of rights” provision). 17 U.S.C. s.203.

amass intellectual-property holdings that smother creative markets.¹¹³ Under an intermediary-based approach, this interpretation is almost entirely reversed. Facilitating the ability of corporate entities to acquire legally secure ownership interests in creative properties facilitates intermediaries' ability to acquire portfolios that spread the costs and risks of mass cultural production, which in turn promotes the incentives of those intermediaries to invest in capital-intensive forms of cultural distribution.¹¹⁴

In an under-discussed article, Prof. I. Trotter Hardy showed how this rationale drove the holder-friendly approach to ownership under the 1909 Act, which established employer ownership as a presumption.¹¹⁵ Even after the qualified work-made-for-hire provision described above was adopted by the 1976 Act, courts in disputed-ownership cases tended to side with the larger entity that was in the best position to exploit the copyright.¹¹⁶ The intermediary's interest in being able to cultivate a creative release also explains why the enumerated categories in which a corporate entity can establish ownership through the "work made for hire" option under the 1976 Act are all multi-component works (e.g., a motion picture) with respect to which a firm could be exposed to opportunistic hold-up claims by contributors of minor elements that cannot be easily removed from a larger creative package.¹¹⁷ Rather than transferring rents to corporations to the detriment of any plausible social interest, the ownership provisions in the copyright

¹¹³ For a description of this type of criticism expressed during deliberations over the 1976 revision to the Copyright Act, see Molly Shaffer Van Houweling, *Author Autonomy and Atomism in Copyright Law*, 96 VA. L. REV. 54, 606.

¹¹⁴ For related thoughts, see Birnhack, *supra* note __, at 128-31.

¹¹⁵ Historical research shows that the 1909 Act's presumption codified judicial tendencies that predate the Act. See Catherine L. Fisk, *Authors at Work: The Origins of the Work-for-Hire Doctrine*, 15 YALE J. L. & HUMANITIES 1 (2003).

¹¹⁶ See I. Trotter Hardy, *An Economic Understanding of Copyright Law's Work-Made-For-Hire Doctrine*, 12 COLUMBIA-VLA JOURNAL OF LAW & THE ARTS 181 (1988). Note that Hardy's study was limited to cases adjudicated through 1987. The governing decisions on joint authorship in the prominent Second and Ninth Circuits, both of which have been issued since the period covered by Hardy's study, are consistent with this trend: both set standards that generally assist large intermediaries in defending against claims of joint authorship by non-employee contributors. See *Aalmuhammad v. Lee*, 202 F.3d 1227 (9th Cir. 1999); *Childress v Taylor*, 945 F.2d 500 (2d Cir. 1991).

¹¹⁷ 17 U.S.C. §101 (2006) (defining "work made for hire" as "a work specially ordered or commissioned for use (1) as a contribution to a collective work; (2) as a part of a motion picture or other audiovisual work; (3) as a translation; (4) as a supplementary work; (5) as a compilation . . ."). On the manner in which the work-made-for-hire provision *supra* enables publishers to avoid fragmentation of rights over a single creative work, see Van Houweling, *supra* note __, at 598.

statute discourage hold-up behavior by individual contributors and reduce the transaction costs incurred by intermediaries in assembling and securing a diversified portfolio of cultural properties.

5. Divisibility and Assignability

The most robust form of a property entitlement has two fundamental features: (i) it excludes all unauthorized uses; and (ii) it is freely assignable to any other party. The second function is often overlooked but it is a critical feature of mature copyright systems, which facilitate complex licensing markets that continuously shift copyright-protected content, or various portions thereof, among the highest-valuing users. Under the 1909 Act, copyright law had implicitly restricted the divisibility and assignability of interests in copyright by (i) treating as a license any assignment that covered less than the full bundle of “copyrights” pertaining to a particular work, and (ii) providing that a licensee had no independent standing to sue for infringement of the licensed interest.¹¹⁸ Although ameliorated by judicial modifications¹¹⁹, those limitations inflated the cost of acquiring copyright interests and limited the feasible universe of transactional forms by effectively coercing sellers and buyers to transact in bundled creative assets in order for transferees to acquire maximal certainty of legal ownership. The 1976 Copyright Act liberalized the market for creative properties through two principal changes. First, it established the principles of “unlimited alienability of copyright”¹²⁰ and “divisibility of copyright”¹²¹, thereby enabling the free assignment of any interest, whether on a full or partial basis or an absolute or contingent basis, in a copyright-protected property.¹²² Second, it clarified that exclusive assignees were deemed to be owners with the ability to

¹¹⁸ See Act of Mar. 4, 1909, ch. 320, s 42, 35 Stat. 1075, 1084; see also 3 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT §10.01 [A] (2010) (stating that the rules on assignment and divisibility made it “impossible to assign anything less than the totality of rights commanded by copyright”).

¹¹⁹ See *id.*

¹²⁰ 17 U.S.C. §201(d)(1); 101 (definition of “transfer of copyright ownership”).

¹²¹ 17 U.S.C. §201(d)(2); 101 (definition of “transfer of copyright ownership”).

¹²² For further discussion, see U.S. CONGRESS, HOUSE REPORT NO. 94-1476, NOTES AND REVISIONS, 17 U.S.C. §201; Von Houweling, *supra* note ___, at 564, 601-602.

bring an infringement cause of action, thereby allowing the transferees of any portion of a copyrighted work to assert ownership over that portion.¹²³

The free assignability and divisibility of copyright interests is an overlooked and vital ingredient behind the copyright system's contribution to the formation and functioning of efficient markets for creative works. These rights underlie the “bread-and-butter” activities undertaken by the brokers, agents, managers and attorneys employed or retained by large distribution and production intermediaries in mass-cultural markets. In particular, assignability and divisibility of copyright interests enhance intermediaries' transactional freedom to maximize the commercial value of a creative property by releasing it sequentially at multiple times, over multiple territories, in different versions, and in different cultural media. This can be well illustrated by reference to the film industry, which has historically released a film through theatrical distribution, followed by DVD (formerly VHS) release at a lower price, and at a still lower price through pay-TV or broadcast-TV syndication.¹²⁴ These windowing strategies have three functions. First, windowing facilitates externally financing a production by enabling an intermediary to segment a work into multiple interests and then “pre-sell” those interests to outside equity investors, distributors and merchandisers. This opportunity is particularly critical for “mini-major” studios and independent production companies, which do not have the alternative of internal financing and therefore rely on this financing source.¹²⁵ Second, windowing “smooths” the revenue stream flowing to an intermediary by extending the life of a creative work from the point of initial distribution through subsequent stages and iterations, which in turn generates financing for other projects. Third, windowing maximizes intermediary profits by segmenting the total consumer population and enabling it to extract consumer surplus at each point on the demand curve. That not only benefits the intermediary but operates to the potential advantage of two groups: (i) artists, because intermediaries then have greater funds

¹²³ 17 U.S.C. §101; §201(d) (2005); 17 U.S.C. §101 (2005) (definition of “transfer of copyright ownership”).

¹²⁴ See Ulin, *supra* note ___, at 29-36.

¹²⁵ For a description, see Ulin, *supra* note ___, at 95-97.

available to fund new projects¹²⁶ and (ii) lower-income users. While price-discrimination operates to the disadvantage of the highest-valuation (and usually, wealthier) consumers at the top end of the demand curve (from whom consumer surplus is transferred and converted to producer surplus), it tends to advantage lower-valuation (and usually, poorer) consumers at the bottom end of the demand curve, to whom content would otherwise not be supplied at all if only a single uniform price were charged.¹²⁷

IV. Do Intermediaries Still Matter?

Even if all of the foregoing is accepted, the intermediary-based approach could be dismissed as an adequate but mostly historical explanation for a model of cultural production that prevailed in a “post-Gutenberg” but “pre-digital” technological environment. Much of the evidence described above to support an intermediary-based approach to copyright describes a physical production and distribution infrastructure that has been partially bypassed by digital production and distribution technologies. Today production and distribution costs have fallen dramatically and the skills required to produce and distribute creative goods are far more widely distributed due to revolutionary advances in editing, copying and dissemination technologies. Based on those developments, some commentators have asserted that the conventional role of the financing and distribution intermediary in creative markets is diminished or even obsolete.¹²⁸ If the production and distribution functions formerly carried out by intermediaries are no longer capital-intensive or skills-intensive, then artists can carry out those functions independently at a feasible cost and the conventional intermediary’s distribution and financing functions are redundant or significantly diminished in importance. The “disintermediation thesis” then follows: the digitization of content

¹²⁶ For similar thoughts, see LANDES & POSNER, *supra* note __, at 39; William W. Fisher III, *Property and Contract on the Internet*, 73 Chi-Kent L. Rev. 1203, 1237-39 (1998).

¹²⁷ This type of price discrimination is a familiar practice in creative markets, where distributors frequently charge a premium price for a product that includes an expanded version of a particular creative work (e.g., a DVD with high-definition features and additional materials) and a lower price for a product that includes a more basic version of the same work.

¹²⁸ For the leading statement in the scholarly literature, see Ku, *supra* note __. For a representative statement from the digital music industry, see Jeff Price, *How Technology Destroyed the Music Industry*, Hypebot.com, avail. at <http://www.hypebot.com/hypebot/2012/09/the-end-of-the-new-music-industry-transformation-how-technology-destroyed-the-traditional-music-indu.html>.

production and distribution reduces the intermediary-based case for copyright (or at least, strong copyright) to a largely academic account of an important but limited period in the history of cultural production.

In this Part, I show that the intermediary-based case for copyright survives the advent of low-cost, high-quality digital technologies for cultural production and distribution, but with some important qualifications that usefully clarify the proper scope of that argument. The reason is simple but overlooked. Even dramatic reductions in copying and distribution costs borne by the producers of creative goods make little difference in, and actually exacerbate, the search and evaluation costs borne by consumers of those goods and hence, the marketing costs borne by the producers and distributors of those goods. Those costs leave in place the high risk and much of the capital intensity attendant to the production and consumption of mass-cultural goods and preserve a vital role for the large intermediary in cultural goods markets.

A. The Disintermediation Myth

The disintermediation thesis relies on the assertion that the costs incurred to produce and deliver a creative good to market have fallen dramatically. Precisely, it requires that artists can execute each required task in the creative supply chain at a lower cost relative to paying the implicit fee demanded by a conventional intermediary for executing that task. Closer scrutiny shows a more complex picture. Production and commercialization costs have fallen to different extents across different media and at different stages of the production, distribution and marketing process through which a cultural good travels from artist to market. In particular, there is no decline (and perhaps an increase) in the screening and marketing costs required to identify commercially valuable items among the rich mass of cultural content and then to persuade potential users of the value of consuming those items.

1. Production and Distribution Costs

The extent to which production and distribution costs have fallen as a result of the “digital revolution” varies across different media.

a. *Film.* Production costs remain high in the case of professional-quality motion pictures, which continue to require multi-million dollar budgets—with rare exceptions, a minimum of several tens of millions of dollars and hundreds of millions of dollars in the most complex productions. If theatrical exhibition (rather than only home video or online distribution) is sought, as would typically be the case, then further costs must be incurred to manufacture prints and distribute those prints to theatrical exhibitors. Those activities are beyond the wherewithal of even most independent production companies, which contract with the major studios for distribution services.

b. *Music.* Production and distribution costs are higher but, for some genres, have fallen within the budget of many artists. Reasonably high-quality recording and editing (usually known as “mixing”) of musical works can be done at home for a feasible cost, assuming the artist can spend approximately \$1000 to purchase the required equipment and software.¹²⁹ The recording can then be distributed costlessly through an online intermediary without a sales function (e.g., YouTube) or, on a commission basis, through an online intermediary for purposes of sales (e.g., CD Baby or Tunecore). These observations must be qualified, however, by the cost of musical instruments and lifetime training costs¹³⁰ and the artist’s cost of living assuming no other source of income. Hence, while recording and distribution costs have declined dramatically, the total cost burden still may not fall within the budget of all (especially less wealthy¹³¹) individual artists.

c. *Books.* The costs of publishing and distributing a book in electronic or print format through a “self-publishing” service are manageable and, so long as the “print

¹²⁹ See DAVIS & LAING, *supra* note __, at 200. Some sources indicate that recording costs are higher in genres that involve complex arrangements that necessitate the assistance of a professional production engineer. See STEVEN GORDON, *THE FUTURE OF THE MUSIC BUSINESS* 280 (3d ed. 2011) (estimating cost of \$50,000 to record a complex musical arrangement).

¹³⁰ See Paul Rutter, *Music into industry*, in *THE MUSIC INDUSTRY HANDBOOK* 19-20 (ed. Paul Rutter 2011).

¹³¹ See GORDON, *supra* note __, at 280 (stating that unsigned artists tend to be drawn from higher socio-economic populations who have the freedom to stop working for some period of time to pursue a musical career).

run” is small, probably fall within the budget of many authors.¹³² That is not true, however, of a large-scale print distribution, which continues to require the physical infrastructure of a major publishing house.

2. *Screening and Marketing Costs*

Suppose that in a given cultural market production and distribution costs have fallen sufficiently such that an individual artist has no reason to use the services of a conventional intermediary—or at least, would only be willing to do so at an appropriately discounted rate. The disintermediation thesis still stands in doubt. That is because it ignores a cost category that is not altered, and may even be exacerbated, in a digital environment. Even if an individual artist can achieve distribution into a broad online market (thereby avoiding all physical distribution costs), he or she must still attract consumer interest that could easily be diverted to the millions of other works available for consumption. The overwhelming majority of artists fail to do so. This fate is especially likely to befall a new artist who has no brand capital by which to signal quality. Accumulating brand capital requires funding, which explains why even the most successful independent production companies in film and music must contract with the “majors” to achieve the broadest marketing exposure.¹³³ A record label still undertakes a variety of promotional and other tasks that are beyond the wherewithal of even the most well-resourced individual: marketing costs often approach \$100,000 for a standard musical release and can exceed \$500,000 for a major artist.¹³⁴ In particular, as smaller

¹³² See David Carnoy, *Self-publishing a book: 25 things you need to know*, CNET.com, June 13, 2012, avail. at http://reviews.cnet.com/8301-18438_7-10119891-82/self-publishing-a-book-25-things-you-need-to-know/. The range of prices offered by the three largest self-publishing companies, which varies based on the “package” selected (including a limited number of print copies and marketing services), extends roughly from as low as \$1200 to as high as \$13,000. For leading services, see CREATSPACE, *Professional Services for Every Step of the Publishing Process*, <https://www.createspace.com/pub/services.home.do?tab=PUBLISHING>; IUNIVERSE, *Compare Self Publishing Packages*, <http://www.iuniverse.com/Packages/PackageCompare.aspx>; XLIBRIS, *Which Full Color Publishing Package is Right for You?*, http://www2.xlibris.com/full_color.html.

¹³³ See Carnoy, *supra* note __; STATEMENT OF MARTIN MILLS, *supra* note __.

¹³⁴ See Vogel, *supra* note __, at 260. These promotional tasks include: (i) producing a music video (which involves costs beyond the budget of most individuals (see DAVIS & LAING, *supra* note __, at 210)); (ii) promoting music to music critics, and hundreds of radio shows and other media outlets; (iii) bulk buying of advertising on television; and (iv) negotiating on a bulk basis with online retailers and other online distribution services. See STATEMENT OF MARTIN MILLS, FOUNDER AND CEO, BEGGARS GROUP, TO

labels ruefully observe, the major record label continues to exhibit an unequaled capacity in securing radio play (and, as a result, major labels were the source of 75%-85% of the songs played on radio during 2005-08).¹³⁵ Both the film and music markets repeat past and current experiences of self-published authors in the literary market: even when a self-published author made an initial breakthrough, contracting with a large publisher was ultimately required to achieve the marketing exposure that catapulted the author to publishing stardom in the broader market.¹³⁶

3. *The Persistence of the Superstar Effect*

A much-discussed thesis advanced in popular business commentary proposes that “superstar” effects—that is, the dominance of a small number of hits in historical cultural markets—would decline in online consumption markets. That thesis predicts that low-cost technologies for digital distribution would generate a “long tail” effect that enabled marginal cultural products to secure an audience, as contrasted with the dominance of a small number of hits in historical cultural markets mediated by conventional intermediaries.¹³⁷ The logic seems cogent: infinite “shelf space” in digital environments expands the choices available to consumers, who then select niche products that had formerly been neglected by the major labels and retailers. But evidence to date indicates a contrary result. While the number of titles available to users increases, the clustering of listeners around a small number of hits is just as, and sometimes even more, skewed in digital environments, as compared to the physical market. Based on data of online video sales, Prof. Anita Elberse and colleagues found that, for the period 2000-2005, there was

U.S. SENATE ANTITRUST CMTE., COMPETITION POLICY AND CONSUMER RIGHTS SUBCMTE., June 21, 2012, avail. at <http://www.judiciary.senate.gov/pdf/12-6-21MillsTestimony.pdf>.

¹³⁵ See Thomas, *supra* note __, at 14, 20-21.

¹³⁶ For a current example, see Lev Grossman, *Books Gone Wild: The Digital Age Reshapes Literature*, TIME, Jan. 21, 2009, avail. at <http://www.time.com/time/magazine/article/0,9171,1873122,00.html>

(reporting that unknown author attracted attention by self-publishing and then secured contract with a traditional publisher to promote the book heavily). For older examples, see BEST AND WORST OF TIMES, *supra* note __, at 59-60 (describing success of *Christmas Story* and *The Celestine Prophecy*, fiction best-sellers that were initially self-published in 1993 and 1994, respectively, and then widely distributed by conventional publishers in 1995).

¹³⁷ See CHRIS ANDERSON, THE LONG TAIL: WHY THE FUTURE OF BUSINESS IS SELLING LESS OF MORE (2006).

a modest “long tail” effect in the home video market insofar as the number of titles that sell only a few copies each week almost doubled; however, the number of titles that *never* sell a single copy quadrupled and there was a powerful superstar effect insofar as an *even smaller* number accounted for the best-performing titles.¹³⁸ Other research yields similar findings. Based on sales data from Nielsen SoundScan, which gathers information on weekly purchases of music through online and physical retailers, the online music service Rhapsody, and the Australian DVD-by-mail service Quickflix, Prof. Elberse has found that demand for blockbuster releases shows strong growth while demand for niche products remains weak.¹³⁹ Other studies of paid music consumption on iTunes and unpaid music consumption through file-sharing networks find a dominant superstar effect in which a small portion of total music files represent the bulk of all downloads while the vast majority is never purchased or listened to at all.¹⁴⁰

Why would the superstar effect persist and even intensify in markets in which the costs borne by users to access lesser-known releases, and the costs borne by retail distributors to hold those releases in inventory, would seem to have been reduced? The likely reason lies in the abundance of content and the scarcity of consumers’ time and ability to evaluate the quality of that content. In a digital environment, consumers’ screening and evaluation burden is increased given the abundance of content choices, which expand due to (i) the reduction in production and distribution costs, and, relatedly, (ii) the ability to enter the market without obtaining funding from, and thereby undergoing the screening process administered by, a sponsoring label. Consuming star

¹³⁸ See Anita Elberse & Felix Oberholzer-Gee, *Superstars and Underdogs: An Examination of the Long-Tail Phenomenon in Video Sales*, MSI REPORTS: WORKING PAPER SERIES 4 (2007).

¹³⁹ To be precise, the findings tend to indicate that the “tail” of the demand curve lengthens but flattens – that is, there are more purchases of niche products but those products are usually only purchased once or twice – while the “head” of the curve becomes even “fatter” – that is, there is even more intense clustering around a small number of hits. See Anita Elberse, *Should You Invest in the Long Tail?*, HARVARD BUS. REV. (July 2008).

¹⁴⁰ See Sean Michaels, *Most music didn’t sell a single copy in 2008*, The Guardian, Dec. 23, 2008, avail. at <http://www.guardian.co.uk/music/2008/dec/23/music-sell-sales> (reporting a study of iTunes downloads in the United Kingdom in 2008 by the UK collective licensing agency and finding that 85% of total inventory did not sell at all and the bulk of all downloads derived from a small group of hits); Will Page & Eric Garland, *The Long Tail of P2P*, 14 ECON. INSIGHT 1 (2007) (finding that, in peer-to-peer file sharing, there is a dominant superstar effect, insofar as most users cluster around a small number of tracks (the top 5% of downloads constitute 80% of all downloads), and a weak long-tail effect, insofar as the vast remainder of tracks are swapped at least once but still do not attract significant attention).

properties that are implicitly endorsed by other consumers reduces search and evaluation costs in an environment in which quality signals are otherwise noisy or nonexistent. This implies that the screening and persuasion function of cultural intermediaries remains intact and is even bolstered in a digital environment. In making the marketing investments required to supply the market with star properties, the intermediary relieves the informational burden borne by uninformed consumers, and therefore relieves the marketing burden borne by the unknown artist or even the known artist with respect to any new creative good. Consistent with this assertion, the aforementioned study of online music downloads finds that the long-tail effect is most pronounced in the case of high-intensity users, which correspond to informed consumers (who presumably do not require the star proxy to assess product quality).¹⁴¹ Given uninformed consumers' preference to imitate the consumption habits of other better-informed consumers, which are used as a proxy for content quality, an intermediary's resources can be deployed to cultivate consumption by well-informed consumers, which snowballs into more widespread consumption among less well-informed consumers, and so on. The result is the familiar superstar effect in mass cultural markets.

4. *Summary*

While academics and other commentators doubt the necessity of cultural intermediaries in a digital environment, professional artists apparently do not. If intermediaries were redundant, then artists would avoid them (why give up money for nothing?) and be successful when doing so. Neither prediction is supported. There is little evidence showing that independent unsigned artists in the music market, who could feasibly bear recording and online distribution costs, experience success in reaching listeners directly without the assistance of a major label's marketing infrastructure. Copyright skeptics sometimes point to current star popular artists like Justin Bieber, who initially garnered attention through a YouTube video, or Adele, who is represented by an independent label, to "demonstrate" that the support of a major label is unnecessary. But even that anecdotal evidence is faulty: those artists were subsequently signed by, or indirectly contracted with, major record labels, who provided the necessary marketing,

¹⁴¹ See Elberse, *supra* note __.

distribution and tour support to catapult these artists to stardom.¹⁴² While there exist digital services that enable unsigned artists to distribute music directly through iTunes or other digital downloading or streaming sites, these almost never provide a meaningful stand-alone income source.¹⁴³ Even a contemporary star artist who had previously elected to operate without a label later elected to return to label sponsorship in order to enjoy the label's marketing expertise and other support services.¹⁴⁴ Consistent with this behavior, trade commentators almost consistently recommend that individual artists retain the promotional, distribution and other support services of a record label.¹⁴⁵ This is well-grounded advice: major-affiliated artists outsell artists affiliated with independent labels by a large margin.¹⁴⁶ If intermediaries were as redundant as some academic and popular commentators eagerly assert, then artists, who can freely choose to operate independently, would bypass them and be successful in doing so. Neither statement is true.

B. The Digital Challenge

There is an important objection to the foregoing argument. Let's adopt the proposition that any creative market, whether digital or physical, requires the services of

¹⁴² For multiple examples, see ROBERT LEVINE, *FREE RIDE* 51-53 (2011).

¹⁴³ See 99.9% of Tunecore Artists Make Less Than Minimum Wage, DIGITAL MUSIC NEWS, Nov. 23, 2011, avail. at <http://www.digitalmusicnews.com/permalink/2011/111123tunecore> (reporting that the average artist using Tunecore, a leading online music distribution service, earns \$179 per year and 99.875% earn revenues equating to less than the minimum wage). This information should be qualified by the fact that artists could be earning revenues through other sources; however, it appears to be consistent with recurrent statements in online and trade commentary concerning the paltry income earned by artists through online self-distribution services.

¹⁴⁴ Trent Reznor: *And Then I Realized, I Needed My Major Label Back*, Digital Music News, Oct. 17, 2012, avail. at <http://www.digitalmusicnews.com/permalink/2012/121017fragmented>.

¹⁴⁵ See GORDON, *supra* note __, at 188 (interview with independent label executive) and 252 (interview with artist manager stating that a major is required to secure radio play) and 278 (interview with president of independent record label); see also MIKE KING, *MUSIC MARKETING* 153 (2009) (stating that funding a commercial radio campaign can cost approximately \$500,000 and is therefore beyond the budget of an individual artist). For similar views, see *Behind the music: is the A&R era over?*, The Guardian, avail. at <http://www.guardian.co.uk/music/musicblog/2011/jan/27/behind-music-industry-a-r>; Geoff Taylor, Chief Executive of BPI (British recorded music industry association), *The role of record labels in the digital age*, July 9, 2008, avail. at <http://www.bpi.co.uk/press-area/news-amp3bpress-release/article/the-role-of-record-labels-in-the-digital-age-7c-bpi-speech-20th-june-2008.aspx>.

¹⁴⁶ See Robert G. Hammond, *Profit Leak? Pre-Release File Sharing and the Music Industry* 16 (Working Paper 2012).

a dominant intermediary to direct and cultivate the consumption choices of uninformed consumers, which reduces the marketing burden that would otherwise be borne by individual artists. It *might* then be concluded that strong copyright is required to enable intermediaries to recoup the capital investment invested, and the risk undertaken, in screening, distributing and marketing cultural goods on a mass scale. But this formulation is too strong. Precisely stated, this argument can only safely assert that copyright is a necessary precondition for the ability of *conventional* intermediaries to earn a sufficient return so as to fund screening and marketing efforts (and, in applicable market segments, fund production and distribution costs that cannot be borne at a lower cost by an individual artist). Conventional intermediaries share a common transactional structure: namely, they all earn returns directly on the *stand-alone* delivery of creative works, to which access is carefully regulated. But there may be other transactional structures that could bear those costs and risks even in the absence of copyright. Given that there is no intrinsic social interest in preserving the book publisher, studio or record label as the dominant intermediary types in mass-cultural markets, even this limited proposition provides a weak ground for robust copyright in a digital environment.¹⁴⁷ Both new and old cultural markets evidence the possibility that the core set of intermediation functions—screening, production, distribution and marketing—can sometimes be feasibly carried out by entities that do not rely on the stand-alone delivery of cultural goods to earn the revenue required to support those activities. These alternative models all share a common *bundled* structure that partially or entirely forfeits access to a cultural good but more tightly regulates access to a complementary excludable good. In particular, two “giveaway” structures are observed in cultural and other intangible goods markets.

1. *Two-Sided Giveaway Models*

Some entities rely on a two-sided market model in which a cultural good is given away to a certain population of end-users while access to an excludable good is provided at a positive cost to another population of users. This is illustrated by the left-hand side

¹⁴⁷ This point is emphasized by Mark Lemley, *Is the Sky Falling on the Content Industries?* 9 J. TELECOMM. & HIGHTECH. L. 125 (2011) [hereinafter Lemley, *Is The Sky Falling*].

of the Figure below. This model will be viable whenever the value of the excludable complementary good is increasing as a function of the number (or quality) of the consumers of the giveaway cultural good. This is the familiar advertising-based model used historically by broadcast television, used (in modified form) by the newspaper and magazine industry (which only recover a minority of costs from sale prices charged to readers), and used currently by internet search engines (such as Google), video distribution sites (such as YouTube) and social networking services (such as Facebook), none of which assess positive charges for user access (other than the implicit positive in-kind charge incurred by knowledge users in the form of personal information) but charge positive charges for advertiser access to users. Note that all these viable giveaway models are only *partial* giveaway models: while access to the giveaway is unrestricted for individual end-users, access is restricted for intermediate users. That is: the ABC television network gives away its content to viewers but regulates access to that content by other networks or other distributors and producers of content.

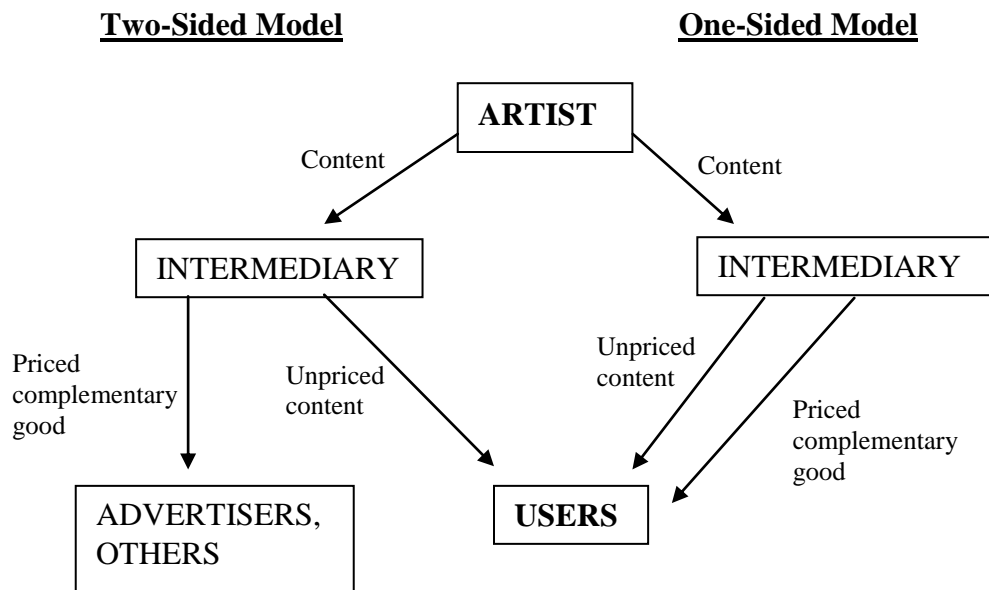
2. *One-Sided Giveaway Models.*

Some entities rely on a single-sided market model in which a cultural good is given away to a certain population but access to a complementary excludable good is provided to that same population at a positive price. This is shown on the right-hand side of the Figure below. Currently this model is used in the internet browser market, where entities such as Microsoft give away the browser application (among other applications) in order to incentivize sales of the operating system in which it occupies a dominant position. The same model is used in the open-source software market, where firms such as IBM subsidize the production and maintenance of zero-priced operating system and software platforms (such as Linux) in order to incentivize the sale of hardware products in which they hold a dominant position.¹⁴⁸ Yet another example is the portable media player device market, in which digital music is either distributed at a zero price (in the pirated market) or sold at a “below-market” price, which enhances the value of the hardware product in which the manufacturer (e.g., Apple) holds a dominant position.

¹⁴⁸ See Ronald Mann, *The Commercialization of Open Source Software: Do Property Rights Still Matter?*, 20 HARV. J. L. & TECH. (2006); Jonathan Barnett, *The Host’s Dilemma: Strategic Forfeiture in Platform Markets for Informational Goods*, HARV. L. REV. (2011).

The revenue-capture mechanism in all these markets is the same. Even without any technological or legal protection against unauthorized usage of an informational asset, the intermediary retains an incentive to produce, distribute and market those assets if doing so sufficiently enhances revenues on sales of a complementary asset over which the intermediary can assert exclusivity.

Figure II: Alternative “Giveaway” Models for Cultural Distribution



C. The Revised Intermediary-Based Case for Copyright

Clearly the stand-alone unbundled model of intermediation is not the only feasible model for supporting the functions typically executed by conventional intermediaries in mass cultural markets: production, distribution, marketing and financing of all of the foregoing tasks. A broader discussion must include the “semi-open” models that have prevailed for decades in the radio and broadcast television markets and also achieved wide dissemination and robust funding of cultural goods. However, the heterogeneity of transactional structures in content markets must be correctly interpreted. The fact that cultural markets have sometimes relied successfully on open (or, more precisely, semi-open) delivery structures has often been used to contest the economic necessity for

copyright. But the mere fact that a particular cultural market has devised (or could theoretically devise) alternative mechanisms by which an intermediary can capture returns through alternative mechanisms in the absence of copyright does not mean that those are the most efficient mechanisms by which to do so. Hence, just because 19th-century U.S. publishers could earn returns on British bestsellers by first-to-market advantages that created a time-limited technological barrier to entry (a famous example cited by then-Professor, now-Justice Breyer¹⁴⁹) does not support the conclusion that those alternative means for establishing exclusivity are an equivalent or superior mechanism relative to copyright. Or, to take a modern example: just because musicians can earn *some* income from live performance does not support the conclusion (as argued by Justice Breyer in his concurrence to the Supreme Court's decision in *MGM v. Groskter*¹⁵⁰) that significantly disabling copyright protections over recorded music results in no harm. The very absence or weakness of copyright protection in those environments precludes making any such assertion because it does not offer market participants the opportunity to elect to waive copyright and adopt an alternative bundled or other product-delivery arrangement.

Viability should not be confused with optimality. The mere feasibility in some cultural markets of funding models that do not rely on maintaining exclusivity on a cultural good modifies, but does not contest, the intermediary-based case for copyright as a precondition for efficient investment in cultural production and distribution. The existence of those alternative models certainly precludes any *strong* proposition that copyright is a necessary condition for supporting intermediation efforts in all mass cultural markets. In response, a *weak* proposition could be adopted: namely, copyright is only a necessary condition for unbundled stand-alone models of cultural intermediation. That would relegate the intermediary-based case for copyright to a historical account of pre-digital mass-cultural markets or a market-specific account of certain mass-cultural markets that impose production, distribution and marketing costs that cannot be feasibly recovered through unbundled delivery mechanisms. But we can safely go further. The co-existence of open, semi-open and closed intermediation models across different

¹⁴⁹ See Breyer, *supra* note __.

¹⁵⁰ 545 U.S. 913, 961-62 (2005) (Breyer, J., concurring).

cultural markets, or even within the same market, supports a *semi-strong* intermediary-based case for copyright. Namely: *in the absence of a cost-comparable technological substitute, copyright (or some form of intellectual property) is necessary to support the efficient selection of intermediation mechanisms in mass cultural markets.*

The reasoning is as follows. *A priori* we have no information by which to evaluate whether the closed intermediary, such as cable television, satellite radio, a record label or movie studio, has superior capacity to evaluate creative content and cultivate the choices of consumers, as compared to a semi-open intermediary, such as broadcast television, terrestrial radio, or a search engine. A legislator, judge or other policymaker has little to no information by which to select efficiently among the possible set of transactional forms—both because the total set of forms is unknown and, even if it were known, the efficient member of that set would be unknown. The fundamental social value of strong copyright lies in the fact that it is transactionally agnostic: that is, it enables market participants to select through the force of competition, and the trial-and-error of experimentation, the most efficient transactional structure for the generation and delivery of creative content.¹⁵¹ Strong copyright is a predicate condition for the viability of closed intermediaries, which rely on the secure protection of content as a stand-alone good, *and* does not preclude any other forms of intermediation, since any intermediary can elect to give away content in order to promote sales of a complementary good. As Prof. Robert Merges has emphasized, intellectual property rights merely provide the *option* to assert exclusivity over the underlying pool of intellectual goods through legal instruments.¹⁵² That option is often declined. To take one example: since 2007, all major record labels have lifted or relaxed “DRM” copy-restrictions on musical tracks distributed as permanent downloads through online retailers such as Amazon and iTunes.¹⁵³ That decision effectively grants users the right to make unlimited (or, depending on the terms of the sale, substantially unlimited) copies of any single musical

¹⁵¹ This applies an argument I have made elsewhere with respect to intellectual property in general, with an emphasis on the patent system. See Jonathan M. Barnett, *Intellectual Property as a Law of Organization*, S. CAL. L. REV. (2011).

¹⁵² See Robert P. Merges, *A New Dynamism in the Public Domain*, 71 U. Chi. L. Rev. 183 (2004).

¹⁵³ iTunes offers DRM-free downloads through its higher-priced “iTunes Plus” option. See “iTunes Stores: iTunes Plus Frequently Asked Questions (FAQ)”, avail. at <http://support.apple.com/kb/ht1711>.

track purchased through an online retailer and forfeits some of the protections for which the labels had lobbied in achieving inclusion of the “anti-circumvention provisions” of the Digital Millennium Copyright Act of 1998.¹⁵⁴

Strong copyright provides nothing more than the *option* to incur the costs required to enforce the relevant entitlement at a certain likelihood of success. By contrast, a weak copyright system *compels* giveaway strategies, limits the feasible set of intermediation mechanisms and, as a result, potentially distorts the efficient selection of intermediation mechanisms by compelling the market to deviate away from the least-cost mechanisms for distributing content to a mass audience. This effect is most clearly illustrated in the popular music market, which has undergone an extended natural experiment on the effects of withdrawing copyright since the launch of the Napster file-sharing service in 1999. Given the accessibility of zero-priced digital music, the effective ability of copyright holders to extract revenues on cultural production and distribution through the stand-alone delivery of recorded music, whether in physical or digital form, is significantly constrained.¹⁵⁵ As a result, artists and intermediaries must extract revenues primarily through live performance.¹⁵⁶ But live performance is almost certainly a less efficient means by which to capture revenues on musical production¹⁵⁷: (i) it has limited economies of scale given the significant “one-off” expenditures involved in any given concert tour or other performance; (ii) it has limited risk-diversification capacities given the inherent constraints on the number of live-performance venues and the number of

¹⁵⁴ See S&P REPORT, *supra* note __, at 6. For other examples of waivers in the online context, see Robert P. Merges, *The Concept of Property in the Digital Era*, 45 HOUS. L. REV. 1239, 1267 (2008).

¹⁵⁵ According to a leading online data tracking firm, Big Champagne Media Measurement, unauthorized downloads represent about 90% of the total digital music market. See David Goldman, *Music's lost decade: Sales cut in half*, CNNMoney, Feb. 3, 2010, avail. at http://money.cnn.com/2010/02/02/news/companies/napster_music_industry/.

¹⁵⁶ It might be argued that the vast majority of artists never received significant royalties on the sale of recorded music, and therefore always principally obtained revenues through live performance. But this ignores the fact that, even if the sale of recorded music did not directly benefit a performing artist through royalty payments, the intermediary supplied an up-front cash advance and engaged in promotional efforts to sell records, which increased the artist's visibility and indirectly promoted the sale of tickets to live performance events. Without significant revenues from recorded-music sales, the incentive to make those promotional efforts disappears.

¹⁵⁷ Only a handful of commentators have expressed skepticism with respect to the viability or optimality of a performance-based funding model for the music market (in part for the reasons stated above), see Schultz, *Live Performance*, *supra* note __; Day, *supra* note __.

performances that can be held at those venues; and (iii) it has limited price-discrimination opportunities given the inherently “lumpy” quality of a live performance.¹⁵⁸ Evidence to date suggests that consumer welfare in some market segments may be adversely affected: while recorded music is widely accessible at a zero price (from an economic point of view, a social gain in the short term), the live performance market has experienced continued increases in ticket prices and declines in output¹⁵⁹ while showing an extreme skew in the distribution of revenues toward older star performers who accumulated brand capital under the formerly robust copyright regime.¹⁶⁰

These arguments, and supporting evidence, should not be understood to mean that there is an irrefutable efficiency case for copyright or the strongest forms of it. But it does suggest that degrading copyright protection, in the absence of cost-comparable technological substitutes, can leave a transactional gap that degrades the market’s ability to screen and market new talent—precisely in an environment in which content is

¹⁵⁸ Note that price discrimination strategies not only maximize a distributor’s profits but, under certain circumstances, benefit consumers, and in particular lower-income consumers, by permitting the distributor to segment a creative work into bundles tailored for the preferences, valuation and budget constraints of different consumer populations. If an intermediary is unable to price-discriminate sequentially-released versions of the same creative work, it will rationally increase prices at the sole exclusive point of initial distribution—namely, the point of first release—in order to capture the “missing” revenue in the forfeited remainder of the distribution chain.

¹⁵⁹ From 1996 through 2008, the average ticket price for the top 100 musical tours increased by 90% on an inflation-adjusted basis and increased the most for the average high-price ticket (an increase of 10.7% annually during 1996-2003). See Aaron Silvenis, *Live Aid? Assessing the Ability of the TicketMaster-Live Nation Consent Decree to Restore Competition Levels in the Primary Ticketing Market*, American Antitrust Institute Working Paper, Apr. 14, 2011; see also Alan B. Krueger, *The economics of real superstars: The market for concerts in the material world*, 23 J. LABOR ECON. 1 (2005). From 2008 through 2011, the average ticket price continued to increase (jumping 13.6% just from 2010 to 2011), with average ticket prices for the most popular events approaching \$100, even though the number of popular music concerts and the total number of tickets sold continued to decline, and overall revenues continued to increase, all during a severe economic recession. See Zack O’Malley Greenburg, *Live Music in 2011: Revenues Up, Attendance Down*, Forbes.com, Jan. 6, 2012.

¹⁶⁰ Superstar status in the live-music market correlates inversely with age: the overwhelming percentage of elite concert performers is constituted by older acts who established their reputations several decades earlier—in virtually all cases, sometime prior to the 1980s. See Jillian Cohan, *The Show Must Go On*, THE AMERICAN, March/April 2008, avail. at <http://www.american.com/archive/2008/march-april-magazine-contents/the-show-must-go-on>. If we consider the top 20 grossing U.S. tours during the period 2000-09, 94% of the time the lead singer was over age 40, there were *no* artists under age 30, and only one of the acts released their first album in 2000 or later. See DELOITTE, TECHNOLOGY, MEDIA & TELECOMMUNICATIONS PREDICTIONS 2011, at p.30.

abundant because production and distribution costs are so low.¹⁶¹ Certainly, a complete welfare analysis must take into account all countervailing social costs—mostly, deadweight losses and transaction-cost burdens¹⁶²—that may recommend against any particular temporal or spatial extension of copyright. The semi-strong case for copyright is more modest. Without copyright or some other robust and cost-effective legal or technological barrier against unauthorized replication of cultural content, there can be no assurance that the market has converged on the most efficient mix of intermediation mechanisms for identifying content and delivering it to market. The reason is simple: copyright-deprived markets operate under a restricted range of intermediation mechanisms that omits all stand-alone “closed” forms of cultural distribution. It is true that there is no social interest in preserving unbundled “Old Media” models of recovering the costs of cultural production, distribution and marketing; but it is also true that there is no social interest in disadvantaging those models in favor of bundled “New Media” models.

Conclusion

Academic and judicial discussions of copyright typically proceed on the assumption that copyright’s principal justification lies in the incentives it provides to potential creators to invest resources in cultural production. That rationale is subject to the objection that a purely utilitarian model does not fit the behavioral profile of artists who have intrinsic incentives to engage in artistic production and do not require significant capital to do so. Even accepting this tenuous objection, the copyright regime is soundly

¹⁶¹ For contrary empirical arguments that the production of new music has been constant or increased since the advent of the internet, even taking into account any potential changes in “quality”, see Waldfogel, *Bye, Bye*, *supra* note __; Waldfogel, *Digital Disintermediation*, *supra* note __.

¹⁶² There is one other important social cost to any increase in copyright strength: namely, copyright may “overcorrect” the market failure endemic to public-goods environments, resulting in socially excessive allocations of resources to creative activity. For the leading modern analysis of this problem, see Glynn S. Lunney, Jr., *Reexamining Copyright’s Incentives-Access Paradigm*, 49 VAND. L. REV. 483 (1996). While the overinvestment contingency cannot be excluded, it is important to compare that state of affairs with the hypothetical state of affairs that would prevail under a regime in which copyright were entirely absent or significantly reduced. In that case, even more severe *under*production effects may occur, which suggests that, even if copyright does induce some overproduction effects, a robust copyright regime that blocks unauthorized third-party usage may still support the most efficient allocation of resources to creative activity relative to any other feasible state of affairs. At a minimum, the point remains empirically unresolved.

justified as a means by which to support the intermediaries that most efficiently supply the suite of production, distribution and marketing services require to achieve broad dissemination in mass cultural markets. Unlike an individual artist, intermediaries are clearly profit-motivated and must always bear significant costs and risks to deliver creative goods to a mass audience. Elucidating the economic rationale behind copyright, and the socially valuable role it has played in supporting the intermediaries that operate the distribution and financing infrastructure behind mass cultural markets, clarifies the role of copyright in cultural markets that have been transformed by low-cost and high-quality digital copying and transmission technologies. Given the inherent intermediation of well-functioning mass-cultural markets that produce rich and difficult-to-evaluate stocks of creative content, the economic case for copyright survives even in markets where there exist viable—but not necessarily optimal—mechanisms for securing returns on cultural production without the access controls supplied by copyright or technological substitutes. In particular, while production and distribution costs have fallen dramatically in some digitized cultural markets, screening and promotional costs persist, and may have even increased, thereby necessitating the continued intervention of an intermediary that can spread those costs most efficiently across a diversified portfolio of creative releases. This is not to say that copyright is a necessary precondition for reasonable levels of cultural output. Rather, copyright rests on a more subtle rationale: it is a precondition for enabling cultural markets to select the most efficient intermediation structures for screening, producing, delivering and marketing cultural works to a mass audience.