

NOTES

CONTRACTING OUT OF THE ORPHAN WORKS PROBLEM: HOW THE GOOGLE BOOK SEARCH SETTLEMENT SERVES AS A PRIVATE SOLUTION TO THE ORPHAN WORKS PROBLEM AND WHY IT SHOULD MATTER TO POLICY MAKERS

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I. INTRODUCTION

On October 28, 2008, Google reached a settlement agreement (currently pending final approval of the court) with authors and publishers in two related class action lawsuits against Google over its use of copyrighted works in Google Book Search.¹ The settlement will enable Google to incorporate out-of-print works into Google Book Search without requiring the express permission of the authors or publishers.² Under the settlement, Google will pay \$125 million, \$34.5 million of which will be used to establish a “Book Rights Registry.”³ The Registry will work as a middleman between users (such as Google) and copyright holders to ensure that copyright holders get paid for the use of their books.⁴ It will actively search for and identify copyright holders for existing out-of-print books.⁵

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¹ See Proposed Settlement, *Authors Guild v. Google Inc.*, No. 05 CV 8136 (S.D.N.Y. filed Oct. 28, 2008), available at http://www.googlebooksettlement.com/r/view_settlement_agreement [hereinafter Settlement]. This settlement agreement would also settle the related publisher lawsuit, *McGraw-Hill Cos. v. Google, Inc.*, No. 05 CV 8881 (S.D.N.Y. complaint filed Oct. 19, 2005). Just prior to publication of this Note, the fairness hearing scheduled for October 7, 2009 was delayed, at the request of the plaintiffs, to allow time for the parties to negotiate modifications to the settlement agreement. See Tom Krazit, *Google Books Hearing Officially Delayed*, CNET NEWS, Sept 24, 2009, http://news.cnet.com/8301-30684_3-10361232-265.html. This request was made shortly after the U.S. Department of Justice filed a Statement of Interest with the court describing its views regarding the proposed settlement. See also Statement of Interest of The United States of America Regarding Proposed Class Settlement, *Authors Guild v. Google Inc.*, No. 05 CV 8136 (S.D.N.Y. filed Sept. 18, 2009), available at <http://thepublicindex.org/docs/letters/usa.pdf>.

² Settlement, *supra* note 1, at §§ 3.2, 3.3.

³ Settlement, *supra* note 1, at art. V.

⁴ Settlement, *supra* note 1, at art. VI.

⁵ *Id.*

Its function will be similar to performance rights organizations like the American Society of Composers, Authors and Publishers (“ASCAP”) in the music industry.⁶

Meanwhile, on Capitol Hill, legislation was proposed last year to address what is known as the “orphan works problem.”⁷ “Orphan works” are in-copyright works without a readily locatable rightsholder. Since copyright protection is now both automatic and very long in duration, the number of orphan works is very large. The prospect of either high money damages or an injunction deters would-be users of orphan works from making productive use of them. Thus, publishers, museums, or filmmakers, wanting to republish, exhibit, or use an orphan work, may refrain from doing so in light of the possibility of large statutory fines for copyright infringement and the possibility of an injunction after a large initial investment. In many cases, the copyright holders of orphan works either do not exist or would not object to the use of their works, and potential users are unable to use the orphan works merely because of their inability to locate the copyright holder.⁸

The orphan works legislation proposed last year would drastically reduce any potential liability for users of orphan works if the user performed a “reasonably diligent search” for the copyright owner prior to using the work, and attributed the work to the copyright owner where possible and appropriate.⁹ The goal of the limitation on remedies is a combination of reducing the inefficiency of users being unable to transact with the copyright holders of orphan works, while at the same time offering as much protection to existing copyright holders as possible from potential exploitation of the relaxed rule by users.¹⁰

The Book Rights Registry, however, serves as a shining example of the market solving the orphan works problem on its own, without any new legislation. Google will be able to make efficient use of in-copyright, out-of-print works without the need to negotiate directly with the rightsholders of the orphan works. The Registry will collect licensing revenue from Google for the use of orphan works, locate the rightsholders, and distribute the revenue to the rightsholders as royalties. Google will no longer bear the high transaction costs of finding and bargaining with the copyright holders of orphan works.

Current copyright laws, which impose large penalties on unauthorized uses of copyrighted material, create a strong incentive for private organizations to find their own way around the orphan works problem by

⁶ See Mike Musgrove, *Google Settles Publishers' Lawsuit Over Book Offerings*, THE WASHINGTON POST, Wednesday, October 29, 2008, at D1, available at http://www.washingtonpost.com/wp-dyn/content/article/2008/10/28/AR2008102803611_pf.html.

⁷ Orphan Works Act of 2008, H.R. 5889, 110th Cong. (2008) [hereinafter Orphan Works Act], available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:h5889ih.txt.pdf.

⁸ See STATEMENT OF MARYBETH PETERS, REGISTER OF COPYRIGHTS, BEFORE THE SUBCOMM. ON COURTS, THE INTERNET, AND INTELLECTUAL PROPERTY OF THE H. COMM. ON THE JUDICIARY (Mar. 13, 2008), available at <http://www.copyright.gov/docs/regstat031308.html>.

⁹ Orphan Works Act.

¹⁰ See Marybeth Peters, Register of Copyrights, *The Importance of Orphan Works Legislation*, <http://www.copyright.gov/orphan/>.

forming collective rights organizations (“CROs”). The Book Rights Registry is the latest example of this, and the first major example of it in the realm of books. In light of the formation of the Book Rights Registry, I would caution Congress that any relaxation of strong copyright would weaken the incentives for private organizations to create CROs of this sort. The orphan works legislation proposed last year would change a strong property rule regime into a judicial liability rule regime with respect to orphan works, thus reducing the incentives for market participants to form CROs. While the scope of this note is limited to the market for books, only time will tell whether other markets present similar opportunities for the creation of CROs. Therefore, my advice to Congress is to wait and see. Instead of altering copyright law, see if the orphan works problem can be solved in the market through the formation of CROs.

II. PROPERTY RULES, LIABILITY RULES, AND THE BALANCE OF TRANSACTION COSTS AND INCENTIVES

The focus of this Note is on post-grant modifications to intellectual property rights (“IPRs”). The proposed Orphan Works Act and the Google Book Search settlement are two such modifications. In order to effectively discuss these post-grant modifications, a discussion of the initial grant of property rights, of characterizing liability and property rules, and of the significance of transaction costs and incentives is necessary. The following sections lay out the basic theory upon which my argument will rest.

A. PUBLIC VS. PRIVATE ORDERING

The government is not the only actor that can grant initial entitlements of IPRs. While it is most common for a government to initially grant property rights, private organizations can, and have, created and enforced IPRs without any initial government grant. A classic example of this is the fashion guilds of the 1930s.¹¹ While fashion design was (and remains) unprotected under both copyright and patent law, in 1933 firms in the fashion industry took matters into their own hands and organized the Fashion Originators’ Guild of America (“FOGA”) in order to curb what they considered to be “style piracy.”¹² Style piracy was the common practice of manufacturers systematically copying the garment designs of other manufacturers after they had been released on the market.¹³ FOGA protected the original designs of its members by collectively boycotting stores that sold garments that were deemed to be knock-offs of its members’ own designs.¹⁴ FOGA established a “Design Registration Bureau” to keep track of its members’ designs, and red-carded retailers who sold copies of registered designs.¹⁵ The organization wielded substantial market power, and enjoyed considerable success in enforcing its

¹¹ See Robert P. Merges, *Contracting into Liability Rules: Intellectual Property Rights and Collective Rights Organizations*, 84 CALIF. L. REV. 1293, 1363 (1996).

¹² See *Fashion Originators’ Guild of America v. Fed. Trade Comm’n*, 312 U.S. 457, 461 (1941).

¹³ *Id.*

¹⁴ *Id.* at 461–62.

¹⁵ *Id.*

protections while it lasted.¹⁶ In 1941, however, FOGA's reign ended abruptly when the Supreme Court held it to be per se illegal on antitrust grounds.¹⁷

While FOGA served as an example of a completely privately created IPR, in the United States this is the exception, not the norm. The Constitution grants Congress the authority "[t]o promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries."¹⁸ Under this grant of power, Congress enacted the copyright and patent laws. It should be noted that the purpose of IPRs in the United States is not to protect the natural rights that creators have in their works; rather, IPRs are granted for the purposes of incentivizing invention and innovation for the benefit of the public at large.¹⁹ This is accomplished by using IPRs to internalize externalities.

B. INTERNALIZING EXTERNALITIES AND INCENTIVIZING INNOVATION

Property rights, at their core, can be conceptualized as an internalization of externalities. Externalities are, in short, the various positive and negative effects resulting from an activity. Where the external costs and benefits of an activity are not borne by those engaging in the activity, this can lead to two types of situations referred to as "tragedy of commons." The first type occurs when there is a failure to internalize negative externalities, such as pollution, which leads to the overuse of a resource. No ownership of a lake, for example, will lead to overfishing as no individual fisher has an incentive to conserve the scarce resource of fish in the lake. A related, yet distinct, form of tragedy of commons occurs when the lack of internalization of the benefits of an activity leads to underinvestment in the activity. This second form of tragedy of commons is the one that is most applicable to IPRs. As an example, if writers cannot reap any reward from novels they have written, then writers will have little incentive to write novels in the first place. A copyright gives a writer the right to sell her book and to prevent others from making unauthorized copies of it. Thus, a main concern for any intellectual property ("IP") regime should be the incentive effect it will have on producers of IP. But the creation of incentives to investment must be balanced alongside the transaction costs that come along with the IPR.

¹⁶ *Id.*

¹⁷ *Id.* at 467-68.

¹⁸ U.S. CONST. art. I, §8, cl. 8 (granting Congress the authority to enact patent and copyright laws).

¹⁹ *United States v. Paramount Pictures*, 334 U.S. 131, 158 (1948) ("The copyright law, like the patent statutes, makes reward to the owner a secondary consideration.... 'The sole interest of the United States and the primary object in conferring the monopoly lie in the general benefits derived by the public from the labors of authors.'" (quoting *Fox Film Corp. v. Doyal*, 286 U.S. 123 (1932)).

1. *Property Rules vs. Liability Rules*

Once an initial legal entitlement has been granted, it can be protected by either a property rule or a liability rule.²⁰ Property rules give owners the right to exclude others from using their property without first gaining express permission.²¹ Users must therefore bargain for permission from the owner before using the property if a property rule is in place. Liability rules, sometimes described as “take now pay later,” permit users to use an owner’s property, but require that the user later compensate the owner for the use.²² Liability rules thus eliminate the need for users to bargain for the use of the owner’s property.

For a simple example of the difference between liability and property rules, imagine a smokestack factory operating next to a small town. The factory blows thick clouds of smoke into the town, much to the annoyance of the 1000 residents. An initial entitlement of the right to pollute could be given to the factory, or an initial entitlement of the right to clean air could be granted to the townspeople. This entitlement could be protected by either a property rule or a liability rule. The four possible entitlements are as follows: first, a property rule in favor of the factory would give the factory the right to emit smoke into the town; second, a property rule in favor of the townspeople would give the townspeople the right to clean, smoke-free air, and the factory must stop polluting; third, a liability rule in favor of the factory would give the factory the right to emit smoke into the town as long as it pays the town reasonable compensation for the decrease in value of the air; fourth, a liability rule in favor of the townspeople would give them the right to have clean air so long as they pay reasonable compensation to the factory for the forgone pollution-generating business.

2. *Transaction Costs*

Ronald Coase theorized that whichever type of right is granted, in the absence of transaction costs, the most efficient outcome will be achieved by private bargaining between the parties after the initial grant of the right.²³ The most efficient allocation of property rights is achieved where each holder of a right is the party that most highly values that property right. If a right is initially awarded to a party who values it less than another party, then the party placing a higher value on the right will pay the current right holder in exchange for the right. Thus, absent transaction costs, it is unimportant which party receives an initial entitlement of a right because the parties will bargain to an efficient outcome.²⁴ This theory can be simply demonstrated using the above factory example. Assume that the townspeople were granted a right to clean air protected by a property rule.

²⁰ See Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1105–10 (1972). Calabresi and Melamed also discuss a third type of rule, called an inalienability rule, where the transfer of the right from a willing seller to a willing buyer is prohibited. Inalienability rules are substantially different from property and liability rules, and are not discussed in this Note.

²¹ See *id.* at 1105–06.

²² See *id.*

²³ See generally R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960).

²⁴ See *id.*

If the pollution generating business is more valuable to the factory than clean air is to the townspeople, the factory will pay the townspeople for the right to pollute. Similarly, assume the factory is granted a right to pollute protected by a liability rule. If the townspeople value clean air more than the factory values its right to pollute, the townspeople would get together and pay the factory to stop polluting. Either way, the most efficient outcome is reached by private bargaining.

Of course, in reality, there are always transaction costs. Transaction costs are costs that a party incurs in bargaining for the exchange of a right.²⁵ In the above factory example, in order for the townspeople to pay the factory to stop spewing smoke, they must all get together and come to an agreement as to how much to pay the factory. This could be costly, time consuming, and difficult, especially if different townspeople value clean air at different rates. Additionally, each townspeople will have an incentive to pay less than her fair share to stop the factory from polluting while nevertheless reaping the benefits of clean air. This is known as the free rider (or freeloader) problem.²⁶ In the opposite situation, if the townspeople are given the right to clean air, but the factory values polluting more, then the factory must communicate and negotiate with each individual townspeople for the right to pollute. Here, each individual townspeople will have an incentive to holdout on a deal with the factory and demand a higher fee. This is known as the holdout problem.²⁷ The holdout problem and the free rider problem can add significant transaction costs, potentially preventing a transaction from occurring.²⁸ In order for a transaction to take place, the difference between the values that the parties place on the right must be large enough to include the transaction costs associated with the transaction.²⁹ Thus, where transaction costs are significant, a transfer of rights may not be realized, inhibiting the parties from achieving the most efficient allocation of rights.³⁰

C. INTELLECTUAL PROPERTY RIGHTS AND THE BALANCE OF INCENTIVES AND TRANSACTION COSTS

While a primary goal of granting intellectual property rights is to incentivize innovation and investment, a large number of strong fragmented rights can lead to high transaction costs resulting in inefficiency. A balance must be struck to maximize incentives and minimize transaction costs in the market. The situation where too many strong fragmented property rights leads to inefficiency is the opposite situation of the tragedy of commons described above, and is referred to by Professor Michael Heller as the “tragedy of the anticommons.”³¹

²⁵ *See id.*

²⁶ *See* Calabresi & Melamed, *supra* note 20, at 1006–07.

²⁷ *See id.*

²⁸ *See id.*

²⁹ *See generally* Coase, *supra* note 23.

³⁰ *Id.*

³¹ MICHAEL HELLER, *THE GRIDLOCK ECONOMY* 2 (2008).

1. *The Tragedy of the Anticommons*

A classic illustration of the anticommons offered by Heller is the Rhine River trade route during the Middle Ages.³² Under the reign of the Holy Roman Emperor, the Rhine was an efficient trade route for merchant ships.³³ Ships would pay a single toll for safe passage along the river. When the Holy Roman Empire weakened in the thirteenth century, German robber barons built castles along the river and demanded tolls from all ships that passed.³⁴ As the number of illicit toll booths increased, the cost of travelling down the river became too high to be worth it, causing merchants to cease travelling down the river altogether.³⁵

Just like the robber barons along the Rhine, IP can be thought of like water, and each new right that is created along a flowing river of commerce creates a new party with whom one navigating the IP area must bargain. Many small copyrights, for example, may together create a thicket of copyrights impeding someone that wishes to create a new work that cuts through the many existing copyrights. Additionally, there can be a significant holdout problem because each individual rightsholder has an incentive to hold out and demand a higher fee. The sheer number of different rightsholders that must be bargained with, together with the holdout problem, can prove too high a transaction cost to make investment worthwhile.

2. *Liability Rules as an Alternative to Fragmented Property Rights*

The problem of the high transaction costs associated with strong fragmented property rights has led some scholars to suggest that liability rules are generally preferable because of the reduction in transaction costs associated with them.³⁶ If a liability rule is in place, instead of having to bargain with each right holder, a predetermined fee can simply be paid for each license. If each robber baron along the Rhine were forced to accept a pre-set reasonable fee, perhaps merchants would continue to make the trip. If each holder of a copyright was forced to allow any user to use her work in a collection for a reasonable fee, she could no longer be able to hold out and demand a higher price.

However, while liability rules can effectively reduce the transaction costs of bargaining with multiple parties, it can also have extremely detrimental effects on incentives if the underlying property is not valued properly. In addition, IP is different in a very important respect from other types of property entitlements: IP can be used by multiple users at the same time.³⁷ As a result of this peculiar characteristic of IP, if the price of a right under a liability rule regime is set too low, there is no way for the rightsholder to buy-out potential users if the rightsholder values the IPR

³² *Id.* at 3.

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Merges, supra* note 11, at 1303–04.

³⁷ *Id.* at 1304. This is why, as stated above, there is no real concern about a tragedy of commons I situation in IP, because IP is not used up when one user uses it. *See supra* Part II.B.

higher than the set rate under the liability rule since there can be an unlimited number of potential infringers or users of an IPR. To illustrate this, in the factory example above, if the factory was given the right to pollute subject to paying the townspeople a set rate for the pollution it caused, the townspeople could potentially pay the factory to stop polluting if they valued clean air higher than the factory valued the right to pollute. However, if there were an infinite number of factories that could exist on that same piece of land at the same time, and word got out that the townspeople were paying firms to stop polluting, then an endless stream of firms would line up and attempt to pollute in order to extract payment from the townspeople. This bizarre situation in the factory example is the norm in IP. For example, if there was a liability rule setting the price of a digital book at five dollars, and the copyright holder of the book valued it at fifty dollars, it would be impossible for him to extract any more than five dollars for the digital copy of the book. Liability rules thus effectively place a ceiling on the price of a right. If the ceiling is placed too low, this will negatively affect incentives for investment.³⁸ On the other hand, if the price of a liability rule for an IPR is set too high, it will essentially function as a property rule, and the parties will privately bargain for a lower price.³⁹

D. MODIFICATION OF INITIAL ENTITLEMENTS: PUBLIC AND PRIVATE

Once an IPR has been initially granted, it is not static. The initial grant of the IPR can be modified via public or private ordering. An example of public modification of an entitlement would be legislation simply changing a property rule regime to a liability rule regime: allowing users to take from a right holder as long as compensation is paid later, determined either by a legislatively set fee schedule or by court determined reasonable compensation. Private institutions, however, can be created that accomplish this same shift from property rules to liability rules. Rightsholders can agree to give a CRO the right to license their works in exchange for compensation determined by the organization. This type of private ordering has several distinct advantages over both legislatively determined fee schedules and judicially determined damages regimes. The following section discusses these three methods of creating a liability rule regime and the costs and benefits associated with them.

III. METHOD OF VALUATION FOR LIABILITY RULE REGIMES

Under a property rule regime the valuation of each right is done at the point of transaction between the right holder and the user. Under a liability rule regime, however, rights are valued collectively. This collective valuation is generally performed by one of three institutions: the legislature (in the form of a statutory fee schedule), the judiciary (in the form of a remedy), or private parties (in the form of a CRO). A discussion of the pros and cons associated with each of these methods follows, focusing on the effect each has on 1) incentives, 2) transaction costs, and 3) valuation of the

³⁸ Merges, *supra* note 11, at 1306.

³⁹ *Id.*

right. The optimal balance of these factors is achieved when a private collective rights organization is used.

A. LEGISLATIVE VALUATION OF LIABILITY RULES

One form of valuation of IPRs under a liability rule regime is legislative valuation, by which Congress sets the rates for various rights and applies the rules mechanically.⁴⁰ Legislatures, however, are not an ideal fit for this task. For one thing, they are susceptible to lobbying.⁴¹ Moreover, although the initial rate set by the legislature for any given right may be an accurate valuation at that time, the values of IPRs are constantly changing, and legislatures are slow to respond to changes.⁴² Not only are statutes slow to change, but the organizations that benefit from the outdated rates have the opportunity to lobby Congress in an attempt to veto a readjustment of the rates.⁴³ A good example of the fixed nature of these legislatively enacted compulsory licenses is the two cent mechanical license for cover versions of songs, which remained at two cents per song from its enactment in 1909 through 1978.⁴⁴ Although the legislative compulsory license does effectively reduce transaction costs, it does so at the expense of incentivizing innovation. While the compulsory license is simple and inexpensive in its operation, a would-be creator will have a disincentive to create if her work will be subject to outdated undervaluation by a legislature.

In sum, legislatively valued liability rules, while reducing transaction costs, suffer from outdated undervaluation, and a corresponding negative impact on incentives.

B. JUDICIAL VALUATION OF LIABILITY RULES

A second form of valuation is a judicially administered regime, in which courts determine the values of rights. A user is allowed to use IP subject to paying the rightsholder reasonable compensation as determined by a court. A clear benefit of this type of regime over a legislatively determined compulsory license is that the rates are set at the time of each disputed transaction. Thus, the problem of rates becoming quickly outdated due to the legislature failing to continually adjust them is not a concern with a judicial regime. Furthermore, a court is not subject to lobbying in the way that a legislature is (although it is subject to persuasive lawyering). A judicial valuation regime therefore preserves to some extent the incentives to innovate by ensuring that the valuation is reasonably determined at the time of the transaction.

The biggest problem with a judicial regime is that it adds the potential of a new very high transaction cost: litigation. Litigation is costly, and in areas of IP that have a very high volume of sales, this cost will likely be

⁴⁰ Merges, *supra* note 11, at 1308.

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.* at 1313–14.

⁴⁴ *Id.* at 1309–11.

very substantial.⁴⁵ A judge will likely not be an expert in the particular market of the IP right at issue, thus a costly parade of experts are expected to educate the judge as to the appropriate valuation of the right.⁴⁶ Moreover, where many IPRs are needed as inputs by a user, the costs associated with potentially litigating each individual right could be overwhelming and effectively prevent the user from making the desired use.⁴⁷ Although a judicial regime limits the adverse incentive effects associated with an outdated legislative price schedule, it suffers from high transaction costs associated with litigation. Since this transaction cost includes the added burden on the courts, it is borne in part by society as a whole. Additionally, incentives are still reduced as compared to property rules since there is less control over the price one could charge for, say, an outstanding work—a court may not be convinced of its incredible value in the same way that an industry insider would.

In sum, judicially administered liability rules offer the potential of improved valuation over legislatively valued liability rules, yet they carry significant transaction costs of their own—litigation costs. Incentives are somewhat reduced, but not reduced as much as under a legislative liability rule regime.

C. PRIVATE VALUATION OF LIABILITY RULES

The third way in which liability rules can be administered is via private CROs. A CRO is a private organization that is voluntarily entered into by rightsholders and has the authority to license the rightsholders' works to users at rates set by the CRO. Since it functions at the transactional level much like a legislative liability rule, it drastically reduces transaction costs, especially where multiple IP inputs are needed by a user. Transactions are handled through the CRO, and the CRO takes on the responsibility of enforcing the rights. The rate schedule is set by the organization, which is made up of expert industry insiders, and unlike legislative fee schedules, the rates that CROs set for IPRs can be constantly updated by the organization. CROs are able to achieve an accurate valuation of rights and thereby maintain strong incentives to invest in the underlying IPR. While rightsholders have less control over the valuation of their works under a CRO than under a property rule regime, the drastic decrease in transaction costs, the expertly tailored valuation, and the shift of the burden of enforcing the right onto the CRO combine to make the CRO a very efficient liability rule regime.⁴⁸ For these reasons, CROs provide the optimal balance between reducing transaction costs and maintaining incentives for investment and innovation by having accurate valuation.

CROs, however, pose a unique problem that is not present in either legislative or judicial liability rules: they have the potential to function as monopolies and extract a surplus from users. If a single CRO is the only

⁴⁵ See Merges, *supra* note 11, at 1316–17.

⁴⁶ *Id.* at 1317.

⁴⁷ *Id.*

⁴⁸ See Merges, *supra* note 11, at 1326–27.

licensor of a right to users, and adequate substitutes for the right are not available, then that CRO could increase the price it charges to users and extract a significant surplus above that which could be had in a competitive market for the right. In this situation, while the rightsholders will still benefit from the reduced transaction costs, users of the right may be harmed by an increase in price under a monopolistic CRO. While each individual IPR already gives a monopoly right to its owner, a CRO could potentially gain a monopoly over a whole category of IPRs. For this reason, some CROs operate under government oversight in the form of a consent decree to guard against monopolistic practices.⁴⁹

Potential antitrust violations aside, a monopolistic CRO will be efficient where the gains from decreased transaction costs and accurate valuation are greater than the surplus the CRO extracts from users. Especially where government oversight is used to minimize the monopoly power of the CRO, the benefits of CROs still far surpass those of legislative and judicial liability rules in light of their optimal balance of transaction costs, valuation, and incentives.

D. CONTRACTING INTO LIABILITY RULES

Assuming that CROs are the most efficient and effective way for some industries to deal with the high transactional costs associated with IPRs, this begs an obvious question: what should a legislature do in order to encourage the formation of CROs? Since CROs are by definition private organizations, legislatures cannot create them. Legislatures can, however, maintain regimes that are conducive to the formation of CROs. Professor Robert Merges argues that maintaining strong property rights in industries where there are high volumes of repeat-player transactions will lead market participants to organize CROs.⁵⁰ He calls this process “contracting into liability rules.”⁵¹

Merges argues that the high transaction costs associated with property rule entitlements lead individual IPR holders into forming CROs.⁵² The CROs that emerge out of what were initially property rule regimes lower transaction costs while maintaining strong incentives and accurate valuation, resulting in a much more efficient system than the legislature could accomplish by instituting a compulsory license. Merges therefore suggests that instead of instituting compulsory licenses in an attempt to reduce high transaction costs, policy makers should exercise restraint, leave strong property rules in place, and allow CROs to form on their own.⁵³

In Part IV of this Note, I will describe a modern copyright phenomenon known as the “orphan works problem” and explain how modern copyright law led to this problem. In Parts V and VI of this Note I will take an in-depth look at two recent developments relating to the orphan works

⁴⁹ For example, ASCAP, discussed *infra* in Part VI.A.1, operates under a consent decree.

⁵⁰ See Merges, *supra* note 11, at 1296–97.

⁵¹ *Id.*

⁵² *Id.* at 1296.

⁵³ *Id.* at 1300.

problem: orphan works legislation proposed in Congress and the creation of a Book Rights Registry under the settlement in the Google Book Search litigation. In terms of the framework described above, the orphan works problem is a variety of anticommons. The proposed orphan works legislation is essentially a type of judicially enforced liability rule with respect to orphan works. The Book Rights Registry is a CRO. After describing these new developments, I will suggest why the proposed orphan works legislation would not be a good move by Congress, why it may actually reduce the incentives for industry participants to create CROs along the lines of the Book Rights Registry, and how the orphan works problem can serve as a catalyst for CRO formation.

IV. MODERN COPYRIGHT LAW AND THE ORPHAN WORKS PROBLEM

“Orphan works” are in-copyright works without readily locatable rightsholders. Revisions to copyright law under the Copyright Act of 1976 have led to a drastic increase in the number of orphan works and the size of what has become known as the “orphan works problem.” The following sections summarize the changes to the Copyright Act and the scope of the orphan works problem as it exists today.

A. LENGTHY COPYRIGHT TERMS & ABANDONMENT OF FORMALITIES

Copyright protection is now automatic and long in duration, however this was not always the case. Over the past century copyright has seen an expansion in duration, and a reduction in the formalities required for protection. The most substantial revisions to copyright law came about via the Copyright Act of 1976.⁵⁴ Under current law, authors are not required to register their works with the copyright office as a prerequisite of gaining copyright protection.⁵⁵ Prior to the 1976 Act, registration was required.⁵⁶ Currently, works gain protection from the moment they are “fixed in any tangible medium of expression,”⁵⁷ and registration is merely a prerequisite to filing suit. Gaining copyright protection has thus become substantially easier for authors.

The 1976 Act not only made it easier to gain copyright protection initially, but it also made that protection last longer. Prior to the 1976 Act, the term of a copyright was twenty-eight years with the option to renew for another twenty-eight years.⁵⁸ The 1976 Act extended the copyright term to the life of the author plus fifty years, and this was further extended in 1998 to life plus seventy years under the Sonny Bono Copyright Term Extension Act.⁵⁹ This term extension applied to all works created after 1978.⁶⁰ Works

⁵⁴ Pub. L. No. 94-553, 90 Stat. 2541 (1976). U.S. COPYRIGHT OFFICE, REPORT ON ORPHAN WORKS, 41 (2006), available at <http://www.copyright.gov/orphan/orphan-report.pdf>.

⁵⁵ 17 U.S.C. § 102(a) (2006).

⁵⁶ REPORT ON ORPHAN WORKS, *supra* note 54, at 42.

⁵⁷ 17 U.S.C. § 102(a) (2006).

⁵⁸ REPORT ON ORPHAN WORKS, *supra* note 54, at 42.

⁵⁹ Pub. L. 94-553, § 302(a), 90 Stat. 2541 (1976); Pub. L. 105-298, 122 Stat. 2827 (1998).

⁶⁰ *Id.*

created prior to 1978 that were in their first twenty-eight year copyright term still required renewal after the 1976 Act, but in 1992 this renewal was made automatic.⁶¹ The total copyright term for works created prior to 1978 was extended to seventy-five years under the 1976 Act, and to ninety-five years in 1998.⁶² Works made for hire have had a similar term increase, currently lasting for the lesser of ninety-five years from publication or 120 years from creation.⁶³ The Supreme Court held the 1998 term extension to be constitutional in *Eldred v. Ashcroft*, but Justice Breyer, in his dissent, offered a warning about a problem that would accompany the shrinking public domain: extension of copyright to very old works could make it prohibitively costly to locate and negotiate with the rightsholders.⁶⁴

While the 1976 Act brought United States copyright law closer to many international copyright regimes, it has led to a shrinking public domain and a vast increase in the number of orphan works. The following section discusses the limits on the scope of copyright protection in this automatic long-lasting copyright regime we have today.

B. LIMITS ON STRONG COPYRIGHT: SUBJECT MATTER AND FAIR USE

An author or creator now automatically gains copyright protection over “original works of authorship fixed in any tangible medium of expression,”⁶⁵ and retains the sole rights to public distribution, public performance, public display, and derivative works for the term of the copyright. The work, however, must have been independently created by the author and it must have some modicum of creativity. There is no copyright protection over facts, since they cannot be created by the author, and there is only minimal protection of compilations of facts where the arrangement and selection is sufficiently original.⁶⁶ Additionally, copyright protection only extends to the “expression” of an idea, not to the idea itself.⁶⁷ Thus, while the term for a copyright may be long, the underlying ideas are never removed from the public domain.

Copyright protection is further limited by the fair use defense to copyright infringement. The fair use defense functions as a safeguard to prevent strong copyright from stifling free expression.⁶⁸ Under the fair use doctrine, copyright protection does not extend to any “fair use” of a work.⁶⁹ A “fair use” of a copyrighted work is a use that is “for purposes such as criticism, comment, news reporting, teaching (including multiple copies for classroom use), scholarship, or research”⁷⁰ Whether a given use constitutes a “fair use” is determined by weighing four enumerated factors:

⁶¹ Copyright Renewal Act of 1992, title I of the Copyright Amendments Act of 1992, Pub. L. No. 102-307, 106 Stat. 264 (1992) (amending 17 U.S.C. § 304 to add an automatic renewal term).

⁶² REPORT ON ORPHAN WORKS, *supra* note 54, at 42.

⁶³ 17 U.S.C. § 302(c) (2006).

⁶⁴ *See generally* *Eldred v. Ashcroft*, 537 U.S. 186, 250 (2003).

⁶⁵ 17 U.S.C. § 102(a) (2006).

⁶⁶ *See generally* *Feist Publications v. Rural Telephone Service*, 499 U.S. 340 (1991).

⁶⁷ 17 U.S.C. § 102(b) (2006).

⁶⁸ *Eldred*, 537 U.S. at 219–20.

⁶⁹ 17 U.S.C. § 107 (2006).

⁷⁰ *Id.*

“(1) the purpose and character of the use, including whether such use is of a commercial nature or is for nonprofit educational purposes; (2) the nature of the copyrighted work; (3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and (4) the effect of the use upon the potential market for or value of the copyrighted work.”⁷¹ In each case, courts will conduct a fact-specific analysis as to whether a given use is a “fair use,” and extra weight will be given to the fourth factor, the effect on the market.⁷² Thus, while copyright is automatic and long in duration, the right is limited in that it does not protect against all uses of the copyrighted work.

C. THE ORPHAN WORKS PROBLEM

Despite the above limits on copyright, the ease of obtaining a copyright and the length of the copyright once obtained have eroded the public domain and expanded the orphan works problem.⁷³ The orphan works problem arises because potential users of orphan works are faced with the possibility of high statutory damages (or an injunction) for copyright infringement, and no way to reduce this risk.⁷⁴ Even if the risk of copyright infringement is minimal, the possibility of large fines will often prevent a potential user from making productive use of the copyrighted work.⁷⁵ For each infringed work, courts have the authority to award statutory damages ranging from \$750 to \$30,000, with the discretion to award up to \$150,000 for willful copyright infringement.⁷⁶ Moreover, courts can award injunctive relief that can be devastating to a user who, for instance, has already incorporated the orphan work into a larger project.⁷⁷

The user base affected by the orphan works problem is large. Publishers, museums, or filmmakers wanting to republish, exhibit, or use orphan works, may decide against using the work due to the possibility of copyright infringement. Often, the rightsholders either do not exist or would not object to the use of their works.⁷⁸ In these cases, potential users are prevented from using the work merely because of their inability to contact the copyright holder. This is an inefficient lack of use of the orphan work, and this inefficiency is the heart of the orphan works problem.

The orphan works problem was first brought to the attention of Congress in 2005.⁷⁹ Under congressional direction, the Copyright Office conducted a comprehensive study on the orphan works problem, and published the results in their 2006 Report on Orphan Works.⁸⁰ According to the report, the general opinion of commentators was that the existing copyright laws were not sufficient to deal with the orphan works problem,

⁷¹ *Id.*

⁷² *See generally* Harper & Row v. Nation Enters., 471 U.S. 539 (1985).

⁷³ *See* REPORT ON ORPHAN WORKS, *supra* note 54, at 42–44, 92.

⁷⁴ *See id.* at 15.

⁷⁵ *Id.*

⁷⁶ 17 U.S.C. § 504(c) (2006).

⁷⁷ 17 U.S.C. § 502 (2006).

⁷⁸ *See* STATEMENT OF MARYBETH PETERS, *supra* note 8.

⁷⁹ *Id.*

⁸⁰ REPORT ON ORPHAN WORKS, *supra* note 54.

and that some type of congressional action was needed.⁸¹ The report recommended specific legislation that would limit the remedies for copyright infringement that a copyright owner could obtain against a user if the user performed a reasonably diligent search for the owner of the work prior to using it.⁸² In May of 2006, a bill was introduced into Congress that would have provided the limitation on remedies called for by the Copyright Office's report in 2006.⁸³ That bill did not become law. In April of 2008, a largely similar bill was introduced, again calling for a limit on remedies in cases in which a diligent search had been performed.⁸⁴ The Senate version of the bill was the Shawn Bentley Orphan Works Act of 2008,⁸⁵ and the House version was the Orphan Works Act of 2008.⁸⁶ Though neither version of the bill became law by the end of the 110th Congress in 2008,⁸⁷ a detailed discussion of this proposed orphan works legislation follows.

V. THE PROPOSED ORPHAN WORKS ACT OF 2008

As discussed in Part III *supra*, there are two main ways that legislation could potentially be structured to directly reduce the transaction costs associated with orphan works: legislative valuation and judicial liability rules. Legislative valuation would entail the creation of a fee schedule that would function as a mechanical compulsory license or liability rule. A judicial liability rule would involve judicial valuation of reasonable compensation for using an orphan work without permission. The orphan works legislation proposed in 2008 takes the form of a judicial liability rule.

The essence of the proposed legislation is to limit the remedies a copyright holder may obtain against an infringer where the infringer performed a reasonably diligent search for the author of the work prior to use.⁸⁸ Instead of permitting the orphan work copyright holder to obtain statutory damages or injunctive relief, recovery would be limited to "reasonable compensation."⁸⁹ The proposed legislation is aimed at promoting more productive use of orphan works by reducing fears of would-be users that the owner of an orphan work will later emerge and sue for an injunction or enormous statutory damages.⁹⁰ While this purpose is laudable, I suggest that the very fears that this legislation attempts to eliminate are in fact a driving force in the decision of private market participants to form CROs.

The proposed legislation has essentially two components. First, in order to be protected by the Act, the user must (a) perform a "reasonably

⁸¹ *Id.* at 69.

⁸² *Id.* at 95–96.

⁸³ H.R. 5439, 109th Cong. (2006).

⁸⁴ Orphan Works Act.

⁸⁵ S. 2913, 110th Cong. (2008).

⁸⁶ Orphan Works Act.

⁸⁷ See <http://www.govtrack.us/congress/bill.xpd?bill=s110-2913> for the status of the Senate bill, and <http://www.govtrack.us/congress/bill.xpd?bill=h110-5889> for the status of the House version.

⁸⁸ See STATEMENT OF MARYBETH PETERS, *supra* note 8.

⁸⁹ See *id.*

⁹⁰ See *id.*

diligent search” for the copyright owner, and (b) attribute the work to the copyright holder, where possible and appropriate.⁹¹ Second, the Act imposes a limitation on remedies for the copyright holder if the user satisfies the above threshold requirements.⁹² The goal of this legislation is to reduce the inefficiency of users being unable to transact with the copyright holders of orphan works, while at the same time offering as much protection to existing copyright holders as possible from potential exploitation of the relaxed rule by users.⁹³

Providing limited relief to a copyright holder of an orphan work would essentially play out as follows: money damages would be limited to either (a) reasonable compensation, or (b) *no* money damages if the use was non-commercial and the user stops infringement once notified.⁹⁴ Reasonable compensation, for purposes of the Act, is “the amount on which a willing buyer and willing seller in the positions of the infringer and the owner of the infringed copyright would have agreed with respect to the infringing use of the work immediately before the infringement began.”⁹⁵ Injunctive relief would be unavailable if the user “recasts, transforms, adapts, or integrates the infringed work with a significant amount of the infringer’s original expression”⁹⁶ (for example, by creating a derivative work), provided that the user pays reasonable compensation to the copyright holder.

The rationale for providing limited relief is that the prospect of either high money damages or an injunction deters would-be users of orphan works from making productive use of them. Limiting the relief is an attempt to counteract this inefficiency. Under the proposed Act, for example, a publisher need no longer worry about the rightsholder of an orphan work showing up and suing for an injunction after she has already invested substantial time, effort, and money into creating and marketing a derivative work based on an orphan work, as long as that publisher satisfied the threshold requirements of performing a reasonably diligent search and properly attributes the orphan work to the rightsholder.

Orphan works legislation of this kind has drawn support from some scholars, who see it as a reasonable modification to modern copyright law that does not completely overhaul the current copyright regime.⁹⁷ By significantly reducing the fear of large statutory damages or an injunction once a reasonably diligent search has been made, users would have greater

⁹¹ Orphan Works Act § 2.

⁹² *Id.*

⁹³ “The legislation is sensible: it would ease the orphan problem by reducing, but not eliminating, the exposure of good faith users. But there are clear conditions designed to protect copyright owners.” Marybeth Peters, Register of Copyrights, *The Importance of Orphan Works Legislation*, <http://www.copyright.gov/orphan/>.

⁹⁴ Orphan Works Act § 2.

⁹⁵ Orphan Works Act § 2.

⁹⁶ *Id.*

⁹⁷ See generally Marc H. Greenberg, *Reason or Madness: A Defense of Copyright’s Growing Pains*, 7 J. MARSHALL REV. INTEL. PROP. L. 1 (2007) (defending modern copyright law against criticism, and describing the proposed 2006 orphan works legislation as a reasonable option for improving copyright law).

incentives to make productive use of orphan works.⁹⁸ Judicially determined reasonable compensation would still be available to rightsholders suing for infringement, limiting the negative effects on incentives to invest in the underlying right.⁹⁹ Additionally, since the proposed act would not impose new formality requirements on authors, it would keep United States copyright law in line with international standards.¹⁰⁰

The proposed Orphan Works Act, however, has significant drawbacks. As discussed in Part III.B *supra*, judicial liability rules carry with them their own transaction costs in the form of litigation expenses. What constitutes “reasonable compensation” under the Orphan Works Act would likely involve a parade of experts testifying as to the true value of the copyrighted work. Similarly, whether the search performed was “reasonably diligent” would be a point of litigation. Under the proposed Orphan Works Act the uncertainty regarding the possibility of litigation would likely produce a chilling effect on users similar to that under the current property rule regime. While providing an affirmative defense to infringement, the proposed legislation would still subject the user to the costs of litigation, which would likely be substantial enough to prevent many users from making productive use of orphan works.¹⁰¹ Likewise, some copyright holders have complained that where statutory damages are made unavailable, as under the proposed Orphan Works Act, the expense of litigation would make it prohibitively costly to sue to recover any compensation whatsoever for the unauthorized use of their work.¹⁰²

Amid the debate over the proposed Orphan Works Act, one thing seems certain: the effect of such a law on the market is difficult to predict with any degree of certainty. In light of this uncertainty, examples of the market developing solutions to the orphan works problem on its own are particularly salient to a discussion of whether any form of orphan works legislation is necessary at all.

The next part of this Note discusses the settlement agreement reached in the Google Book Search litigation, the creation of the Book Rights Registry, and how this serves as an example of a private market solution to the orphan works problem.

⁹⁸ See Jerry Brito & Bridget Dooling, *An Orphan Works Affirmative Defense to Copyright Infringement Actions*, 12 MICH. TELECOMM. TECH. L. REV. 75, 107–10 (2005), available at <http://www.mttl.org/voltwelve/brito&dooling.pdf>. See also Sami J. Valkonen & Lawrence J. White, *An Economic Model for the Incentive/Access Paradigm of Copyright Propertization: An Argument in Support of the Orphan Works Act*, 29 HASTINGS COMM. & ENT. L.J. 359, 396–99 (arguing that the proposed Orphan Works Act of 2006 (substantially similar to the 2008 bill) would enhance output by reducing barriers to the use of orphan works).

⁹⁹ See REPORT ON ORPHAN WORKS, *supra* note 54, at 121.

¹⁰⁰ See *id.* See Berne Convention for the Protection of Literary and Artistic Works art 5(2), amended Sept. 28, 1979, 828 U.N.T.S. 221. The Berne Convention, to which the US is a member, requires that copyright protection not be terminated by failure to comply with formalities. See also Brito & Dooling, *supra* note 98, at 111.

¹⁰¹ See Pamela Brannon, *Reforming Copyright to Foster Innovation: Providing Access to Orphaned Works*, 14 J. INTELL. PROP. L. 145, 167 (2006).

¹⁰² See REPORT ON ORPHAN WORKS, *supra* note 54, at 117.

VI. A PRIVATE SOLUTION: THE GOOGLE BOOK SEARCH SETTLEMENT AND THE CREATION OF A NEW COLLECTIVE RIGHTS ORGANIZATION FOR ELECTRONIC BOOKS

Under the settlement agreement in the Google Book Search litigation, a new CRO called the Book Rights Registry will be created. CROs function as middlemen between rightsholders and users by collecting royalty payments for the use of protected works and ensuring that the rightsholders get paid. They are essentially private liability rule regimes, entered into voluntarily by parties in the market.

In the music industry, performance rights organizations such as the ASCAP, Broadcast Music, Incorporated (“BMI”), and SESAC monitor the public performance and broadcast of copyrighted music (such as songs played on the radio), collect licensing fees from users (such as radio stations), and pay the fees to the copyright holders as royalties. In order to put the Book Right Registry in context, I will first give a brief review of the history and function of ASCAP in the recording industry.

A. COLLECTIVE VALUATION OF MUSIC PERFORMANCE RIGHTS: ASCAP

Copyright protection extends to public performances of copyrighted musical works.¹⁰³ When television or radio stations play copyrighted works, however, they don’t generally negotiate directly with individual rightsholders for the right to play their copyrighted songs. The transaction costs of this would be astronomical. Rather, performing rights societies like ASCAP act as go-betweens for copyright holders and users, and implement, essentially, private liability rules. Before ASCAP, restaurants and nightclubs made a regular practice of flagrantly performing copyrighted songs for their patrons without compensating the owner of the copyrighted song.¹⁰⁴ In response to this, Victor Herbert along with a handful of other composers formed ASCAP in 1914.¹⁰⁵ ASCAP began as a method for spreading the cost of litigating copyright violations since no single composer had enough capital to stand up to the owners of the restaurants and nightclubs.¹⁰⁶ ASCAP won a series of legal victories in which courts held that copyright holders must be compensated for public performances of their copyrighted works whether they are performed at restaurants, dance halls, hotels, or movie theaters.¹⁰⁷ ASCAP found a more lucrative market in the 1920s when it began collecting royalties from radio stations that played copyrighted songs.¹⁰⁸ ASCAP grew even further with the rise of television.¹⁰⁹

ASCAP’s basic function as it exists today is to act as a non-exclusive licensor for copyrighted music. It issues licenses to radio and television

¹⁰³ 17 U.S.C. § 106(4) (2006).

¹⁰⁴ See *Merges*, *supra* note 11, at 1329–30.

¹⁰⁵ See *Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc.*, 441 U.S. 1, 4 (1979).

¹⁰⁶ *Merges*, *supra* note 11, at 1330.

¹⁰⁷ *Id.*

¹⁰⁸ *Id.* at 1333.

¹⁰⁹ *Id.* at 1333–34.

stations and distributes the royalties to its members according to a rate schedule set by ASCAP. The price of the licenses ASCAP charges to users is tailored to reflect the value of the artistic work to each industry.¹¹⁰ The division of licensing revenue as royalties involves a combination of sampling techniques and self-reporting by licensees.¹¹¹ Members of ASCAP are on the whole very satisfied with its division of royalties, and commentators likewise praise the sophistication of its royalty apportionment methods.¹¹²

As discussed in Part III.C *supra*, however, CROs raise potential monopoly concerns, and ASCAP is a prime example of this. ASCAP has always primarily licensed its members' performance rights in the form of a blanket license, in which the user (e.g., a radio station) pays a set fee for the right to perform any and all of the millions of songs ASCAP offers.¹¹³ This practice results in a lack of competition among individual rightsholders over pricing terms since ASCAP sets the price of the blanket license.¹¹⁴ Prior to 1950, ASCAP was essentially the exclusive licensor for its members, and users were unable to bargain with ASCAP's members individually.¹¹⁵ Additionally, at that time there was no legal restraint in place to prevent ASCAP from choosing any fee for its license, no matter how unreasonable.¹¹⁶

In 1950, following a private antitrust suit against ASCAP by motion picture exhibitors,¹¹⁷ the government made sweeping modifications to a prior 1941 consent decree¹¹⁸ that ASCAP had been operating under.¹¹⁹ The new decree required, among other things, that ASCAP's right to license its members' works be non-exclusive.¹²⁰ This ensured that users would be free to negotiate directly with the individual rightsholders for performance rights. Additionally, under the amended decree, once a user applied to ASCAP for a license, that user automatically became licensed, and must thereafter negotiate a fee with ASCAP.¹²¹ If an agreement over a fee could not be reached, the user could bring the dispute to a specially designated rate court where a judge would decide the fee, and the burden of proof would be on ASCAP to demonstrate the reasonableness of the fee it was demanding.¹²² The amended consent decree allowed ASCAP to continue to retain the benefits of drastically reduced transaction costs and expertly tailored valuation, to the benefit of rightsholders, while simultaneously

¹¹⁰ *Id.* at 1335–38.

¹¹¹ *Id.*

¹¹² *See id.* at 1338–39.

¹¹³ Simon H. Rifkind, *Music Copyrights and Antitrust: A Turbulent Courtship*, 4 CARDOZO ARTS & ENT. L.J. 1, 7 (1985).

¹¹⁴ *Id.*

¹¹⁵ *Id.*

¹¹⁶ *Id.* at 7.

¹¹⁷ *Alden-Rochelle, Inc. v. ASCAP*, 80 F. Supp. 888, *relief*, 80 F. Supp. 900 (S.D.N.Y. 1948).

¹¹⁸ *United States v. The Am. Soc'y of Composers, Authors, & Publishers*, 1940-3 Trade Cas. (CCH) 56,104 (S.D.N.Y. 1941).

¹¹⁹ *United States v. The Am. Soc'y of Composers, Authors, & Publishers*, 1950-1 Trade Cas. (CCH) 62,595 (S.D.N.Y. 1950).

¹²⁰ *Id.*

¹²¹ Rifkind, *supra* note 113, at 10.

¹²² *Id.*

limiting ASCAP's potential to abuse its monopoly power, to the benefit of users.

Following the amended consent decree, ASCAP has survived multiple antitrust lawsuits, most notably the attack on its use of a blanket license in the 1979 Supreme Court case *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*¹²³ The Court in *Broadcast Music* held that ASCAP's blanket license did not constitute per se illegal price fixing under the Sherman Act,¹²⁴ and should instead be analyzed under a rule of reason by balancing its costs and benefits.¹²⁵ The fact that ASCAP was merely a non-exclusive licensor, and that users were free to bargain with the individual rightsholders figured prominently in the court's decision.¹²⁶

ASCAP is relevant to a discussion of the Google Book Search settlement for several reasons. First, it is an early example of a private organization forming to create a liability rule regime where a strong property rule regime once existed with corresponding high transaction costs. Second, its function is very similar to the yet-to-be created Book Rights Registry, to which this Note turns next. Third, the amended consent decree under which ASCAP operates provides a framework for analyzing the monopoly problems posed by the Google Book Search Settlement. The next section discusses the history and function of Google Book Search, and describes how it invited the large-scale litigation that Google has faced for the past few years. This is followed by a discussion of the settlement that was reached in October of 2008 (currently pending final approval of the court) and the creation of a new CRO: the Book Rights Registry.

B. A BRIEF HISTORY OF GOOGLE BOOK SEARCH AND THE CLASS ACTION LITIGATION

1. *Google Book Search's Beginnings*

Google, the American company best known for its namesake search engine, announced Google Book Search (then dubbed "Google Print") in 2004.¹²⁷ Google Book Search searches the text of scanned book pages. While a search engine for the text of books was not a particularly remarkable announcement, Google's plan for digitization of books for Google Book Search, the Google Library Project, was much more noteworthy. The Library Project consisted of agreements between Google and several libraries and institutions, including the New York Public Library and Stanford University, to scan and digitize their stacks.¹²⁸

¹²³ *Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc.*, 441 U.S. 1 (1979).

¹²⁴ 15 U.S.C. §§ 1-7 (2006).

¹²⁵ *Broadcast Music*, 44 U.S. at 24.

¹²⁶ See Rifkind, *supra* note 113, at 16.

¹²⁷ See History of Google Books, <http://www.google.com/googlebooks/history.html>. In November of 2005, Google changed the name of "Google Print" to its current name, Google Book Search. Posting of Jen Grant to GoogleBlog, <http://googleblog.blogspot.com/2005/11/judging-book-search-by-its-cover.html> (Nov. 17, 2005, 2:49 AM).

¹²⁸ The original libraries were: University of Michigan, the New York Public Library, Stanford and Oxford. See History of Google Book Search, <http://www.google.com/googlebooks/history.html>. For a list of the current library partners, see <http://www.google.com/googlebooks/partners.html>.

Google's self-proclaimed goal of the project was "to work with publishers and libraries to create a comprehensive, searchable, virtual card catalog of all books in all languages that helps users discover new books and publishers discover new readers."¹²⁹ Google did not limit the project to digitizing works that had already passed into the public domain. On the contrary, it engaged in massive scale scanning and digitization of works that were still under copyright protection.¹³⁰

Copyrighted and public domain works were both made searchable using Google Book Search online. For public domain works, Google made the entire text freely available to users over the Internet. For books still in-copyright, Google made only snippets of the text viewable online, and provided links to assist users in either finding the book at a local library or purchasing it online from a retailer like Amazon.com.¹³¹ Google profited by displaying text advertisements in the user's browser window alongside the pages of the digitized books.

Needless to say, this bold endeavor did not go unnoticed, and before long Google found itself in multiple lawsuits.

2. Google Book Search Litigation

In 2005, book authors and the Authors Guild filed a class action lawsuit against Google.¹³² Five publishers representing the American Association of Publishers filed suit against Google as well.¹³³ The authors and publishers alleged that Google's Library Project constituted copyright infringement on an enormous scale. Specifically, they alleged that Google, by scanning the books, creating a searchable electronic database for the books, and displaying brief excerpts without the copyright owners' express permission, violated their copyrights.¹³⁴ Google asserted that its uses of the copyrighted material were fair uses under the fair use defense to copyright infringement.¹³⁵ Recent case law suggests that Google's fair use argument had significant merit.¹³⁶ Google maintained that since its uses were fair uses, it did not need to get the permission of each and every copyright

¹²⁹ Google Books Library Project Overview, <http://www.google.com/googlebooks/library.html>. Google also began a Partner Program in which it entered into agreements with publishers of in-print books to incorporate their books into Google Book Search.

¹³⁰ See David A. Vise, *Publishers Sue Google To Stop Scanning: Book Copyrights Violated, They Say*, WASH. POST, Oct 20, 2005, available at <http://www.washingtonpost.com/wp-dyn/content/article/2005/10/19/AR2005101901463.html>.

¹³¹ For books that Google incorporated into Google Book Search via its Partner Program with publishers, as opposed to its Library Project, the publishers were allowed to specify how much text the user would see in the search results. See James Grimmelmann, *How to Fix the Google Book Search Settlement*, 12 J. INTERNET L., April 2009, at 10, 11.

¹³² *Authors Guild v. Google Inc.*, No. 05 CV 8136 (S.D.N.Y. filed Sept. 20, 2005).

¹³³ *McGraw-Hill Cos. v. Google Inc.*, No. 05 CV 8881 (S.D.N.Y. filed Oct. 19, 2005).

¹³⁴ See Class Action Complaint, *Authors Guild v. Google Inc.*, No. 05 CV 8136 (S.D.N.Y. Sept. 20, 2005), available at <http://www.authorsguild.org/advocacy/articles/settlement-resources.attachment/authors-guild-v-google/Authors%20Guild%20v%20Google%2009202005.pdf>.

¹³⁵ See Answer, Jury Demand, and Affirmative Defenses of Defendant Google Inc. at 7, *Authors Guild v. Google Inc.*, No. 05 CV 8136 (S.D.N.Y. Nov. 30, 2005), available at <http://www.authorsguild.org/advocacy/articles/settlement-resources.attachment/googles-answer-to-authors-guild/Google%27s%20Answer%20to%20Authors%20Guild%2011302005.pdf>.

¹³⁶ See *Perfect 10 v. Google*, 487 F.3d 701 (9th Cir. 2007) (holding Google's display use of thumbnail versions of copyrighted images in its image search engine constituted a fair use).

holder before digitizing each book.¹³⁷ The transaction costs associated with getting prior permission would have been immense because of the orphan works problem. It is estimated that up to seventy-five percent of the books in the libraries are out-of-print, yet still in-copyright.¹³⁸ It would be difficult and costly to negotiate with, or even locate, the rightsholders for a large portion of that seventy-five percent.¹³⁹ Unless Google's uses were fair uses, Google would bear the immense transaction costs associated with the orphan works problem going forward, not to mention enormous damages for past infringement.

C. THE SETTLEMENT AGREEMENT AND THE CREATION OF THE BOOK RIGHTS REGISTRY

On October 28, 2008, the parties to the Google Book Search litigation reached a settlement agreement that is currently pending final approval of the court.¹⁴⁰ Google has agreed to pay \$125 million, \$34.5 million of which will be used to establish a Book Rights Registry.¹⁴¹ The Registry will have the authority to act as a non-exclusive licensor representing the interests of rightsholders.¹⁴² This authority extends to out-of-print orphan works.¹⁴³ The Registry will work as a middleman between Google and rightsholders, collecting licensing revenues from Google and distributing them to authors and publishers.¹⁴⁴

It is worth noting that this \$125 million, while no paltry sum, is miniscule compared to what Google could have faced if it had been found guilty of copyright infringement. To illustrate this point, under the settlement, \$45 million of the total \$125 million will be paid to rightsholders whose works were scanned and used by Google without permission.¹⁴⁵ The settlement calls for that to be distributed to rightsholders at the rate of \$60 per book.¹⁴⁶ If Google were liable for copyright infringement, the court could award statutory damages alone of \$750 to \$30,000, with the discretion to award up to \$150,000, for willful copyright infringement *per book*.¹⁴⁷ Of the seven million books scanned and incorporated into Google Book Search so far, approximately one million are public domain, one million are displayed with permission from

¹³⁷ Google's General Counsel, in response to the lawsuit, stated, "We believe that our product is legal . . . , that the courts will vindicate this position, and that the industry will come to embrace Google Print's considerable benefits." Posting of David Drummond to GoogleBlog, <http://googleblog.blogspot.com/2005/10/why-we-believe-in-google-print.html> (Oct. 19, 2005, 8:54 PM).

¹³⁸ See Lessig 2.0 Blog, http://www.lessig.org/blog/2008/10/on_the_google_book_search_agre.html (Oct. 29, 2008, 7:25 PM).

¹³⁹ For example, in a study conducted by Carnegie Mellon University Libraries, the libraries were unable to locate the rightsholders for twenty two percent of a sample of books from their stacks. See REPORT ON ORPHAN WORKS, *supra* note 54, at 92.

¹⁴⁰ See Settlement, *supra* note 1.

¹⁴¹ *Id.* at § 5.2.

¹⁴² *Id.* at § 6.1.

¹⁴³ *Id.*

¹⁴⁴ *Id.*

¹⁴⁵ *Id.* at § 5.1(a).

¹⁴⁶ *Id.*

¹⁴⁷ See 17 U.S.C. § 504(c) (2007).

publishers, and five million are out of print.¹⁴⁸ Thus, the statutory damages for those five million books could potentially range from \$3.75 billion to \$150 billion, or \$750 billion for a willful violation. In comparison, the relatively low payout amount likely required of Google reflects the strength of Google's fair use argument. The settlement should be viewed as a compromise through which both sides intend to reap substantial financial benefit.

Under the agreement, Google's revenue will come primarily from the following three sources: 1) selling subscriptions to institutions to a database of electronic books; 2) selling full access to digital books to individuals, for viewing online; 3) displaying advertising alongside the pages of books, collecting advertising revenue from the advertisers.¹⁴⁹ The first two sources of revenue mentioned are new additions to Google Book Search's only previous revenue source—displaying advertisements. Google will pay the Registry sixty-three percent of all revenues it earns from the digitized books, and the Registry will be responsible for distributing it to the authors and publishers (minus an administrative fee).¹⁵⁰ Google will determine the prices it intends to charge for the institutional full-access subscriptions of the service, but will require the Registry's approval before selling the subscriptions at those prices.¹⁵¹ For sales to consumers of access to individual books, the rightsholders will have the option of setting whatever price they choose for their book, or allowing Google to determine the selling price using an algorithm designed by Google.¹⁵²

Under the agreement, Google's freedom to digitize books is different for each of three categories of books: 1) in-copyright, in-print works, 2) in-copyright, out-of-print works, and 3) out-of-copyright public domain works. For in-print books, the settlement adopts an "opt-in" approach, and Google may only display and sell access to the digital version after obtaining the express permission of the author and publisher.¹⁵³ For out-of-print books, however, the settlement allows Google to adopt an "opt-out" approach whereby Google is permitted to fully incorporate the digitized books into Google Book Search without gaining the express permission of the rightsholders, and must only remove the books from Google Book Search at the express request of rightsholders.¹⁵⁴ Thus, for orphan works, Google can not only allow users to search the text of the book online and display snippets in the search results, but can also sell institutional subscriptions for access to the full text, and sell individuals access to the

¹⁴⁸ Juan Carlos Perez, *In Google Book Settlement, Business Trumps Ideals*, PC WORLD, Oct. 30, 2008, available at http://www.pcworld.com/businesscenter/article/153085/in_google_book_settlement_business_trumps_i_deals.html.

¹⁴⁹ Settlement, *supra* note 1, at §§ 4.1–4.6.

¹⁵⁰ *Id.* at § 2.1(a).

¹⁵¹ *Id.* at § 4.1.

¹⁵² *Id.* at § 4.2. Google will design a pricing algorithm to determine the optimal price for each book in order to maximize revenue for each rightsholder. *Id.*

¹⁵³ *See id.* at §§ 3.2–3.5. Google may still scan and display bibliographic information without the rightsholders' express consent, but cannot display the text of the book in any way to the public. *See id.* at § 3.4(a).

¹⁵⁴ *Id.* at §§ 3.2–3.3. Users will be able to preview up to twenty percent of the text of out-of-print in-copyright works at no cost using Google Book Search. *Id.* at § 4.3(1).

full text of the books online without needing the express permission of the rightsholders. For public domain works, Google will continue to make full use of the works and provide them in their entirety to the public for free online via Google Book Search.¹⁵⁵

The settlement essentially gives Google a green light to continue making productive use of orphan works without any need to bear the transaction costs of locating and negotiating with the rightsholders, and without any fear of liability for copyright infringement. It also protects rightsholders by allowing for them to opt out if they choose to, and tasking the Book Rights Registry with ensuring they are compensated for uses of their works. Upon the approval of the court, the settlement will effectively solve the orphan works problem that Google faced.¹⁵⁶

The Book Rights Registry will be not-for-profit.¹⁵⁷ Its board will have equal representation from publishers and authors.¹⁵⁸ It will maintain a database of information about rightsholders, including their contact information and information pertaining to their requests about what uses Google is authorized to make of their works.¹⁵⁹ It will also be tasked with actively searching for and identifying copyright holders of existing out-of-print books.¹⁶⁰

Perhaps the most fascinating aspect of the Books Rights Registry is its potential to have a broader function as a multipurpose collective rights organization. Under the settlement agreement, the Book Rights Registry will not be limited to representing the interests of rightsholders with Google alone. On the contrary, the Registry has the ability to represent authors and publishers with third-party companies as well. The Settlement Agreement, however, states that the Registry must first acquire the express permission of the rightsholders before doing so.¹⁶¹ The extent to which the registry (upon approval of the settlement) will function as a central clearinghouse for electronic books with other companies besides Google is difficult to predict based only on the terms of the settlement agreement.¹⁶² A spokesperson from Google has been quoted by the Wall Street Journal as emphasizing the pro-competitive nature of the Book Rights Registry,

¹⁵⁵ The Settlement also describes procedures for what to do with funds that are mistakenly paid to the Registry under the assumption that the works are under copyright, but later turn out to have been public domain works. *See id.* at § 6.3(b).

¹⁵⁶ Visual art in books, such as photographs, artwork, and illustrations (except children's books), is not covered by the settlement unless the rightsholder of the book also holds the copyright to the visual art. *Id.* at § 1.72.

¹⁵⁷ *Id.* at § 6.2(a).

¹⁵⁸ *Id.* at § 6.2(b).

¹⁵⁹ *Id.* at § 6.1(b).

¹⁶⁰ *Id.* at § 6.1(c).

¹⁶¹ *See id.* at § 6.2. "The Registry will represent the interests of the Rightsholders, both in connection with the Settlement as well as in other commercial arrangements, including with companies other than Google (subject to the express approval of the Rightsholders of the Books involved in such other commercial arrangements)." *Id.* at Attachment I § 8(C).

¹⁶² "If authors and publishers want it to, the Registry also could come to serve as a central clearinghouse that could help consolidate and organize rights holder permissions for future services aimed at providing or improving access and use of books — including possible competitors to Google, entities with entirely different business models, or more specialized niche services." Posting of David Sohn to Center for Democracy & Technology Blog, <http://blog.cdt.org/2008/10/29/google-settles-lawsuit-with-book-publishers-and-authors>, (Oct. 29, 2008, 2:14 PM).

emphasizing that the charter of the Registry specifically allows it to “work with other third parties to develop alternative (and competing) digital services.”¹⁶³ The uncertainty over this broader function has led to some skepticism, and Google has a first-mover advantage over any competitors seeking to use the registry since the settlement agreement grants Google a license to use out-of-print works without first gaining permission.¹⁶⁴ The registry, however, could simply get the permission of authors and publishers to allow it to freely enter into agreements with companies besides Google.¹⁶⁵ The biggest potential limit on the Registry’s ability to deal with other companies is the requirement that it gain the express permission of rightsholders for any such future deals—this could prevent it from entering into new deals involving the use of orphan works, since the rightsholders for orphan works are unavailable and therefore cannot give their express approval.¹⁶⁶

While only time will tell how the Book Rights Registry will function in practice, it has the potential to be a highly successful CRO. As such, it will drastically reduce transaction costs in the electronic book market, most notably those surrounding the licensing of orphan works, while maintaining accurate valuation and strong incentives to invest. Like ASCAP, however, the Book Rights Registry poses monopoly problems that, if left unchecked, could allow the Registry to fix prices for books and extract a surplus from users (such as Google), which would result in higher prices to consumers as well. The Settlement Agreement, fortunately, already incorporates some limits similar to those that the amended consent decree imposes on ASCAP.¹⁶⁷ The following section discusses these monopoly issues, how the settlement deals with them, and what other possible steps could be taken to limit potential abuse of monopoly power.

D. MONOPOLY PROBLEMS POSED BY THE SETTLEMENT

There are essentially two monopoly problems that are, to some extent, inevitable under the settlement. First, the Book Rights Registry will be granted substantial authority to represent the interest of authors and publishers in negotiations with users (such as Google). Second, Google itself will have a first-mover advantage and will initially be the only

¹⁶³ The full quote from the Google spokesperson: “Digitizing the world’s information is a tremendous undertaking, and we structured the settlement agreement in a manner to encourage competition. The charter of the Book Rights Registry explicitly states that the Registry will be able to work with other third parties to develop alternative (and competing) digital services. We feel both the economic incentives and the efforts of the Registry will help to encourage more people to digitize books.” Posting of Marisa Taylor to WSJ Blog, <http://blogs.wsj.com/digits/2009/01/26/few-free-books-in-the-google-library/> (Jan. 26, 2009, 3:10 PM ET).

¹⁶⁴ “[I]t remains to be seen if or how successfully the Registry will [function as a central clearinghouse]. Also, the class action settlement effectively will give Google a license with the broad class of authors and publishers (assuming that few choose to opt out of the settlement), an advantage newcomers won’t have.” Sohn, *supra* note 162.

¹⁶⁵ Paul Aiken, executive director of the Authors Guild, has said, “It could be that individuals are sent a letter and asked to check a box that says, ‘Sign me up for any new licensing deals you come up with, and give me 30-days’ notice so I can optout.’” Eriq Gardner, *A Digital Power Is Born in Book Publishing*, LAW.COM, <http://www.law.com/jsp/legaltechnology/pubArticleLT.jsp?id=1202426533225>.

¹⁶⁶ See *infra* Part VI.D.2.

¹⁶⁷ See *supra* Part VI.A.

company with an effective fast track around the high transaction costs posed by the orphan works problem. These issues are discussed individually below.

1. *Monopoly Issues with the Book Rights Registry*

Under the settlement, the Book Rights Registry will have the authority to negotiate on behalf of all rightsholders that do not opt out of the settlement, and it will be the only organization with this ability.¹⁶⁸ The Settlement Agreement specifically states, for example, that the Registry has the authority to negotiate the terms of new revenue models for services that Google may implement in the future, such as the ability to print books on-demand, to download PDF copies of books, to sell individual subscriptions (akin to the institutional subscriptions, but for individuals), and to publish customized course packets for educational institutions.¹⁶⁹ If uninhibited, the Registry could use its monopoly power to extract a surplus from Google, and indirectly from consumers, by insisting on very favorable terms for these new revenue models. The same concern would apply to the Registry's negotiations with companies other than Google, assuming the Registry takes on the broader function of a multipurpose CRO.

The key limit on the Registry's monopoly power that already exists in the Settlement Agreement is the same key limit that was placed on ASCAP in the 1950 amended consent decree: non-exclusivity.¹⁷⁰ Any user is free to negotiate with the individual copyright holders, and the individual copyright holders are likewise free to seek out side deals. Thus, while the Registry may be the only entity with the authority to negotiate on behalf of *all* book rightsholders, negotiations over individual works can take place directly with the rightsholders themselves.

The monopoly power of the registry could be further limited by borrowing another term from the ASCAP consent decree: the creation of a rate court to which users could appeal if they are unable to come to an agreement with the Registry. Specifically, the Department of Justice could require the Registry to sign an antitrust consent decree expressly providing for this dispute resolution mechanism.¹⁷¹ Though this mechanism has rarely been employed by ASCAP,¹⁷² it could still serve as an additional limit on the Registry's ability to extract a surplus from users.¹⁷³

¹⁶⁸ Settlement, *supra* note 1, at § 6.1.

¹⁶⁹ *Id.* at § 4.7.

¹⁷⁰ *Id.* § 2.4. See *supra* Part VI.A.1 for a discussion of the consent decree that ASCAP operates under.

¹⁷¹ See James Grimmelmann, *How to Fix the Google Book Search Settlement*, 12 J. INTERNET L. April 2009, at 10, 13 (suggesting that the Department of Justice require the Registry to sign an antitrust consent decree).

¹⁷² See Merges, *supra* note 11, at 1340.

¹⁷³ The Department of Justice is currently investigating the Google Book Search Settlement, and it is unclear at this time whether they will oppose it or what changes, if any, they would call for. See Miguel Helft, *U.S. Presses Antitrust Inquiry Into Google Book Settlement*, N.Y. TIMES, June 9, 2009, available at <http://www.nytimes.com/2009/06/10/technology/companies/10book.html>.

2. Monopoly Issues with Google

Under the terms of the settlement, Google will initially be the only company with the right to use orphan works without first needing to obtain the rightsholders' permission. Google will pay rightsholders (via the Registry) a percentage of revenue generated by their books (sixty-three percent), and will not pay an upfront fee for inclusion (beyond compensating rightsholders whose books Google already incorporated without permission). The monopoly concern here is that Google, in light of its first-mover advantage, will be able to extract a surplus from consumers, such as individuals buying access to individual books or institutions paying for an institutional subscription.

There are significant barriers to entry for competitors with respect to orphan works. Under the terms of the Settlement Agreement, the Registry may enter into agreements with companies other than Google, with the caveat that the rightsholders must give their express approval of any such deals.¹⁷⁴ This limits competitors' ability to strike deals with the Registry regarding orphan works because the rightsholders of orphan works cannot be located in order to gain their express permission. In light of this, the Internet Archive attempted (unsuccessfully) to intervene in the settlement as a party defendant—not in an attempt to block the settlement, but in an attempt to benefit from the same limited liability for use of orphan works as Google will under the settlement.¹⁷⁵ A potential competitor would, thus, likely need to follow in Google's footsteps by using orphans, waiting to be sued, and attempting to enter into a similar settlement agreement. This method is both costly and risky, but the barrier to entry could be removed by modifying the Settlement Agreement to expressly give the Registry authority to enter into deals with other companies regarding orphan works *without* requiring the express permission of rightsholders who cannot be located (or by simply adopting an opt-out approach to new deals instead of an opt-in approach).¹⁷⁶

Even as the settlement currently stands, however, Google's competitors may clearly strike deals with the Registry regarding all books that are not orphans. Additionally, since the Registry is tasked with locating the rightsholders of orphan works,¹⁷⁷ the total number of orphaned books will likely decrease substantially as the Registry continues to locate rightsholders and provide their contact information to Google and its

¹⁷⁴ See Settlement, *supra* note 1, at § 6.2. "The Registry will represent the interests of the Rightsholders, both in connection with the Settlement as well as in other commercial arrangements, including with companies other than Google (subject to the express approval of the Rightsholders of the Books involved in such other commercial arrangements)." Settlement, *supra* note 1, at Attachment I § 8(C).

¹⁷⁵ See Letter from Adrian R. Katz, Arnold & Porter LLP, to Judge Denny Chin, Authors Guild v. Google Inc., No. 05 CV 8136 (S.D.N.Y. April 17, 2009) available at <http://www.opencontentalliance.org/2009/04/17/internet-archive-files-intervention-request/> (construed as a motion to intervene and denied by the court in an order on April 24, 2009. See Order in Response to Letter to Judge Denny Chin, Author's Guild v. Google, Inc., No. 05 CV 8136 (S.D.N.Y. April 24, 2009), available at <http://www.scribd.com/doc/14596133/SDNY-Judge-Chin-Intervention-Denied>).

¹⁷⁶ While it is currently unknown what changes, if any, the Department of Justice or the Court will request be made to the Settlement Agreement, this one change would likely be the most effective limit on Google's potential monopoly power.

¹⁷⁷ Settlement, *supra* note 1, at § 6.1(c).

competitors alike. Thus, the Registry's ability to enter into agreements with competitors and the gradual cataloging of orphan books serve as limits on the extent of the first-mover advantage that Google will have following the final approval of the settlement.

It is worth noting that the settlement contains a "most favored nation" clause that requires the registry to offer Google the same or better terms as the Registry offers to any other competing party within ten years of the settlement.¹⁷⁸ While this may be of some concern, it still does not prevent other companies from making deals with the registry on substantially similar terms as Google, and competing with Google for sales to consumers.

Yet another substantial limit on Google's monopoly power contained in the terms of the settlement involves the pricing of the books and services. While Google will, by default, set the price of electronic books for sale to individual consumers, the rightsholders themselves are free to set whatever price they choose if they do not want to use Google's algorithm-determined default price.¹⁷⁹ Thus, Google will not be able to extract a surplus above that which an individual rightsholder would charge on her own. Similarly, the price that Google charges for institutional subscriptions is subject to the approval of the Registry, so Google is not free to charge whatever fee it chooses.¹⁸⁰

3. *Monopoly Costs vs. Transaction Cost Reduction*

While the potential for the Book Rights Registry and Google to extract a monopolist surplus is real, it is substantially limited by the terms discussed above. As long as the reduction in transaction costs associated with this solution to the orphan works problem is substantially greater than any monopoly surplus the Registry or Google is able to extract, the settlement will result in a substantially more efficient market for electronic books. In light of the non-exclusive nature of the Registry's authority, the potential competition for Google, and the rightsholders' freedom to choose whatever price they desire instead of Google's algorithm-determined prices, the transaction cost savings will outweigh any monopoly surplus extracted by the Registry or Google. Additionally, as suggested above, the possibility of an antitrust consent decree governing the Registry could limit the Registry's monopoly power even further. The settlement allows Google to sidestep the enormous transaction costs associated with obtaining preapproval from missing rightsholders. While the orphan works legislation proposed last year (discussed in Part V, *supra*) would not create the same monopoly concerns as the Google Book Search settlement, the transaction cost savings associated with the Book Rights Registry are far more substantial than those possible under the proposed legislation and would result in a more efficient market for electronic books.

¹⁷⁸ *Id.* at § 3.8(a). See Grimmelmann, *supra* note 172, at 15 (arguing that the most favored nation clause could prevent any serious competitor from entering the market, and should be stricken).

¹⁷⁹ Settlement, *supra* note 1, at § 4.2(b).

¹⁸⁰ *Id.* at § 4.1(a).

VII. LESSONS FOR POLICY MAKERS

Thus far, two very different solutions to the orphan works problem have been examined: the proposed Orphan Works Act of 2008, and the Google Book Search settlement. There are two broad lessons that can be drawn from this discussion. First, in light of the numerous benefits discussed in Part VI.C, *supra*, the Google Book Search settlement is superior to the proposed Orphan Works Act as a solution to the orphan works problem with respect to books. Second, in order to incentivize the formation of CROs akin to the Book Rights Registry, Congress should refrain from passing legislation similar to the Orphan Works Act. Each of these is discussed below.

A. THE GOOGLE BOOK SEARCH SETTLEMENT IS A MORE EFFECTIVE SOLUTION TO THE ORPHAN WORKS PROBLEM THAN THE PROPOSED ORPHAN WORKS ACT OF 2008

The Google Book Search settlement is preferable to the Orphan Works Act primarily because of the huge transaction cost savings associated with the settlement. A judicial liability rule regime under the proposed Orphan Works Act would involve costly litigation expenses over both the reasonableness of the search performed prior to use of the work and what constitutes reasonable compensation for the use of the work. Those litigation costs would be borne by both the user of the orphan work and the rightsholder suing for reasonable compensation. While the Orphan Works Act would somewhat reduce users' fear of high damage awards or an injunction, the Google Book Search settlement eliminates that fear entirely; Google will be able to make productive use of orphan works without any fear of damages. At the same time, the rightsholders of orphan works will still be compensated under the Google Book Search settlement. The new CRO, the Book Rights Registry, will collect sixty-three percent of the revenue Google earns from the use of orphan works, search for and locate the rightsholders, and distribute royalties to the rightsholders once located. Other companies besides Google that strike deals with the Registry will likewise benefit from the substantial transaction cost savings.

Despite these issues, there are two positive aspects of the proposed Orphan Works Act. First, the Act would have broad coverage of all categories of orphan works. While this Note focuses on books, the Google Book Search settlement is slightly limited even with respect to books—it does not include visual art in books unless the copyright holder of the book also holds the copyright to the visual art.¹⁸¹ Visual art is, thus, one narrow area with respect to books that the proposed Orphan Works Act would cover but the settlement does not. Second, there is no monopoly concern under the Orphan Works Act since all users would gain the benefits of reduced liability after performing a reasonably diligent search.

Despite the positive aspects of the Orphan Works legislation, the transaction cost savings under the private liability rule regime of the

¹⁸¹ *Id.* at § 1.72. Visual art in children's books, however, is included in the settlement. *Id.*

Google Book Search settlement makes it a far more effective solution to the orphan works problem with respect to books.

B. KEEP THE CURRENT PROPERTY RULE REGIME IN PLACE TO
INCENTIVIZE CRO FORMATION

In light of the benefits associated with CROs, specifically their ability to drastically lower transaction costs while maintaining strong incentives and accurate valuation, policy makers should attempt to foster the conditions that can lead to their formation. The pending creation of the Book Rights Registry is evidence that the current copyright regime is conducive to the formation of CROs. I would caution that while the judicial liability rule regime for orphan works under the proposed Orphan Works Act would likely lead to a reduction of some of the transaction costs associated with the orphan works problem, this reduction in transaction costs would have a negative, indirect side effect: it would reduce the incentives for market participants to create vastly more efficient private CROs as a way to contract out of the orphan works problem. This is because the high transaction costs associated with property rule regimes drive market participants to invest in the creation of CROs. Professor Merges argues that “[t]o encourage effective collective valuation mechanisms—liability rules—one should start with a property rule. The pressure of high transaction costs in an industry where repeat dealings are the norm will produce a better transactional mechanism than a legislature could create in advance.”¹⁸² Merges calls this process “contracting into liability rules.”¹⁸³ By settling with the author and publisher classes, Google has contracted out of the orphan works problem it faced, and contracted into a liability rule regime. The new CRO created under the settlement, the Book Rights Registry, will offer transaction cost savings far beyond those possible under the judicial liability rule regime of the proposed orphan works legislation. Moreover, unlike legislative fee schedules, the Book Rights Registry carries the benefits of expertly tailored valuation and strong incentives to invest in the underlying right.

Note that this analysis has been limited to the orphan works problem as it applies to the electronic books market, and that other markets, such as photographs, are beyond the scope of this Note. While this analysis does not focus on potential antitrust issues with the settlement, the Department of Justice should avoid aggressively pursuing the Book Rights Registry in its infancy. The Registry would likely avoid the label of per se illegal price fixing, and would likely survive a rule of reason analysis in light of the potentially large transaction cost savings and the non-exclusivity of the Registry’s authority even if some monopoly concerns exist.¹⁸⁴ Nevertheless, bogging the Registry down with expensive litigation at its birth could prevent its potential benefits from ever being reaped by rightsholders, Google, or consumers. Specifically, it could hinder the Registry’s potential to serve as a central clearinghouse for electronic books

¹⁸² Merges, *supra* note 11, at 1392–93.

¹⁸³ *Id.* at 1303.

¹⁸⁴ See *supra* Part VI.D.

that works with a myriad of retailers. The Department of Justice could, however, demand certain modifications to the Settlement Agreement, as discussed in Part VI.D, *supra*, in order to reduce the monopoly concerns surrounding the settlement.

In short, as stated at the outset of this Note, Congress should not hastily enact legislation (such as the Orphan Works Act proposed last year) without allowing sufficient time for the market to attempt to solve the orphan works problem on its own. The orphan works problem sprang largely from the 1976 Copyright Act, and industries may be on the verge of finding innovative new ways to reduce the high transaction costs associated with locating the rightsholders of orphan works. In the digital age, these solutions to the orphan works problem could come in forms Congress could never have imagined. Instead of changing the rules of the playing field, Congress should strive to maintain a level of consistency that will assist industry participants in making long-term decisions about investing in solutions to the orphan works problem.

VIII. CONCLUSION

This Note has described two very different attempts to solve the orphan works problem. First, the orphan works legislation proposed last year, which would have implemented a judicial liability rule regime with respect to orphan works, limiting the damages that rightsholders could extract from infringers if the user made a reasonably diligent search for the rightsholder prior to using the work. Second, the Google Book Search Settlement, which creates a new CRO called the Book Rights Registry to locate and pay rightsholders for Google's use of their works, and which gives Google the right to make productive use of orphan works without the need to first locate and obtain the permission of the copyright holders of the orphan works. The settlement, thus, serves as a private market solution to the orphan works problem. This private market solution is preferable to the proposed congressional solution in light of the large transaction cost savings and expertly tailored valuation that will result from the new CRO. The current copyright regime in the United States, which imposes large statutory damages for unauthorized uses of copyrighted works, serves as a catalyst forcing private companies to find their own solutions to the orphan works problem. For this reason, Congress should refrain from hastily passing new legislation, and should instead leave the current regime in place and wait and see if companies contract out of the orphan works problem on their own.

We are entering a new era in the market for books as retailers, libraries, authors, and publishers adapt to the vastly reduced transaction costs possible in the new digital age. It is my hope that this Note has shed some light on an important aspect of the Google Book Search settlement—its function as a private market solution to the orphan works problem—and that policy makers and legal scholars will not overlook the significance of this new development as they continue to debate solutions to the orphan works problem in the future.