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The Economics of Copyright and Fair Dealing

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The Economics of Copyright and Fair Dealing^{*}

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Résumé / Abstract

La *Loi sur le droit d'auteur* (L.R.C. 1985, ch. C-42) comporte plusieurs exceptions au droit exclusif des titulaires de droit d'auteur, parmi lesquelles se trouvent les dispositions sur « l'utilisation équitable » qui stipulent que l'utilisation équitable d'une œuvre littéraire ou artistique aux fins d'étude privée, de recherche, de critique et de compte rendu, de communications de nouvelles ne constitue pas une violation du droit d'auteur. Notre objectif ici est de caractériser le rôle et la nature de cette exception *du point de vue* de la théorie et de l'analyse économiques contemporaines et à la lumière de la récente décision de la Cour suprême du Canada en la matière (CCH Canadienne Ltée c. Barreau du Haut Canada, 2004 CSC 13, [2004] 1 R.C.S. 339).

Mots clés : droit d'auteur, utilisation équitable, Cour suprême.

The Copyright Act (R.S.C., 1985, c. C-42) includes several exceptions to the exclusive right of copyright holders, including the provisions concerning "fair dealing", which state that fair dealing in respect of a literary or artistic work for the purposes of private study, research, criticism or review, or news reporting does not constitute a violation of copyright. Our objective in this paper is to characterize the role and nature of this exception from the standpoint of contemporary economic theory and analysis and in the light of the recent Supreme Court of Canada on this subject (CCH Canadian Ltd. v. Law Society of Upper Canada, [2004] 1 S.C.R. 339, 2004 SCC 13).

Keywords: *copyright, fair dealing, Supreme Court.*

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1. The *Copyright Act* (R.S.C., 1985, c. C-42) includes several exceptions to the exclusive right of copyright holders, including the provisions concerning “fair dealing” in sections 29, 29.1 and 29.2. Sections 29, 29.1 and 29.2 state that fair dealing in respect of a literary or artistic work for the purposes of private study, research, criticism or review, or news reporting does not constitute a violation of copyright.

2. The specific purpose of this article is to answer the following five questions *from the standpoint* of contemporary economic theory and analysis:
 - [Q1] What is the economic basis for the fair dealing exception in the *Copyright Act*?
 - [Q2] To what extent does the absence of efficient markets, likely to allow authors and those who want to use their works to effect a monetary exchange in copyright matters, justify an expansive interpretation of fair dealing?
 - [Q3] What explains this absence of efficient markets for copyright works and what impact does the absence of such markets have on the creation and dissemination of literary and artistic works?
 - [Q4] What are the possible mechanisms for creating markets in which the market creation could contribute to gains in productivity, efficiency, and significant benefit thanks, among other factors, to the lowered costs of these transactions and the reduction in the social costs that the lack of such a market causes?
 - [Q5] To what extent should the fair dealing exception for literary and artistic works protected by copyright depend upon proof that the use of the works has not had an unfavourable effect on the market for the works in question?

Plan and Summary

3. To properly understand the source of the problems posed by an economic analysis of copyright, and of the limits and exceptions that might be usefully introduced, particularly with respect to the concept of “fair dealing” in literary and artistic works [hereinafter referred to as “works”] that are protected by copyright, and the market mechanisms that are likely to increase the economic efficiency of copyright, one must begin by considering conditions for efficiency (efficient allocation of human and physical resources, efforts, and talents to production and distribution) that are specific to the field of such works. That is what we will do in the first two sections.
4. After that, in Section III, we will look into the limits of copyright, and in particular the specific exception that “fair dealing” constitutes for works protected by copyright. We will examine the Supreme Court decision in *CCH Canadian Ltd. v. Law Society of Upper Canada*. In Section IV, we will move on to an economic analysis of the reasons given as a possible rationale for a relatively liberal interpretation of the fair dealing concept.
5. In Section V, we will look into conditions that allow efficient markets or market mechanisms to emerge, which will lead us to comment on the appropriateness of factoring in these effects on the market, and hence on the value of the work, in an effort to provide a framework for the fair dealing concept.
6. In Section VI, we will consider alternatives and the role that an organization like Access Copyright may be able to play in increasing economic efficiency in the production and distribution of works protected by copyright, particularly in terms of the reproduction and photocopying of works.
7. Relying strictly on economic theory and analysis, we will develop a line of argument that leads to the following conclusions, with specific examples to support the conclusions.
[R1] There are purely economic reasons for the fair dealing exception to the exclusive rights of creators over their works.

- [R2] It is in the interest of a socially efficient assignment or allocation, now and in the future, of resources for the production and dissemination of works in a manner consistent with the recent Supreme Court decision, that this fair dealing should be
1. an integral part of the rights of users and ought not to be unduly thwarted
 2. defined appropriately, particularly when research and private study are the purposes of the use, in order
 - a. to avoid any unintended harm to the copyright
 - b. to foster the emergence of efficient means of exchange (market-based institutions) between users and creators of copyright works while respecting the rights of each.

It is within this analytical framework that we must consider not only alternatives to the use of works protected by copyright but also alternatives to the exercise of the fair dealing exception itself, particularly in view of the recent Supreme Court decision.

- [R3] There are economic reasons to explain the absence of efficient means of exchange (efficient markets) in copyright, particularly with respect to the right to reproduce works; this absence of efficient market mechanisms may have socially undesirable consequences on the production and distribution of original works, hence the importance of properly understanding the underlying reasons for this in order to be able to devote the resources needed to solve the problems that may arise as a result.

- [R4] The identification and measurement of the effects of fair dealing on the work, the markets for the works, and hence their value are certainly factors that are relevant in establishing a reasonable framework for this copyright exception, but the way in which it is measured must, if the expected results are to be achieved, be based on a broadened definition of the concept of a “market” and hence a broadened definition of the concept of “value.” A market, from the standpoint of economic theory and analysis, includes much more than the number of units transacted between sellers and buyers. It also includes
1. potential buyers (those who would buy or buy more at a lower price) and potential sellers (those who would sell or sell more at a higher price)

2. future buyers and sellers
3. information providers, who assess, analyze, or confirm the quality of goods and services, trend analysts, and journalists who make sure that accurate news is available, etc.
4. generally speaking, all suppliers of ancillary services within a market or related to a market
5. and above all, the institutions that organize and facilitate transactions, for example by maintaining physical or virtual premises that conduct transactions, processing the financial transactions alongside the transactions in goods and services, which provide the market liquidity that makes it possible for buyers and sellers to find one another and to meet in one form or another to negotiate and eventually do business, etc.

[R5] Preference should be given to a policy for the creation of efficient market mechanisms for the reproduction of works that places an emphasis on simple and low-cost mechanisms, and that fosters the production of high-quality original works and the distribution of works, with due regard to the rights of authors and users. This specifically is what we will analyze here: the role and appropriateness of the licences issued by Access Copyright.

I. Introduction: The Problem

8. According to Maurice Allais, who won the 1988 Nobel Prize for Economics, the goals of economics are, on the one hand, analysis and research into the mechanisms that can contribute to meeting the virtually unlimited needs of human beings with the limited resources available to them and, on the other hand, to define and characterize those institutions that can provide a framework for doing so. In order to meet their needs, people consume goods and services whose nature and characteristics play a major role in the choice of efficient mechanisms for producing, distributing, and using them.
9. Works are particular goods whose characteristics are, however, well known to economists. They may be described as the goods or products of “information.” Unlike typical products such as farm or manufacturing products, information products (whether they take the form of entertainment, legal knowledge, technological information, software or expertise), have the following features: once the information has been produced or made, it can be reproduced, distributed, or disseminated at zero cost. Likewise, when the information product has been produced or created, identical or nearly identical copies can be made at zero cost or almost zero cost, and made available simultaneously in competition with the original product in the marketplace.
10. In other words, producing a work requires significant fixed costs, but once the work (the original copy) has been made, the cost of making a reproduction is almost zero: the *marginal* reproduction cost is close to zero.
11. How then ought we to define the level of consumption of an information product to ensure not only that the maximum material well-being is provided for citizens but also that existing institutions will be able to achieve this level of consumption? It is a complex issue. The optimal level of consumption is generally considered to be the level achieved when the price of the good is equal to its marginal production cost, insofar as demand or consumption of the good at this price is such that the monetary value of the total net surplus generated (that is, the total value of consumption less the total cost, which is the

sum of the fixed cost and the variable cost of production) is positive. Otherwise (negative total net surplus), it is better not to produce the good in question. Thus the optimal consumption level (production, distribution, and dissemination) is either zero or equal to the level obtained through the marginal cost pricing. This level corresponds to what economists call a first-best optimum.

12. A competitive market is generally the preferred mechanism for defining and achieving an optimal level of production and consumption. But for an information product, a price that is equal to the marginal cost of (re)production will not enable the seller/producer to generate revenue sufficient to cover all of the costs involved in production and distribution, and in particular the significant fixed costs.
13. A competitive market (price = marginal cost) can therefore not be used directly to provide an optimal allocation of resources because the price of works should by definition be zero or almost zero. This means that it is highly likely that too few individuals would be prepared to take up a career as an author and to devote the time and resources needed to produce quality original works.
14. In response to this problem, two streams of thought have developed. The first argues that one ought to assign property rights to authors and allow the market to emerge and determine an equilibrium price (that is, one that ensures that authors and consumers/users are satisfied with the exchange or transaction level that is thereby achieved; the level obtained is called individually rational because no agent would want to alter the price in question) that is higher than the marginal cost and makes it possible to cover all of the production and distribution costs.
15. The other stream of thought argues that we must promote strict research for a socio-economic optimum and to guarantee that, with the cost for the (re)production of a work at zero, the use and reproduction of works will be free of charge. Authors would then have to be compensated in various ways from government subsidies with the government, in

return for its subsidies, claiming the right to distribute the work free of charge. Each of these approaches poses specific problems.

16. Overly high copyright royalties could give the producers of the work a monopoly, and we all know that a monopoly is rarely the optimal solution: the price of each copy could be too high and the number distributed too low. Furthermore, each work is clearly the indirect result of the previous works. As the adage goes (reformulated yet again): “A dwarf sitting on a giant’s shoulders can see much farther than the giant.” Overly punitive copyright royalties might lead to a level of use that is less than optimal because of an overly limited distribution of the works.
17. Free use has its own set of problems. If the government had to fund the production of works, whether directly through grants to creators or indirectly by keeping a record of every use, how could it establish the relative value of the works produced in order to compensate authors properly? The government might want to control its disbursements, reduce them or even link them to arbitrary factors, to the detriment of authors and users.
18. This brings us once again to what I described above, that is, the limits to a competitive market for an information product. What author would be prepared to spend time and resources to produce a quality product whose selling price depends on the goodwill of the machinery of government? Free use (distribution) would likely lead to the same situation as author royalties that are too high: a reduction in knowledge and ideas, this time resulting from underproduction of quality works rather than from overly limited distribution of the works.
19. Between these two alternatives, represented at one extreme by giving market power to authors through stiff royalties and, at the other extreme, the free use/reproduction of works resulting from low royalties, what position ought to be adopted?
20. Fair dealing lies at the heart of this issue. The concept makes it possible in a number of specific cases to “infringe” authors’ rights without the risk of legal action: this is a form

of confiscation of the (intellectual) property rights that belong to an individual for the benefit of the community. Seen from the confiscation viewpoint, we can see the risks involved in inappropriate use of this tool. What then is the proper role for fair dealing? At what point does the balance tip from a form of fair dealing that creates wealth to an excessive use that destroys wealth?

21. Economic analysis can provide answers to these questions. The problem is complex, as Cooter and Ulen suggested in *Law and Economics*, HarperCollins Publishers, 1998: “Put succinctly, the dilemma is that without a legal monopoly not enough information will be produced but with the legal monopoly too little information will be used.”
22. Obviously, solutions will not be completely efficient or optimal in the sense of a first-best optimum, whether the solution is from the standpoint of what provides the level of production and consumption that maximizes the overall welfare of citizens, whether they are authors/producers or consumers.
23. The whole art lies in finding a solution that can be useful and be realized at low cost while at the same time coming close to an optimal solution. One can obtain an idea of the complexity of the task by looking at the considerable efforts currently being made on behalf of those entitled to royalties on recorded music to identify new business models that could strike a balance between the rights of authors, composers, performers, and producers on the one hand and the rights of consumers and users on the other within the framework of technological developments that make the complete repertoire of recorded musical works potentially available at a marginal cost or almost zero.
24. Before describing in detail, in the second part of this report, the solution that economic analysis suggests, it is useful to briefly review the key factors involved, namely the working documents and the relevant decisions that allow us to zero in on the complexity of the problem, in order to be able to demonstrate why the proposed solution is useful and also to convince the various stakeholders of that. This is what the next few sections focus on. As we will not be able to implement a completely efficient solution (first-best), it is

important to remember that as soon as one enters into a realm of solutions that have bounds placed upon them, the best becomes the enemy of the good: things never work out well when you run with the hare and hunt with the hounds.

II. The Allocation of Resources to the Production/Dissemination of Works

A. The Concepts of Public Good, Private Good, and Private-Public Good

25. The concepts of public good and private good lie at the core of any economic analysis of efficient fair dealing with works. Private goods and services represent the vast majority of goods produced and consumed in our societies. Private goods possess two important properties that condition their exchange, price, and levels of production: exclusion and rivalry.
26. Exclusion refers to the fact that it is possible to prevent an individual from consuming the product in question if that individual refuses to pay the asking price. Rivalry refers to the fact that the consumption of one unit of the good by an individual destroys it and thus prevents the consumption of that *same* unit by another individual. Furthermore, private goods are additive or divisible in the sense that the total quantity of private goods consumed is the *sum* of the quantities consumed by each individual.
27. For public goods, the very opposite is the case. They are characterized by the properties of non-exclusion and non-rivalry. Non-exclusion means that it is technically or economically impossible to exclude an individual and prevent that person from consuming the good or service in question, even if the individual refuses to pay the asking price. Non-rivalry means that many individuals can consume the *same* unit at the same time and in some cases the whole of the good in question. Unlike private goods, public goods are non-additive or indivisible: each individual can consume all of the public good while the level (the total quantity) of the public good available remains identical no matter how many individuals consume it.

28. To illustrate these concepts, we can use national defence and street lighting as examples of public goods, and food and clothing as examples of private goods. On the one hand, if I eat a tomato, I destroy it and that particular tomato cannot be consumed by anyone else (rivalry). An individual can also be prevented from consuming a tomato if he refuses to pay the asking price (exclusion). On the other hand, I can benefit from the security provided by national defence, and implicitly I consume it in its entirety, and this does not prevent my neighbour from benefiting equally from the security provided by national defence, which he implicitly also consumes in its entirety (non-rivalry). I contribute to the financing of the government-determined level of national defence through my taxes. If my neighbour can choose whether or not to contribute to national defence and refuses to do so (let us assume that it is possible for him to refuse to have his taxes used to pay for national defence), he would nevertheless continue to benefit from the *same* level and quality of security as mine, because it is impossible for the national defence authorities to protect only those who pay into it (non-exclusion).
29. At a concert, the seats are private goods, but the performance or concert itself is a public good (local). I can consume the whole concert, all the instruments and all the performances, all the notes and all the voices without preventing my neighbour from also consuming all of these (the concert “product” has the properties of non-rivalry and non-exclusion). On the other hand, it would not be a good idea for a person to try to sit in my seat (the “product” that is my seat has the properties of rivalry and exclusion). The concert experience thus consists of a public good and a private good.
30. What is the best way of determining the quantity (level, quality) that is socially efficient in producing a product, good, or service? What is the best way of determining the quantity that each individual should consume?
31. For private goods, the market is the most efficient tool. Through a trial and error process, it is possible to establish an equilibrium price that generally meets supply and demand requirements (no buyer and no seller wants to change the amount of the supply or demand at the price in question). This equilibrium price also means that all exchanges

that generate an enhancement of well-being (that is, when the value of the product in the hands of the buyer is higher than its value in the hands of the seller) are effectively achieved.

32. For public goods, no business is encouraged to produce these goods for the benefit of citizens because the properties of non-rivalry and non-exclusion mean that this business would be unable to obtain financing and cover the production costs. The market is therefore not a solution that can be considered directly. The financing of public goods is accordingly accomplished by means of taxation (and the coercive power that accompanies the right to collect taxes), which may constitute an implicit price often based not only on the marginal value to each consumer of the public good or service in question but also on the ability of citizens to pay taxes. It is worth noting that public goods and services are not necessarily produced by the State and that the State can produce private goods. The State can also assign the production or activity to various firms while funding them at the same time. It is therefore important to avoid mixing up “public goods and services” in the sense of the political organization with “public goods and services” from the standpoint of economic analysis; in the former, the (public) producer of goods and services is at issue whereas, in the latter, we identify the presence or absence of certain properties, in particular the properties of non-rivalry and non-exclusion.
33. Some goods possess only one of the two properties, either exclusion or rivalry. These may be considered private-public goods, which are sometimes called mixed goods or impure public goods. Private-public goods with the properties of exclusion and non-rivalry, such as cable television networks, can thus be distinguished from private-public goods with the properties of non-exclusion and rivalry, such as public parks (which may become congested).
34. It is difficult for the market to optimally allocate resources to the production and distribution of private-public goods that are non-exclusive and rivalrous. It is nevertheless

not necessary to examine this in further detail in this report, because non-rivalry is an important characteristic of works.

35. On the other hand, the market can optimally allocate resources to the production and distribution of private-public goods that are exclusive but non-rivalrous. Indeed, the fact that I can read a work in its entirety does not prevent my neighbour from reading the *same* work in its entirety. The number of readers can increase considerably without making any changes to the “amount” of the work: there is no rivalry in the consumption of the work itself. But what about the property of exclusion for this same work? Are works in fact non-exclusive and non-rivalrous public goods or are they exclusive and non-rivalrous private-public goods?
36. Before answering these questions, we need to look at the different forms of exclusion. Exclusion can be technical, legal, or economic. Exclusion is technical if it is possible to accurately identify the group or set of consumers of a particular good or service (for example, users of a toll highway). It is legal if, based on the principle that technical exclusion is impossible, the law requires users or consumers to identify themselves without necessarily requiring them to pay. For example, in France, owners of “dangerous” dogs need to identify themselves to city hall. Lastly, the exclusion is economic if it is possible not only to identify the users (that is, if there is a technical or legal exclusion) but also set a price that establishes the level of exclusion (the dividing line between users and non-users). Generally speaking, technical and legal exclusions are followed by economic exclusions that make it possible to directly finance, in whole or in part, the production of private-public goods or services that are consumed.
37. As we shall see, at the outset, works constitute public goods that benefit from becoming private-public in order to ensure that their existence, emergence, and development are ensured. The property of non-rivalry is obvious for works. Alternatively, the property of non-exclusion that often exists at the outset may be challenged. Throughout the history of the copying of works, exclusion has virtually always been envisaged and applied. However, the form of this exclusion has evolved considerably.

38. In times gone by, exclusion was technical. Indeed, because of technical limitations related to the reproduction of works, only copies sold by transcribers and later by printers were available. As a result of technical advances, technical exclusion gradually faded into the background in favour of legal exclusion in the form of copyright. Let us note also that economic exclusion has always been applied to copies of works, because copies of works have generally been sold in the marketplace: those who refuse for a variety of reasons to pay the asking price for a particular work had no option but to do without the work in question. The advent of photocopying and low-cost digitization changed everything.

B. The Role of Information

39. The basic problem involved in the efficient or optimal allocation of resources (how many resources? which resources?) to the production and dissemination of the works, as for many other products and services, results from the fact that information about the costs (total and marginal) of producers/sellers/suppliers and about the values (total and marginal) that users/buyers/consumers attach to or receive from each of the works is *imperfect* and *incomplete*. It is therefore within this imperfect and incomplete information universe that we must characterize the institutions most likely to successfully achieve the proper level for the production and distribution of the works.

Perfect and Complete Information

40. A perfect information universe is one in which there are no uncertainties or unknowns although the agents may have different information: costs may be known with certainty but only by the producers, and values may be known with certainty but only by the users. A complete information universe, on the other hand, is defined as one in which all agents have the same information or the same information structure even though the information may be imperfect and hence uncertain.

41. In a perfect and complete information universe, one in which it is possible to observe the work and the costs of authors/producers with certitude and to unfailingly be able to appraise the quality of the works produced, that is, the value that users attach to the works produced, the latter could be considered pure public goods and could (should) be financed by the State.
42. Indeed, once a work has been created, possibly at considerable expense to the authors (the costs incurred being considered (i) fixed, as the costs to create the work are independent from the number of copies or future users, and (ii) unrecoverable, as the costs incurred that cannot be recovered if it is ever decided one day to destroy the work in question), the reproduction and distribution of the work are possible at zero or almost zero marginal cost. This amounts to a framework in which there would be neither rivalry nor purpose to exclusion. This is the perfect and complete information universe that many stakeholders refer to when discussing copyrights, often without mentioning it explicitly. That's a source of analytic misunderstandings and mistakes that are unfortunately all too common.
43. A benevolent state with access to all relevant information (in a perfect and complete information universe), could make appropriate payments directly to authors for their specific works created from the significant exercise of their talents, judgment, and labour, and it could even distribute and disseminate the works produced to all user citizens. The benevolent State
- in doing so, would make the maximum dissemination of these works and ideas possible
 - would thereby promote the emergence of a situation described by Justice Binnie (in *Théberge v. Galerie d'Art du Petit Champlain Inc.*, [2002] 2 S.C.R. 336, 2002 SCC 34, par. 30-31, as cited in *CCH Canadian Ltd. v. Law Society of Upper Canada*, [2004] 1 S.C.R. 339, 2004 SCC 13, par. 10) described as "... a balance between, on the one hand, promoting the public interest in the encouragement and dissemination of works of the intellect and the arts and , on the other hand, obtaining a just reward for the creator ...,"

- and would thereby contribute, as is proper, to the optimal development of the arts and sciences.

To use the language of economic theory, this situation corresponds to a first-best optimum.

Imperfect and Incomplete Information: Second-best Optimum

44. We are not living in a perfect and complete information universe. Each economic agent, whether authors or users, has private information (incomplete or asymmetric information) that they can and generally do use in order to pursue and achieve most of their own objectives. Furthermore, the available information is generically imperfect or uncertain. Under such conditions, the State, however benevolent it may be or want to be, is not in a position to establish a level of compensation that would encourage authors to produce the combination or portfolio of works that are “socially optimal,” whether from the standpoint of either quantity or quality, nor is it in a position to distribute and disseminate works on the basis of the relative total and marginal values assigned to them by the people who are users. The consequences of this information problem can take different forms, but the direct remuneration of authors by the State would, in all likelihood, give rise to favouritism in addition to the overproduction of works of insufficient quality.

45. To avoid these traps caused by imperfect and incomplete information, it is essential to think about, devise, and make use of alternative mechanisms that are necessarily imperfect and less than optimal but which are nevertheless relatively effective in a context in which the imperfection and incompleteness of information is unavoidable, meaning that it is impossible to achieve a first-best optimum. This leads us to the solution that economists call the second-best optimum.

46. In searching for an *optimal* solution *when there are information constraints*, an effort should naturally be made to diverge as little as possible from the first-best optimal solution. Doing so will mean that the inevitable and inescapable loss of optimality will be as small as possible. In this second-best optimum, the agents involved, whether

producers/sellers/suppliers or users/buyers/consumers, should be asked and encouraged to implicitly and credibly reveal their private information about costs and values. This implicit disclosure is necessary if the mechanism for resource allocation is to play its role, in keeping with the principles of justice and fairness for which the Supreme Court itself spoke, citing David Vaver (*Copyright Law*, Toronto, Irwin Law, 2000, p. 171): “User rights are not just loopholes. Both owner rights and user rights should therefore be given the fair and balanced reading that befits remedial legislation.” [CCH Canadian Ltd. v. Law Society of Upper Canada, [2004] 1 S.C.R. 339, 2004 SCC 13, par. 48]

47. The asymmetry of information is not, however, an insurmountable problem. It is appropriate to sacrifice one of the two properties of a public good to ensure production and dissemination. The rights solution adopted in respect of creative works has thus been to give authors a property right, and hence an exclusive or exclusionary right, over their works. Thus although non-rivalry exists, and is admitted as obvious and unavoidable with respect to works that can be reproduced at almost zero cost, non-exclusion can be circumvented, controlled, and mothballed, at least in part, for the explicit purpose of encouraging the emergence of a resource allocation that is compatible with the value of the works produced by the authors/creators and the need to encourage good authors to produce good works: only good authors and only good works.

48. The basic idea, which may appear counter-intuitive if we fail to place it within an imperfect and incomplete information framework, is the following: the exclusive right [the copyright] — exclusion right — to reproduce the work, to perform or represent it in public, to transform it or adapt it, translate it, publish it, communicate it to the public by telecommunications, and to authorize these actions will in fact ensure that there is significant dissemination, if not optimal or maximal dissemination. From a public good in a perfect and complete (utopian) information universe, works thus become non-rivalrous and exclusionary private-public works in the real universe of imperfect and incomplete information which is our actual information universe.

49. The creation of copyright is what makes exclusion possible. In the short term (static), these copyrights and the level of exclusion to which they lead generate inefficiency and sub-optimality. Indeed, photocopying a work does not destroy it and can be done at almost zero cost. Thus, once a work has been produced, it becomes effective to multiply the copies in order to disseminate it as widely as possible. However, this solution would generate and allocate only a minimal portion of the rewards derived from the works to their authors. This fact necessarily reduces the incentive to creation, putting an end (dynamic) to a situation of chronic underproduction of quality works — to everyone’s detriment, whether authors/producers/suppliers or users/consumers/buyers.
50. It would therefore be appropriate to give owner rights to authors (copyright) and to encourage the development of a set of mechanisms and market procedures in which authors/producers/suppliers and users/consumers/buyers can trade freely. Copyrights have a basic and essential characteristic, which is that they can be traded, bought, and sold. They thus make it possible to create a market that is capable of “correcting” the very public (pure) nature of goods/works (in a perfect and complete information universe), which without this correction would lead to the underproduction of quality works (in an imperfect and incomplete information universe). This exclusionary power can and should under normal circumstances allow for the emergence of willing exchanges between the parties. As in any other competitive market, the interests of authors and users are likely to be balanced in terms of price, quality, and quantity.
51. In reality, the emergence of efficient markets can be impeded by several factors that may turn out to be present in the market for the works that are under consideration in this report. We will return to this in Section V after reviewing in the next section the restriction on the expression of copyright that is bound up in the rules on fair dealing, as stipulated in the *Copyright Act* and interpreted by the courts, including the Supreme Court, and after having proceeded to an economic analysis of the reasons for this restriction.

III. Limits on the Expression of Copyright

A. Fair Dealing in Copyright Law

52. Canada's *Copyright Act* protects the works of creators by giving them the sole right to authorize the publication, performance, or reproduction of these works (s. 3(1)). Copyright applies to the following original works: works (books, brochures, poems, computer programs), dramatic works (films, videos, plays, screenplays, and treatments), musical works (compositions that include both lyrics and music or music alone), artistic works (paintings, drawings, maps, photographs, and sculptures), and lastly architectural works. Copyright also applies to the performance of works by a performer (s. 15), to sound recordings such as records, cassettes, and CDs (s. 18), and also to broadcasting communication signals (s. 21).

53. Copyright protection is automatic in Canada: as soon as the original work has been fixed (in print, in a recording, or electronically saved), it is immediately protected by copyright. International treaties also protect Canadian copyrights in most foreign countries and vice versa.

54. In Canada, copyright protects intellectual property rather than physical property: the words in a novel or a song, rather than the book or paper itself on which the novel or song may be printed. Copyright protection also expires in law at a particular point in time.

55. The *Copyright Act* assigns sole rights to the creator of a work or to the copyright holder of the work, including the following rights:

- . the sole right to reproduce the work
- . the sole right to perform or present the work in public
- . the sole right to convert or adapt the work
- the sole right to translate it
- . the sole right to publish it

- the sole right to make any recording, film or other contrivance by means of which the work may be reproduced
- the right to communicate the work to the public by telecommunication, etc.

The Act also gives the creator or copyright holder the sole right to authorize any of the above.

56. The *Copyright Act* nevertheless contains several exceptions to the sole right of copyright holders, including the provisions on fair dealing in sections 29, 29.1, and 29.2. The concept of fair dealing has existed in various forms since the introduction of Canadian copyright legislation in 1924.

57. Section 29 states that fair dealing for the purpose of (i) private study or (ii) research does not infringe copyright. Section 29.1 states that, under certain circumstances, fair dealing for the purposes of criticism or review does not infringe copyright. For this exception to be applicable, a number of specific factors pertaining to the work must be mentioned. Depending on the circumstances, these are as follows: the source and the name of the author, performer, maker, or broadcaster. Lastly, s. 29.2 states that fair dealing for the purpose of news reporting does not infringe copyright if the same factors that were mentioned in connection with s. 29.1 are mentioned.

58. For fair dealing, it is not necessary to obtain the consent or authorization of the copyright holder, even if the behaviour or action of the user would normally constitute a copyright violation.

59. The concept of fair dealing suffers from not being defined anywhere. The courts have the difficult task of interpreting the meaning of this exception, and to make a determination from among different points of view. The procedure followed in such instances is as follows: first, the courts must establish that infringement of copyright has occurred; then, the burden to demonstrate that the activity is an exception rests with the defendant.

60. The few paragraphs above make it clear that everything is a matter of degree when one speaks of fair dealing. What is the importance assigned to this exception in Canadian case law today? Are we in a restrictive or expansive interpretation phase? To answer these questions, we will examine only the context for the important judgment handed down by the Supreme Court of Canada on March 4, 2004, in the case of *CCH Canadian Ltd. v. Law Society of Upper Canada*.

B. The Supreme Court: *CCH Canadian Ltd. v. Law Society of Upper Canada*

61. The Supreme Court of Canada in the case opposing *CCH Canadian Ltd.* to the Law Society of Upper Canada specifically addresses the concept of fair dealing.

62. The case leading to this judgment goes back to the early 1990s. The Law Society of Upper Canada maintains and operates the Great Library at Osgoode Hall in Toronto. This reference and research library has one of the largest collections of legal materials in Canada, and provides a request-based photocopy service for Law Society members, the judiciary, and other authorized researchers. Under this photocopy service, legal materials are reproduced by Great Library staff and delivered in person, by mail, or by facsimile transmission to authorized requesters. The Law Society also has self-service photocopiers available for use by patrons of the Great Library.

63. In 1993, three publishers of legal works in Canada, *CCH Canadian Limited*, *Thomson Canada Ltd.*, and *Canada Law Book Inc.*, commenced copyright infringement actions against the Law Society, seeking a declaration of subsistence and ownership of copyright in eleven specific works published by them: three reported judicial decisions, three headnotes preceding these decisions, the annotated *Martin's Ontario Criminal Practice 1999*, a case summary, a topical index, the textbook *Economic Negligence* (1989), and the monograph "Dental Evidence", being Chapter 13 in *Forensic Evidence in Canada* (1991). According to the publishers, the Law Society had infringed copyright when the Great Library reproduced a copy of each of the works through its photocopying service. The Law Society and the Great Library denied any liability.

64. The case went to trial in the fall of 1998 and a decision was handed down on November 9, 1999. In order to determine the originality of a work, according to Gibson J., the publishers' works should be judged against a standard of intellect and creativity. On the basis of this standard, the Federal Court found that the publishers had copyright only on the annotated *Criminal Practice*, the textbook *Economic Negligence* (1989), and the monograph "Dental Evidence." Gibson J. concluded that the remaining eight works were not original and therefore not covered by copyright.
65. In October 2001, the Federal Court of Appeal heard the arguments with respect to the appeal and the cross-appeal of the trial judgment and handed down its decision on May 14, 2002. The Law Society did not challenge the trial judge's (Gibson J.) findings with respect to the three works in question, but questioned whether the monograph constituted a work within the meaning of the *Copyright Act*. The Federal Court of Appeal adopted the "sweat of the brow" approach to originality. It found that a work that is not a mere copy is original. On the basis of this criterion, Linden J.A. held that the eleven works involved in the case were original and therefore covered by copyright.
66. On appeal from the Federal Court, the Supreme Court, through McLachlin C.J. took the concept of a work's originality under consideration. The Supreme Court held that the *Copyright Act* affirmed that copyright in Canada exists on "every original literary, dramatic, musical, or artistic work." Furthermore, the jurisprudence suggests different interpretations of originality. A number of courts use the sweat of the brow concept to define the concept of originality. It was enough for the work to be something other than a mere copy. For other courts, a work needed to be creative to be original.
67. In *CCH v. Law Society of Upper Canada*, the Supreme Court decided that the interpretation of the concept of originality should be somewhere between these two positions or definitions. Thus, to be considered original, a work must be more than a copy. It is nevertheless not essential that the work be creative. On the other hand, it is

essential that there be an exercise of skill and judgment. This exercise of skill and judgment will necessarily involve intellectual effort.

68. The Supreme Court then concluded, on the basis of these arguments and considerations, that all of the works at issue in the litigation were indeed original works and were, consequently, protected by copyright.

69. On the other hand, the Supreme Court found that the Law Society did not infringe copyright when a single copy of a reported decision, case summary, statute, regulation, or limited selection of text from a treatise is made by the Great Library in accordance with its access policy. Furthermore, the Supreme Court concluded that the Law Society did not authorize copyright infringement by maintaining a photocopier in the Great Library and posting a notice that it was not responsible for any copies made in infringement of copyright. The photocopy service constituted “fair dealing” in respect of the works in question.

70. The interpretation of s. 29 of the *Copyright Act*, which provides that fair dealing for the purpose of research or private study does not infringe copyright, therefore lies at the core of this judgment. In examining the notion of fair dealing, the Court made the following general observation:

“Before reviewing the scope of the fair dealing exception under the *Copyright Act*, it is important to clarify some general considerations about exceptions to copyright infringement. Procedurally, a defendant is required to prove that his or her dealing with a work has been fair; however, the fair dealing exception is perhaps more properly understood as an integral part of the *Copyright Act* than simply a defence. Any act falling within the fair dealing exception will not be an infringement of copyright. The fair dealing exception, like other exceptions in the *Copyright Act*, is a user’s right.” [CCH Canadian Ltd. v. Law Society of Upper Canada, [2004] 1 S.C.R. 339, 2004 CSC 13, par. 48; excerpts from this decision will be cited as follows in the form CCH par. NN]

71. Thus the Court clearly raised the status of fair dealing to that of a user right. The Court took this user right even further by stating:

“In order to maintain the proper balance between the rights of a copyright owner and users’ interests, it must not be interpreted restrictively. ... As Professor Vaver ... has explained: "User rights are not just loopholes. Both owner rights and user rights should therefore be given the fair and balanced reading that befits remedial legislation."” [CCH par. 48]

72. Certainly, the Court gave a rather broad interpretation of the term “fair dealing” and referred to the concepts of justice and fairness in interpreting the rights of both authors and users. The Supreme Court then established a number of important principles:

- the scope of fair dealing ought not to be restrictive;
- the exception provided in s. 29 of the *Copyright Act* may still be invoked by a defendant insofar as the defendant can prove that the work was used for purposes of research or private study;
- when a copy is made for research purposes, the word “research” must be given a broad meaning to ensure that user rights are not unduly restricted, even when the research is being conducted “for profit.”

73. The Supreme Court also noted that the *Copyright Act* does not explicitly define the notion of “fair dealing” and does not explain what needs to be understood by the notion. It asserts that it “is a question of fact and depends on the facts of each case” [CCH, par. 52]. It is definitely up to the judge of the facts to determine whether such use, which a user argues is fair by invoking the exception under s. 29 of the *Copyright Act*, in fact corresponds to “fair dealing” given the particular facts involved. Thus, the Supreme Court concludes on the one hand that the possibility or right to rely on or use the fair dealing exception must be recognized in a rather broad and liberal manner, but argues on the other hand that a framework is needed for reliance on the exception. Dealings that in principle could be considered *prima facie* as “fair dealing” could in fact, because of the use to which they are to be put, no longer be so, given the context for the use in question.

74. In order to determine whether a copy of a work does in fact constitute fair dealing, the Court cited Linden J. of the Appeal Court and considered six factors or criteria that provide “a useful analytical framework to govern determinations of fairness in future cases” [CCH, par. 53]. We describe below the six factors or criteria given in the CCH decision.

75. In the next section, we will delineate the characteristics for implementing or applying a number of factors or criteria, the kind of implementation or application that could benefit from the clarification provided by economic theory and analysis. These characteristics appear to be essential if the principles of balance and respect for the rights of all concerned, along with the principles of efficiency as put forward by the Supreme Court, are to be respected, realized, and implemented.

76. The six factors that define the analysis framework for fair dealing are the following:

- ***the purpose of the dealing***: “In Canada, the purpose of the dealing will be fair if it is for one of the allowable purposes under the *Copyright Act*, namely research, private study, criticism, review, or news reporting ... [Moreover] ...some dealings, even if for an allowable purpose, may be more or less fair than others ...” [CCH par. 54].
- ***the character of the dealing***: “In assessing the character of a dealing, courts must examine how the works were dealt with. If multiple copies of works are being widely distributed, this will tend to be unfair. If, however, a single copy of a work is used for a specific legitimate purpose, then it may be easier to conclude that it was a fair dealing. If the copy of the work is destroyed after it is used for its specific intended purpose, this may also favour a finding of fairness. It may be relevant to consider the custom of practice in a particular trade or industry to determine whether or not the character of the dealing is fair.” [CCH par. 55].
- ***the amount of the dealing***: “Both the amount of the dealing and importance of the work allegedly infringed should be considered in assessing fairness. If the amount taken from a work is trivial, the fair dealing analysis need not be undertaken at all

because the court will have concluded that there was no copyright infringement.” [CCH par. 56].

- ***alternatives to the dealing***: “Alternatives to dealing with the infringed work may affect the determination of fairness. If there is a non-copyrighted equivalent of the work that could have been used instead of the copyrighted work, this should be considered by the court. ...[I]t will also be useful for courts to attempt to determine whether the dealing was reasonably necessary to achieve the ultimate purpose.” [CCH par. 57].
- ***the nature of the work***: “The nature of the work in question should also be considered by courts assessing whether a dealing is fair. Although certainly not determinative, if a work has not been published, the dealing may be more fair in that its reproduction with acknowledgement could lead to a wider public dissemination of the work — one of the goals of copyright law. If, however, the work in question was confidential, this may tip the scales toward finding that the dealing was unfair.” [CCH par. 58].
- ***the effect of the dealing on the work***: “The effect of the dealing on the work is another factor warranting consideration when determining whether a dealing is fair. If the reproduced work is likely to compete with the original work in the market for the original work, this may suggest that the dealing is not fair. Although the effect of the dealing on the market of the copyright owner is an important factor, it is neither the only factor nor the most important factor that a court must consider in deciding if the dealing is fair.” [CCH par. 59]

77. With respect to the latter point, it is useful to recall here that the Supreme Court adds the following comment immediately after the specific case of *CCH v. Law Society of Upper Canada* (2004):

“Another consideration is that no evidence was tendered to show that the market for the publishers’ works had decreased as a result of these copies having been made. Although the burden of proving fair dealing lies with the Law Society, it lacked access to evidence about the effect of the dealing on publishers’ markets. If there had been evidence that the

publishers' markets had been negatively affected by the Law Society's custom photocopying service, it would have been in the publishers' interest to tender it at trial. They did not do so." [CCH par. 72].

And the Court continued with a comment concerning a possible way of measuring this effect on the market for the work:

"The only evidence of market impact is that the publishers have continued to produce new reporter series and new legal publications during the period of the custom photocopy service's operation." [CCH par. 72].

IV. Economic Analysis of the Concept of Fair Dealing

78. The six factors referred to by the Supreme Court to provide a framework for fair dealing with works protected by copyright may benefit, for the purposes of interpretation, from the light shed on them by economic theory and analysis. The purpose of our analysis here is to characterize, from the standpoint of economic theory and analysis, the desirable mechanics for applying these criteria to ensure that they lead to a satisfactory framework for the idea of fair dealing, as desired by the Supreme Court.

79. Economic analysis would appear to be the most likely tool for a rigorous analysis of the issues, definitions, comments, and observations that address (a) the conditions for an efficient allocation of resources to the production and dissemination of works, (b) the very concept of a market, and (c) lastly, on the observance of rights for individuals and groups, as much from the producer/seller/supply side as from the standpoint of the author/buyer/demand side, with respect to the market for a property such as a work.

80. The Supreme Court affirms that the use of a work for purposes other than those expressly foreseen in the *Copyright Act*, namely research, private study, criticism, review, or news reporting, will obviously not be fair dealing (CCH par. 54). But insofar as these acts or dealings with works protected by the *Copyright Act* are not specifically defined, and insofar as the Supreme Court affirms that the fair dealing exception ought not to be interpreted restrictively to avoid "the undue restriction of users' rights," the door would

appear to be open to the excessive use of the exception. Indeed, research and private study would seem at first glance to apply to a very broad and quasi-exhaustive number of dealings with works protected by copyright. Hence the need for a framework for the fair dealing exception, which is relatively liberal at the outset, and this to qualify it by means of other factors or criteria that are more practical, in order to maintain the balance between copyright holders and users. The Supreme Court attributes a great deal of importance to maintaining this balance. It is therefore with this in mind that we will consider below each of the five other criteria from the standpoint of economic theory and analysis.

81. The Supreme Court further asserted, with respect to the purpose of the dealing: “some dealings, even if for one of the allowable purposes, may be more or less fair than others” (CCH par. 54). In addition to “research done for commercial purposes,” which was mentioned by the Supreme Court, another case that is definitely relevant to the case currently before the Copyright Board deserves to be mentioned, namely the photocopying of a textbook whose market is necessarily limited to educational institutions. In this specific case, it is difficult to understand how one could allow fair dealing, even for the purpose of research and private study, without jeopardizing “obtaining a just reward for the creator.”

82. The Supreme Court stated “If multiple copies of works are being widely distributed, this use will tend to be unfair.” (CCH par. 55). It further stated “If the copy of the work is destroyed after it is used for its specific intended purpose, this may also favour a finding of fairness.” Thus the general fair dealing exception should be limited in time (destroyed after use) and in space (a single or virtually single copy, distributed in a limited way). This restriction in time and space is, to be sure, necessary to enable the copyright holder to receive a “just reward” for the creative work involved. Unless a fairly precise limit on fair dealing is defined, it is difficult to see how a balance between the rights of copyright holders and the rights of users can be achieved. In the above-mentioned case of photocopying a textbook whose market is necessarily limited to educational institutions, an economic interpretation of the criterion for the purpose of the dealing, and the

example of “study notes” mentioned by the Supreme Court (CCH par. 55) lead us to reiterate the conclusion of the previous paragraph: in light of the criterion concerning the type of dealing, it is difficult to see how one could allow fair dealing for this case without jeopardizing “obtaining a just reward for the creator.”

83. The Supreme Court stated that both the amount of the dealing and the importance of the work need to be considered in assessing whether or not the dealing was fair. Thus the use of a trivial part of a work is not considered a copyright infringement. From an economic standpoint, it is easy to understand this statement because copyrights that are too strict would inevitably lead among other things to an increase in the production cost of new works. Indeed, many works are inevitably derived from previous works. It is therefore far from obvious that a stiff royalty payment would lead to the promotion, advancement, and dissemination of culture and knowledge, because the production cost for each new work would thus possibly become exorbitant. From the standpoint of economic theory and analysis, one ought therefore to give due regard to the fact that, in the use of a small (trivial) portion of a work, access to the work is a public good. But how are we to interpret the expressions “importance of the work” and “a trivial part of the work” in connection with the given purpose?

84. The reproduction of a work, in full or otherwise, may be important for a given purpose, for example research, and not for another purpose, for example criticism. Similarly, the reproduction of a page, chapter, or poem in a collection of one hundred poems may be considered trivial or not depending on the context and size of the excerpt within the work in question. A published collection of one hundred poems may well be famous because of three or four poems within the collection. The reproduction of one of these three or four poems would then, from the economic standpoint, represent an important (and not trivial) dealing with respect to the work from the standpoint of quality if not quantity. It is difficult to determine how one might concretely define a general empirical rule for this criterion of the “amount of the dealing.” The only practical way to approach it appears to be on a case-by-case analysis, which is necessarily onerous for all the parties.

85. The existence of alternatives to the dealing in the work, covered by the fair dealing exception, according to the Supreme Court, should reduce the protection provided by the exception and lead the courts to consider unauthorized dealing in the work as a copyright infringement. How then to characterize these alternatives and determine whether an alternative exists or not? To answer this question satisfactorily, one must look into the reasons, from the standpoint of economic theory and analysis, that could justify fair dealing as an exception to copyright. That is what we will do below.
86. But it is safe to say at this point that the Supreme Court in CCH gives only examples of alternatives to dealing in the work (“non-copyrighted equivalent,” “alternatives to the custom photocopy service”), whereas what is needed from the standpoint of economic theory and analysis is also an examination of alternatives to “fair dealing” in the work. The difference is important and crucial. For example, we should consider the existence of an efficient and inexpensive mechanism that could allow users to acquire copyrights without relying on the exception relative to fair dealing as an alternative, not to the use of the work itself but to the reliance on the exception to fair dealing
87. Indeed, what is at issue is simply the cost in terms of alternatives and substitutes. It is clear that the alternative to the photocopy service that was considered by the Supreme Court (CCH par. 70), to wit requiring that patrons “always conduct their research on site at the Great Library” and “be required to do all of their research and note-taking in the Great Library,” would be unreasonable or excessive because it would be too expensive “given the volume of research that can often be required on complex legal matters.”
88. Leaving aside the unreasonable or excessive costs to users, the alternative would appear practically, physically, and technologically to be thoroughly feasible and affordable. Thus the economic interpretation of the criterion for alternatives to use, as illustrated by the Supreme Court, must pertain to and essentially be based upon an evaluation of the relative costs of the alternatives considered and on identifying those persons, whether users or copyright holders, who would be responsible for paying these costs. The paragraphs of the Supreme Court decision relating to a criterion for alternatives lead us to

think that in order to facilitate the work of users (and reduce the costs to them in the alternative being considered), the Court agrees that they should exercise the fair dealing exception without any compensation to the copyright holders.

89. Giving users the opportunity to have access to works while paying the relevant copyrights, for example by subscribing directly or indirectly to a licence made available indiscriminately to all users, is of the first importance. On this point, the Supreme Court states: “The availability of a licence is not relevant to deciding whether a dealing has been fair.” (CCH par. 70). This statement must be understood in relation to another statement in the same paragraph: “If a copyright owner were allowed to license people to use its work and then point to a person’s decision not to obtain a licence as proof that his or her dealings were not fair, this would extend the scope of the owner’s monopoly over the use of his or her work in a manner that would not be consistent with the *Copyright Act*’s balance between owner’s rights and user’s interests.” These two statements within the same paragraph are intimately bound up and must be interpreted as such.

90. An author could exercise potential monopoly over the work by marketing a licence for the use of the work, and it is in relation to this that the Supreme Court stated that the existence of such a licence is not relevant to deciding whether a dealing has been fair. An author could indeed exercise some market power — and we shall return to this below — and unduly control the use of the work by marketing a mandatory licence for the use of that work. This would get around the fair dealing exception admitted in the *Copyright Act*, and would for all practical purposes invalidate the right of users. This is what the Supreme Court explicitly intends to thwart by reaffirming the right of users to fair dealing in order to promote the dissemination of works.

91. It may be presumed that in the absence of this potential monopoly power, the existence of a licence would have a very different function, namely to simply and solely allow “just reward for the creator.” This is true for the case currently before the Copyright Board. It is the Board, and not any particular author, that would end up establishing the rate (the price or the value) of licences for a multitude of works.

92. In this context, the potential monopolistic power of the author over his work does not exist. Hence from the point of view of economic theory and analysis, a licence that would allow access, in a context that emulates a competitive marketplace analogous to Copyright Board hearings, to a multitude of works without users being subjected to the potential monopolistic power of authors, may represent an alternative not to the use of a specific work, but an alternative to the need to rely on the relative fair dealing exception, while at the same time promoting the achievement of the intended objective of this exception in addition to the objective of achieving a balance between user rights and the rights of creators.
93. With respect to the criterion of the impact of dealing on the market for works, the Supreme Court states: “The only evidence of market impact is that the publishers have continued to produce new reporter series and legal publications during the period of the custom photocopy service’s operation” (CCH par. 72). Clearly, this observation alone cannot constitute evidence that there is no impact on the market for the works in question. The main question remains open: how ought we, in the light of economic theory and analysis, to verify whether or not the presumed fair dealing has had an unfavourable impact on the market and hence on the value of the work in question? To answer this question, it is necessary to properly understand and define what constitutes the market for a work, which is in reality an asset, and what are the bases of its value.
94. As we mentioned above, a market consists not only of current and potential buyers and sellers now and in the future, but also providers of ancillary and related services, such as organizers and facilitators (*market makers*) and those responsible (lawyers and judges) for the design and enforcement of rules and laws concerning trade and contracts between buyers and sellers. It is clear that the impact of dealing on a work, its market, and hence its value, cannot be restricted to the observation that “publishers have continued to produce new reporter series and legal publications during the period of the custom photocopy service’s operation.” Restricting the impact on the work to this observation would amount to saying that when a big department store continues to operate in spite of

the many instances of shoplifting, it means that theft has no impact on the market for the goods being bought and sold. This is clearly not what the Supreme Court is stating.

95. Thus the effect of the dealing on the work must be understood to mean that what we are talking about is not only the direct impact on the behaviour of buyers and the behaviour of current sellers, but also the impact on all potential current and future buyers and sellers, on all suppliers of ancillary services who work to organize and facilitate the operation of the relevant markets (*market makers*, communicators, publicists and critics, computer experts and logistics specialists, lawyers and judges, bankers, etc.) and institutions (contracts, licences, property, etc.) that condition the existence of the efficient markets that promote the rationality of agents in an imperfect and incomplete information universe. The criterion for the impact of the dealing on the work, which is an important and generally acknowledged criterion, must in its application be based on a broadened concept of a market and hence of value, in order to promote the optimal allocation of resources to creation and production of original works and to their dissemination as well.
96. In order to complete the presentation on the economic perspective of factors or criteria that should, according to the Supreme Court, provide a structure for the exercise of the fair dealing exception, it is necessary to look into the reasons that could justify such an exception from the standpoint of economic theory and analysis. This issue refers here to the institutional conditions and arrangements that are conducive to fostering the emergence of the *appropriate* level of production for *quality* works at the *right* time. To use the language of economic theory, how and under what conditions would fair dealing contribute to the achievement of a second-best optimum, which is to say an allocation of resources to the production and dissemination of works that is the best possible under the constraints imposed by imperfect and incomplete information?
97. Three main economic rationales can be identified in connection with a relatively unrestrictive interpretation of the fair dealing exception: (i) limiting the potential market power that authors or some authors could exercise, (ii) fostering the dissemination of the ideas conveyed in the works and lastly, (iii) do the best possible in the absence of

efficient markets (owing to the significant transaction costs, for example, or the absence of appropriate institutions capable of facilitating exchanges).

Limiting the Market Power of Authors

98. With respect to the first argument put forward in favour of a relatively unrestrictive interpretation of fair dealing, one must consider the structure of the market in question. Economists agree that the market for works is not a pure and perfect competitive market. The main reason for this is that the goods exchanged are differentiated rather than homogeneous. The market structure to be analyzed in most cases matches what economists call “monopolistic competition.”
99. Monopolistic competition, when adapted to our context, may be described in terms of the following four characteristics: (i) authors produce similar products that are imperfectly substitutable — these are called varieties of differentiated goods; (ii) each author produces, at decreasing marginal cost, a variety for which the author may determine the conditions of use, for example the price; (iii) the number of authors is sufficiently high to make each of them negligible with respect to the whole; lastly, (iv) the market or the industry can be entered or left freely, meaning that expected economic profit is zero.
100. In view of the four characteristics, it can clearly be seen that monopolistic competition is not a monopoly. Copyright indeed gives an author a monopoly over a work, but substitutability among works, while not perfect, does nevertheless exist in an important and restrictive way in determining the price of a work. Should we, on the pretext that Apple’s iPod has been a commercial success and there are not yet any perfect substitutes, move a part of the patents protecting it into the public domain early? The market power of authors is generally weak, and when it is significant, it is usually because the work created is truly new (with no current substitutes) and valuable (in heavy demand). The profitability of a work is an incentive to the creation of new works of high value to compete with the work in question. Reducing or cancelling out this profitability would

significantly lower the incentive to creation at the expense of the current or future well-being of everyone.

101. To conclude, it is difficult if not impossible to establish the soundness of an unrestrictive interpretation of fair dealing if the objective of this interpretation is specifically to limit the market power of authors. Any argument that bases fair dealing on a general principle that presumes a need to control the market power of creators does not appear to be convincing, although there may be a number of situations that lend themselves to this interpretation.

Promoting the Dissemination of Ideas and Knowledge

102. The second argument for an unrestrictive interpretation of fair dealing is that the exception promotes the dissemination of ideas and knowledge. Surprisingly, the same argument is put forward as a rationale for the existence of both the *Copyright Act* and the exceptions to the application of the Act. From the standpoint of economic analysis, the argument is that a very high level of protection for authors leads to what economists call “the tragedy of the anticommons.”
103. The tragedy of the anticommons may be considered the reverse of the “tragedy of the commons,” a concept that for at least four decades has directly or indirectly inspired major works and international conventions on the management of the common resources of humanity such as water, biodiversity, the oceans, or greenhouse gas emissions. This vision, which is pessimistic and without any illusions about human nature, postulates that all common resources that are free and available to the whole of humanity are doomed to disappear because of inevitable chronic over-utilization.
104. The classic example of the tragedy of the commons is a village of herdsmen, in which each herdsman can let his animals graze in a field that does not belong to any particular person. Because the use of the meadow is free and without limits and the herdsman derives income from his livestock, it is in the interest of each herdsman to take his

animals to the meadow as often as possible, as early as possible, and for as long as possible. Inevitably, the meadow becomes a muddy field. In the end, everyone loses and the village disappears.

105. The “tragedy of the anticommons” gives consideration to and characterizes the reverse situation to the tragedy of the commons described in the previous paragraph. Here, several individuals own an essential feature of a common resource giving them a veto right over the use of the resource. The (high) number of veto rights inevitably ends in making it impossible to exploit the resource, because each individual wants as much compensation as possible for their veto right over the resource.
106. This problem is particularly severe in the area of patents, where excessive fragmentation of rights can occur when they are awarded for pieces of knowledge, so much so that it becomes impossible to use the invention because it involves negotiating so many different licences at such high cost.
107. A parallel can be drawn between copyrights and patents. One example would be a student who in order to complete an assignment, such as a thesis, wants to photocopy significant portions of dozens of works in university or public libraries. If the student had to contact each author to obtain approval or even negotiate the price of the photocopy with the author, it is reasonable to expect that few students would ever complete their assignments and theses or essays. Other examples naturally come to mind to provide a rationale, at least *prima facie*, for fair dealing for research purposes.
108. In short, the argument is that if complementary or quasi-complementary works are protected in numbers that are too large, or by royalties that are too high, there is a risk that they will be so under-used that the result would be a “tragedy of the anticommons.” This means that identifying and obtaining all the licences required would become too onerous in terms of time and resources. If the problem is particularly serious, then most or all works will not be able to be used and the rate of growth for innovations and the production of original works will suffer thereby.

109. The complementarity of works can be seen in many instances. In primary and secondary schools, works can definitely be viewed as complementary goods; to properly develop minds, students must have access to a rather large range of works of various kinds, various forms, and from various fields, the value of all of which is supermodular, with the marginal value of one work increasing as the other works are used. Let us examine this phenomenon.
110. Is broadening the fair dealing exception the best way to combat the possibility of a tragedy of the anticommons? In other words, in economic terms, should private-public goods, which are non-rivalrous and exclusive, be converted into works that are or could be quasi-pure public goods on grounds that there is a risk of under-utilization? This conversion would be effected by reducing the field of application of the property of exclusion, a reduction that would allow a less and less restrictive interpretation of fair dealing. Would possible gains in terms of dissemination not be offset (significantly) by the decrease in the incentive to produce that would result from limiting the exclusivity field of application? At another level, we find here once again the impact of dealing on a work. Increasing or simply facilitating the possibility of exercising fair dealing could lead to a significant reduction in the production of new works, hence the need to establish a framework for fair dealing that uses factors or criteria such as those set out by the Supreme Court.
111. To better answer the above questions, it would be appropriate to examine what is done in the field of patents. The solution there is to establish patent pools, while at the same time allowing exemptions for the experimental use of patents. This system was devised to counter the impact of the tragedy of the anticommons, to the greatest extent possible, with patent pools functioning as a mechanism that allows many firms or organizations to pool their patents in a way that is both necessary and sufficient to develop a given technology or to produce specific goods.

112. The objective of patent pools is to make available on the market a single licence for all the patents in question. The firms involved, namely those that place their patents in the pool, but other firms as well, may then purchase the licence in question in order to use the technology concerned and/or to make available the goods that make it possible to produce this set of patents. Generally speaking, the patent pool is administered by an undertaking established by the members of the pool and dedicated to the promotion of the single licence to various third-party firms. Examples of this (See Robert P. Merges, *Institutions for Intellectual Property Transactions: The Case for Patent Pools*, Faculty of Law, University of California at Berkeley, 1999) include patent pools for the production of sewing machines (1856), folding beds (1916), aircraft (1917), and various pools for the production of today's consumer electronics devices (1997, 1998, 1999).

113. Patent pools have in the past made it possible, and they still make it possible today, to frequently allow for the emergence of high value industries while observing the rights of the inventors who hold the patents that are thus commercialized. No one today would want to question the soundness of these patent pools, some of which are even facilitated by governments themselves, which are concerned to ensure that inventions and innovations contribute as much as possible and as quickly as possible to the welfare of their citizens. As stated by R.P. Merges, *op. cit. supra* 105:

“It is also worth noting that some pools have been formed only with the help of a “visible hand” to overcome the collective action problem inherent in group bargaining. In several cases where technology useful to the military was not being developed because of a logjam of conflicting property rights, the lurking threat of the eminent domain power contributed to the formation of patent pools. In at least one case, a long-term industry patent pool was formed in the wake of the government's forced licensing; this pool itself embodied an interesting governance structure built on an industry-wide practice of technology exchange through IPR [intellectual property rights] licensing. The emergence of these pools suggests an interesting avenue for future government policy: encouraging firms to contract around their patents as an alternative to more forceful government intervention, e.g., a compulsory licensing scheme.” (Source: George

Bittlingmayer, "Property Rights, Progress, and the Aircraft Patent Agreement," 31 *Journal of Law & Economics* 227, 1988).

114. Licences for the reproduction and photocopies of works protected by copyright, such as the licences issued by Access Copyright, may be considered completely analogous to the licences issued by patent pools. The same reasons that are given to justify, from the standpoint of economic efficiency in allocating resources to creation, invention and innovation along with the pools and licences to which they give rise and which establish a degree of balance between the rights of copyright holders and the rights of consumers, may be given to justify the development of licences for the reproduction and photocopying of works protected by copyright, including works in schools and libraries.
115. There is also the risk that patent pools could cause a number of competition problems. Such concerns include the possible reduction in horizontal market competition among those who are parties to the pool (if they are competitors), the risk of facilitating collusion in downstream markets, excluding competing technologies, or even reducing incentives for innovation. The competition authorities in various countries, including the European Union, the United States, and Canada, have established analogous criteria for the analysis of patent pools. The purpose of these criteria is to determine whether the technologies pooled together in this way are substitutes or complements, and they also take into account other considerations designed to identify any provisions that are likely to reduce competition. For copyright management organizations like Access Copyright, the latter problem does not arise insofar as rates are submitted for approval to the Copyright Board of Canada which, before ruling on tariffs, hears the arguments from the various parties concerned.

Countering the Negative Effects of the Absence of Efficient Markets

116. The third argument for fair dealing as an exception in the *Copyright Act* is the absence of efficient markets that would allow for copyrights to be transacted. Let us take for example a user who wants to photocopy part of a work, presumably in infringement of

copyright, but who has no information about how to proceed to pay the copyright. Doing so would require that the user spend significant time and resources to do so, and it would be virtually impossible to accomplish this at reasonable cost.

117. On the face of it then, in this specific instance, the fair dealing exception to the *Copyright Act* could be retained. If the costs that would be incurred to pay the copyright royalty for a work proved to be exorbitant, then the dissemination that is desired for the work could require that users be able to avail themselves of the fair dealing exception. Furthermore, to determine whether copying a work in whole or in part is fair or not, the Supreme Court adopted a number of criteria, including “the existence of alternatives” and “the effect of the dealing on the work.” One may deduce from this that the existence of alternatives or a significant effect of the dealing on the work ought to argue in favour of rejecting fair dealing for the work in question. The problem or the conflict, however, has only been shifted: indeed, what is now needed is agreement on the notion of alternatives and the notion of the effect on the work, and hence the market for and value of the work.
118. We further note that the absence of analogous markets or mechanisms, or the failure for such markets or mechanisms to emerge, may be the very consequence of a liberal interpretation of the fair dealing exception. Indeed, without property rights, the market cannot emerge. Thus, reducing the scope of application for fair dealing, following a broadened, liberal, and relatively unrestrictive interpretation of fair dealing, could prevent the appropriate market from emerging and functioning efficiently, and this in turn would justify a broad, liberal, and relatively unrestrictive interpretation of the exemption from fair dealing. This would all lead to a vicious circle that would be harmful to the production and dissemination of original works.
119. Thus, the absence of efficient markets could justify a broad, liberal, and relatively unrestrictive interpretation of fair dealing. In order to make it possible to better understand the issues involved in whether or not efficient markets emerge, and to be able to state an opinion about why a more or less restrictive interpretation of fair dealing

would contribute to social well-being, it is necessary to look into the factors that can explain the absence of such markets from the standpoint of economic theory and analysis.

V. The Emergence of “Efficient Markets”

A. Definition

120. There are many different definitions of the concept of a market. From the economic standpoint, a market is where supply and demand play out. In the strict commercial sense, a market consists of all consumers of a product in a geographically delimited area in a specific period of time; the broader commercial interpretation is that a market may include the whole environment for a product or a company: suppliers, clients, banks, the State, regulations, institutions, technology, etc.
121. Demand is the relationship between quantities of a specified product that sellers/producers are prepared to sell at various prices. The slope of the supply curve is upward: the quantity available increases as the price goes up. The shape and position of the supply curve are influenced by the behaviour of all those who are considering the production/making of a work, not only actual authors/producers/sellers but also *potential* authors/producers/sellers. Thus, the supply relationship is not limited to current authors of works because it also includes potential authors, who are relative non-authors (that is, who are not yet producing but who are likely to do so).
122. Demand is the relationship between quantities of a specified product that buyers/users are prepared to purchase at various prices. The slope of the demand curve is negative: the quantity in demand diminishes as the price increases. The demand curve, in terms of both its shape and position, is influenced by the behaviour of all those considering the possible acquisition of a work or product, not only actual consumers/users/buyers, but also *potential* consumers/users/buyers. Thus the demand relationship is not limited to current clients for the author or current buyers of a work because it also includes potential clients, who are relative non-buyers (who have not yet bought but who are likely to do so).

123. According to economic theory, when a good (work) is sold in the marketplace at a price at which consumers are demanding more units of goods (works) than enterprises (authors) can or want to sell or produce, then the price of the good tends to increase. Conversely, the price will tend to decrease when the quantity in supply exceeds the quantity in demand. The adjustment mechanism of price and quantity leads the market to an equilibrium point. This point of stability is defined as the point at which the pressures on price cancel one another out: producers are prepared to sell the same quantity of goods as consumers want to buy. And neither the authors/producers or users/buyers want to change the total quantity transacted.
124. At market equilibrium, the marginal value for users of an additional work is equal to the marginal cost to the authors (or the marginal author). The market may therefore be viewed as a mechanism that coordinates the various parties involved through a signal: the price. This signal makes it possible for each to make decisions that are compatible with the decisions of the others.
125. In addition to the actual authors/producers/sellers who are currently active in the market for works, we must include the *potential* authors/producers/sellers who would decide to go into production if the price were higher than the equilibrium price. Some authors/producers/sellers can be both actual and potential insofar as a price increase beyond its current level would encourage them to produce more. Similarly, in addition to actual consumers/users/buyers who are currently active in the market for works, we must add *potential* consumers/users/buyers who might decide to become consumers if the price were to drop below the equilibrium point. Some consumers/users/buyers are both actual and potential insofar as a reduction in the price to below its current level would encourage them to consume more. Both potential authors/producers/sellers and potential consumers/users/buyers have an impact on the equilibrium price and are an integral part of the market, even though their current decision is to abstain from producing or consuming.

126. We will talk about an efficient market when all of the exchanges desired by producers and consumers are transacted. All transactions or transfers between sellers and buyers that generate a surplus or profit through the exchange are then realized. Determining this equilibrium or convergence point in a centralized way would be an enormous task; hence the interest in developing decentralized mechanisms, such as competitive markets, in order to find the desired equilibrium point by trial and error.
127. It is through these concepts of demand, supply, market equilibrium, efficient markets, and a broader perception of the concept of a market that we can better identify ways of factoring in the effects of fair dealing on a work, and hence on the market (extended) and the value of the work. The Supreme Court's finding to the effect that "the only evidence of market impact is that the publishers have continued to produce new reporter series and legal publications during the period of the custom photocopy service's operation" ought not to be understood as "the fact that publishers had continued their activities in spite of what was happening at the Great Library at Osgoode Hall" that is, as an indicator that infringing copyrights had no impact on the market for the works in question.
128. In reality, not only is this interpretation of the Supreme Court finding a *non sequitur* but checking whether dealing in the works in question by the Great Library had an impact on the market for the works, **by using and not checking only this particularly imperfect indicator**, namely the fact that the publishers continued to publish, would be inappropriate, to say the least. Fortunately, the Supreme Court finding is not an affirmation that this criterion would be sufficient as a method for determining whether the dealing was fair or not.
129. In fact, it appears obvious that the activities of publishers will continue as long as the question of their copyrights in the works in question is not resolved once and for all. Simply from the profitability standpoint, publishers can be expected to react appropriately as soon as the issue has been dealt with. In the meantime, they will want to keep their options open by continuing to publish in order to be able to develop their activities further if the ultimate decision is in their favour. Observing that publishers have

been able to continue to publish during the Court proceedings in no way means that they will be able to continue to do so at their anticipated levels, whether from the quality or quantity standpoints, if the decision should turn out to be irreversibly against them. Hence the *non sequitur*.

130. One way of illustrating why such a simple verification is irrelevant is to use an example. If a person steals a designer watch, the value includes the materials used, as reflected in the manufacturing cost (let us say \$100) in addition to the intellectual property, as reflected in the value of the design (let us say \$1,000). Let us assume that it can be demonstrated that the person in question had never purchased the watch because that person was unable to pay or not interested in paying the value of the intellectual property incorporated into the watch. This means that the theft would have literally no effect on the market for the watch in question, and the effective supply and demand would remain the same, and the price would also remain in equilibrium. In such a case, would it be justifiable to convict the person who committed the theft to a sentence that is proportional strictly to the value of the materials (\$100)? Clearly not. Restricting the measurement of the impact of the dealing in a work to a straightforward finding, such as the fact that publishers have continued to publish as a way of determining whether the dealing in question was fair or not, would be to make the same analytical mistake. Fortunately, this is not what the Supreme Court said. The Court found that the publishers were able to continue their activities, but did not say that this was the indicator to be used to determine the impact of the dealing on the market for the work.
131. The characterization and measurement of the effects of “fair dealing” on a work in the marketplace, and hence the value of the work, must be based on proper concepts (broadened) of the market and hence of the value. Thus the effects on all the partners in the current and potential market in question, including effects on the providers of ancillary services and on institutions that make it possible to organize and facilitate transactions with a view to reducing costs, are eminently relevant to the application of this criterion formulated by the Supreme Court.

B. Conditions for Emergence

132. There are several possible reasons why an efficient market has not emerged. In the case that concerns us here, three reasons appear to play a major role: (i) the problems involved in setting a price for the reproduction of works, (ii) the high transaction costs, and (iii) the vague definition of property rights.

The Problems Involved in Setting a Price

133. In a competitive market, the price enables producers and consumers to make their respective production and consumption choices. The process of setting a price for an exchange may be lengthy and complex, but in the vast majority of cases, the price is ultimately set. In some instances, the transactions are not effected because a price cannot be agreed upon: neither suppliers nor consumers can set the value of the good or service to be exchanged. In such instances, the absence of a method for determining the value of the good or service in question means that there is no market for it. Supply and demand therefore remain latent, on standby.

134. The goods or services whose value is difficult to assess are often complex goods and services whose value is unclear. The options market is one of the most striking examples of a market coming into existence after the development of a method for calculating value and hence determining a price. An option is a financial contract that gives the holder a right he can exercise when he sees fit, mainly when the conditions make it appropriate to exercise this right. There are “call options” and “put options.” A call option is a financial contract in which the buyer of the option has the right (which he can choose to exercise or not) to buy shares (often shares in a company) from the share option seller or subscriber on a specified date (the European model) or by a specified date (the American model), at a price established in advance, called the “option exercise price.”

135. Until the early 1970s, no one had been able to establish the value of this type of good and the options market was virtually nonexistent, although there was a potential demand (a need) and a potential supply, both latent or on standby.
136. In 1973, three economists and mathematicians, Fischer Black, Myron Scholes, and Robert Merton, developed a formula for calculating the price of an option: thus the market was born. The worldwide size of the market for options and other derivatives went from a notional amount (a measurement of the quantity transacted) that was worth virtually zero in the mid-70s to a notional amount worth over 400 billion Canadian dollars (\$C400,000,000,000,000) in June 2005. The increase in efficiency and well-being associated with the emergence of such a market could not be measured and could only be revealed and achieved through the genius of Black, Scholes, and Merton. In fact, the latter two won the Nobel Prize in 1997 for their work in this field (Fischer Black died in 1995).
137. The sometimes significant effort involved in establishing the value of complex goods such as options and other derivatives in general must not be underestimated. Once the method for determining the value of the good and hence its price is discovered and widely accepted, then the market can develop and generate considerable social benefits.
138. In the case of copyrights, in particular the rights concerning the reproduction and photocopying of works, the problem involved in determining the price at which these transactions (in various forms and at different scales in a variety of contexts) ought to be effected is a complex one that also must not be underestimated. Hence the importance of the work being done to attempt to determine such prices. Until an appropriate method has been identified and widely accepted as logical and reasonable, the potential legal supply and demand in copyrights will remain largely latent and on standby.

Transaction Costs

139. A transaction cost is a cost tied to an economic exchange, more specifically, to a market transaction. These costs can take different forms. Coordination costs are the transaction costs associated with the need to determine the price and other details of the transaction, and to ensure that buyers and sellers know one another, mutually know how to locate one another, and are able to conclude transactions together.
140. There is also a distinction between two types of transaction costs as they relate to the problem of motivation. The first type of cost has to do with the incomplete and asymmetrical nature of information, a basic problem that we discussed above. It means that sellers and buyers do not have access to all relevant information required to determine whether the terms of an agreement are acceptable to both parties, and whether they will truly be met. The second type of transaction cost that relates to the problem of motivation has to do with what economists call imperfect commitment, which is to say the inability of the parties to credibly meet their primary requirements and their commitments.
141. The main transaction costs in the copying of works are primarily coordination costs rather than motivation costs.
142. The concept of transaction cost makes it possible first of all to explain why not all transactions are market transactions. For example, firms can efficiently limit transaction costs by ensuring that there is coordination and cooperation among their employees. Within firms, coordination is provided through a hierarchical decision structure rather than markets.
143. The concept of transaction costs also explains why certain markets are missing. In some instances, the transaction costs are so high that the net mutual benefit generated by the potential exchange becomes zero or even negative. The exchange therefore does not occur and the market cannot emerge. A drop in transaction costs could at a later stage

allow the market in question to emerge. At this point, we wish to emphasize the fact that one of the most important factors for the phenomenal economic growth that has occurred around the world since the beginning of the 19th century has been the establishment of legal, socio-economic, and political institutions that make a dramatic decrease in transaction costs possible. These developments are ongoing and they condition the current and future growth.

144. As for authors' royalties, in particular the royalties for the reproduction and photocopying of works, the transaction costs, as we saw earlier, can easily become exorbitant. It is therefore crucial to identify or devise mechanisms that can significantly reduce transaction costs so that all exchanges that can generate surpluses or create value can in fact be realized. Needless to say, this is a considerable challenge. Hence the importance of current work to find ways to reduce these transaction costs, even imperfectly. Until an appropriate method for governing transactions (the reproduction and photocopying of works) at low cost has been identified and widely accepted, the potential legal supply and demand with respect to copyrights will remain partly latent, or on standby, because of the absence of a methodology for determining value and hence price.

Property Rights

145. The absence of well-defined property rights may also be one of the reasons for the absence of a market. Property rights have or ought to have the essential feature of being exchangeable in a market. These exchanges make a more efficient allocation of resources possible. If a person holds rights that could be better used by another party, then a profitable exchange between the two parties should be possible in order to allow, through the transfer of these rights, a more efficient situation to come into being. This indeed is one of the virtues of the rules of competitive markets as defined by Ronald Coase, the 1991 Nobel Prize winner in Economics, in his famous proposal, which states that when transaction costs are low, the final owner of a property right, whatever the situation at the outset, will be the one who can use it best, and the level of transactions will then be independent of who initially owned the property right.

146. Furthermore, the institution of property, accompanied by strict control over rights and the exercise of these rights, including the right to exclude, is the institution that is best placed and most efficient to motivate the creation, maintenance, and improvement of assets. Examples from everyday life (public transportation, public washrooms...) and from history (the inefficiency of communist countries) demonstrate the efficiency of the motivations that stem from private property.
147. The famous Peruvian economist Hernando de Soto in his work “The Mystery of Capital” maintains that in the underdeveloped countries, unlike the developed countries, the property regime is not formal, which makes it difficult for the general population to play a role in generating wealth. According to De Soto, the problem is not that the poor or those who are excluded lack capital, but rather that they do not have well-defined property rights over the goods they possess. In other words, they own “dead capital.” They have homes, land, and crops, but no rights or titles to property. They have businesses, but no corporations.
148. In the production of works, copyright in its various forms has favoured a phenomenal outburst of literary and artistic production. These rights must of course be capable of being exercised as well as actually exercised and complied with. The exercise and respect for copyright, including the right of exclusion, is an important pillar of our societies that needs to be preserved and protected. The emergence of efficient markets or alternative mechanisms to the markets can only be assured if rights are affirmed and respected.
149. A broader, liberal, and relatively unrestrictive interpretation of the fair dealing exception to the Act, which amounts to a weak affirmation of copyright, could prevent the relevant market from emerging and functioning efficiently. Accordingly, what is needed is a common and simultaneous strong affirmation of copyright and a search for alternatives to efficient markets that, given the current state of technology and the many opportunities for exclusion, are likely to fail to emerge quickly enough. But the ultimate objective must remain the emergence of efficient markets in the field of copyright.

VI. Study of Alternatives and the Role of Access Copyright

150. Earlier, we described the characteristics of a first-best optimum in the allocation of resources to the production and dissemination of works: the government pays authors directly (possibly by levying a royalty on all uses of a work — the total amount levied could then be transferred to the creator — or by the imposition of a general or specific tax to be shared among creators) and disseminate the works at their marginal reproduction cost. Problems of imperfect and incomplete information prevent the achievement of this optimum.
151. Earlier also, the characteristics of a second-best optimum in allocating resources to the production and dissemination of works were described as follows: in order to remain as close as possible to the first-best optimum in the allocation of resources, it is necessary to create property rights that allow authors to collect a sufficient portion of the value of their works in order to live from their art and provide a rationale for their creative efforts. The possibility of photocopying original works at virtually zero cost is very harmful to the market for works, and makes the costs of complying with property rights very high and even exorbitant, thereby further increasing the transaction costs. The market thus collapses with ultimately harmful effects on the creation of quality original works, which demand a significant amount of labour and intellectual effort (talent and judgment) on the part of the creator. To counter these harmful effects, a way must be found to reduce transaction costs.
152. This leads us to the characterization of what we might call a third-best optimum in the allocation of resources to the production and dissemination of works:
- to favour, through copyright pools, a significant reduction in transaction costs by simplifying exchanges between creators and users through the sale of a single non-discriminatory licence for access to a large pool of works;
 - to encourage the search for a generally acceptable way of establishing the price of the good constituted by the reproduction of works;

- to promote the design of efficient (inexpensive) mechanisms through which users and creators can make transactions freely while respecting each other's rights in a fair and balanced manner, in other words by emulating the operation of a free and competitive market.

153. The first step in allowing this limited optimum to emerge is to prevent its collapse. A collapse could result from the withdrawal of the object for which the licences are issued (and hence the revenues to institutions whose role is to facilitate exchanges) for a significant portion of the works and hence of the rights in question, under a more liberal interpretation of the fair dealing exception than is desirable. Such a situation may have the undesirable consequence of making it impossible for the remaining works to bear the cost of the efficient marketing of the rights attached to them and their maximal dissemination.

154. In the current technological and institutional context, the third-best optimum probably represents the best that can be done. The Copyright Board should therefore acknowledge the soundness of the approach that has been taken by Access Copyright:

- to recommend to the Copyright Board a method for determining the competitive price (with fair and balanced protection of the rights of both authors and users) for the reproduction of original works protected by copyright;
- to recommend effective (inexpensive) author rights management mechanisms to promote the maximal distribution and dissemination of works;
- to foster, through copyright pools, a significant reduction in the field of application for exclusion, without necessarily unreasonably broadening the fair dealing exemption, by marketing a single straightforward licence for access to a vast pool of works.

CONCLUSION

155. In conclusion, we can state that we have answered the five questions asked by Access Copyright:

[C1] Limits on the exercise of copyright, such as the fair dealing exception, may be able to bring the observed production and dissemination of works close to their socially profitable, desirable, or optimal levels, where market institutions and related mechanisms that could and should govern copyright exchanges remain embryonic, relatively undeveloped, and not very efficient.

[C2] To promote a socially efficient allocation, now and in the future, of resources to the creation, production, and dissemination of works, it would be preferable for fair dealing to be defined in a manner consistent with the Supreme Court's decision in CCH, so as to prevent unintended harm to copyright and to foster the emergence of efficient exchange mechanisms and processes (market-based institutions) with respect to copyright in a manner that respects the rights of users and creators. If the fair dealing framework were to comply with these issues, it would in the end promote a higher level of production and dissemination of original works. It would also encourage creators and users to make joint efforts to search for efficient transaction mechanisms. In the absence of a satisfactory fair dealing framework, these mechanisms would either take a long time to emerge or would be doomed to failure because of inadequate resources.

[C3] It is important to be aware of the economic reasons (problems in determining the prices at which transactions have or could have occurred; overly high transaction costs; property rights poorly defined, poorly stated, and poorly protected) that explain the absence of efficient market institutions for copyright, and in particular for the right to reproduce works. This absence of efficient market institutions is likely to have undesirable effects on the creation, production, and dissemination of original works. This is the background against which the Supreme Court stated its application criteria, and in particular the criterion for alternatives. In order to achieve the objectives stated in the Copyright Act and reaffirmed by the Supreme Court, the alternatives criterion, which is particularly relevant as a framework for

the fair dealing exception, must cover not only alternatives to dealing (including photocopying) in works, but also alternatives to fair dealing itself.

- [C4] The characterization and measurement of the effects of fair dealing on a work are of course relevant to the determination of a reasonable framework for the exception, but the method used to keep track of dealings, if it is to yield the desired results, must be based on a broader concept of the “market” and hence a broader definition of the concept of “value.” Thus, the impact of dealing/use on the market for the work must therefore include its impact on suppliers of ancillary services and on institutions whose role is to facilitate exchanges in various ways, including the reduction of transaction costs. One particularly important effect that needs to be taken into consideration in applying the impact on the work of dealing is the potential disappearance of the institutions whose role is to organize and facilitate exchanges in the field of copyright. This disappearance could result from the withdrawal of a large percentage of the works and hence of the rights covered by the user licences, which could result from an overly liberal interpretation of the fair dealing exception.
- [C5] To counter these harmful effects, the approach that ought to be encouraged, in keeping with the Supreme Court judgment, is a policy to create efficient market mechanisms and institutions, including mechanisms for the reproduction of works, with an emphasis on simplicity and low cost, with a view to promoting the production of quality original works, as well as their dissemination, in a manner consistent with the rights of both authors and users. Viewed from this standpoint, the desirability of the Access Copyright proposals with respect to the role and relevance of licences for primary and secondary schools (imperfect but nonetheless efficient, low cost, and incentive-producing market mechanisms) becomes clear.