

THE ECONOMICS FAIR USE/DEALING: COPYRIGHT PROTECTION IN A FAIR AND EFFICIENT WAY

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ABSTRACT. The Canadian Copyright Act (R.S.C., 1985, c. C-42) includes several exceptions to the exclusive right of copyright holders. Among the most important are the provisions concerning “fair dealing”, which state that the use of a copyright protected 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 decision on this subject (CCH Canadian Ltd. v. Law Society of Upper Canada, [2004] 1 S.C.R. 339, 2004 SCC 13). We propose in the conclusion a market based approach to maximize the dissemination of works while avoiding unnecessary recourse to the fair dealing exception.

1. INTRODUCTION

The Canadian *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. Those sections state that fair dealing in respect of a literary or artistic work for the purposes of

This article is based in part on my expert testimony before the Copyright Board of Canada in the hearing *Access Copyright Elementary and Secondary School Tariff 2005-2009*. As such, it is written with a large, informed if non-specialist, legal and economic audience in mind. I am grateful to an anonymous referee for excellent comments as well as to Claude Brunet, David Collier and Louis Gratton (lawyers at Ogilvy Renault, now Norton Rose), Roanie Levy (Access Copyright), Paul Audley (Paul Audley and Associates), and Nicolas Marchetti (CIRANO) for their help, encouragement and comments on previous versions of this paper. Needless to say, I remain solely responsible for the content of this paper and of any of its shortcomings.

private study, research, criticism or review, or news reporting does not constitute a violation of copyright. Similar exceptions appear in most if not all national copyright laws throughout the developed world. Hence, although the current paper is rooted in the Canadian context, its messages and conclusions are relevant to the current worldwide debate on copyright extent and protection.

This article addresses the following questions: What is the economic basis for the fair dealing exception in the *Copyright Act*? To what extent does the absence of efficient markets, which would allow creators and users to effect a monetary exchange in copyright matters, justify an expansive interpretation of fair dealing? 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? What are the possible mechanisms for creating markets when markets could contribute to gains in productivity, efficiency, and creation thanks to lower transaction costs and reduced social costs due to the lack of such markets? To what extent should the fair dealing exception depend upon proof that its use has not had an unfavourable effect on the market for the works in question? This article is about the economics of fair dealing and as such it differs from more law-oriented ones.

To properly understand the source of the problems posed by the limits and exceptions that might be usefully introduced to copyright, particularly with respect to the concept of “fair dealing” in literary and artistic works [hereinafter referred to as “works”] 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 such works. That is what the first two sections tackle. Section

III considers the limits of copyright and the “fair dealing” exception in particular. The Supreme Court of Canada (hereinafter referred to as “SCC”) decision in the landmark case *CCH Canadian Ltd. v. Law Society of Upper Canada* (hereinafter referred to as “CCH”) is then examined. That is a famous case on fair dealing in which the Court emphasized that fair dealing is a right of the user, thereby putting copyright user and owner on a kind of parity and being relatively generous to fair dealing.¹ Section IV presents an economic analysis of the possible rationale for a relatively liberal interpretation of the fair dealing exception. Section V considers the conditions that would allow efficient markets or market-like mechanisms to emerge, which will lead us to comment on the appropriateness of considering those conditions among the so-called effects of fair dealing on the market for works, and hence on the value of works. Section VI discusses market-like alternative institutions, particularly the role that an organization like Access Copyright in Canada and similar copyright collective organizations elsewhere may be able to play in increasing economic efficiency in the production and dissemination of protected works.

The analysis is developed in a law and economic framework and leads to the following conclusions.

¹Fair dealing in the UK/Canada is an expression equivalent to the US fair use but their nature and scope differ in many ways. For a comparative analysis of fair use in the US and fair dealing in the UK and Canada post-CCH, see D’Agostino (2008). It might be interesting to mention at the outset that the US Copyright Office leaflet on Fair Use (2009) states (*passim*) that the right to reproduce or to authorize others to reproduce the work is subject to certain limitations, one of the more important ones being the doctrine of “fair use.” This doctrine has developed through a substantial number of court decisions over the years and has been codified in Section 107 of the law with a list of purposes for which the reproduction of a particular work may be considered fair: criticism, comment, news reporting, teaching, scholarship, and research. The distinction between fair use and infringement may be unclear and not easily defined as there is no specific number of words, lines, or notes that may safely be taken without permission and simply acknowledging the source of the copyrighted material does not substitute for obtaining permission. The Office goes on by stating that copyright protects the particular way authors have expressed themselves but it does not extend to any ideas, systems, or factual information conveyed in a work. The safest course is always to get permission from the copyright owner before using copyrighted material. When it is impracticable to obtain permission, use of copyrighted material should be avoided unless the doctrine of fair use would clearly apply to the situation. If there is any doubt, it is advisable to consult an attorney.

First, there are purely economic reasons for the fair dealing exception to the exclusive rights of creators over their works.

Second, it is in the interest of a socially efficient static and dynamic allocation of resources to the production and dissemination of works in a manner consistent with the recent SCC decision in CCH that this fair dealing exception should be an integral part of the rights of users and ought not to be unduly thwarted. This is particularly the case when research and private study are the purposes of the use. In so doing, we must avoid unintended harm to copyright and foster the emergence of efficient means of exchange (market-based institutions) between users and creators. It is within this analytical framework that we must consider not only alternatives to the use of works but also alternatives to the exercise of the fair dealing exception itself.

Third, there are economic reasons for the absence of efficient exchange mechanisms (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 in order to be able to devote resources to solve the problems that may arise as a result.

Fourth, 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. The way in which those effects are 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 not only the units transacted between sellers and buyers, but also

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), as well as future buyers and sellers. It includes also 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, suppliers of ancillary services within a market or related to a market. Finally, it includes the institutions that organize and facilitate transactions and process the associated financial transactions ensuring the necessary market liquidity, etc.

Fifth, preference should be given to policies that aim to create efficient, simple and low-cost market or market-like mechanisms that foster the production and distribution hence reproduction of quality original works, with due regard to the rights of authors-creators and users. In the later part of this article, I describe a market-like based mechanism which would not only favor a maximal dissemination of works but also avoid unnecessary recourse to the fair dealing exception.²

An important caveat is in order. This article is written with a large, informed if non-specialist, legal and economic audience in mind. Hence certain sections may appear somewhat superfluous to some while they will hopefully be illuminating to others.

The main contribution of this article is to argue for a proper interpretation of what the SCC may (or must) have meant in CCH if the objectives pursued are to be met. Two elements of the decision are scrutinized and analyzed: the role of alternatives to the dealing in the work and the effect

²It is appropriate here to mention that the economic interpretation (or at least my own interpretation as an economist) of the fair dealing exception is that it is simply a mean to achieve the broad objective of providing optimal incentives for creators and maximal dissemination of works under severe informational constraints and therefore restricted efficiency conditions rather than a fundamental right associated with free speech. An anonymous referee affirms: "... a blanket license scheme won't work for the cases that matter most to Americans when we think of fair use. The author has a narrow view of what fair use is about. At a minimum he/she should acknowledge that it's his/her view, not the dominant of judicial view."

of the dealing on the work. The SCC stated in particular that existence of “alternatives” such as “non-copyrighted equivalent” works or “alternatives to the custom photocopy services” needs to be considered when deciding whether to allow a defense of fair dealing. When such alternatives exist, the dealing is likely unfair. However, the existence of a license is not considered by the SCC as a proper alternative to judge if the dealing is fair or not. This article will argue that “alternatives” shouldn’t be seen only as “alternatives to dealing in the work.” In addition, the inquiry should also consider the examination of alternatives to fair dealing in the work. The difference is important and crucial. For example, the existence of an efficient and inexpensive mechanism that could allow users to acquire copyrights without relying on the fair dealing exception should be considered as an alternative not to the use of the work itself but to the reliance on the fair dealing exception. Regarding the effect of the dealing on the market for the works, this article will argue first that the preferred copyright policy should be to create properly designed efficient market-like mechanisms and institutions to favor copyright transactions, such as blanket licenses priced through copyright boards acting as surrogate for markets, and second that the first step in allowing a constrained optimum in production and dissemination of original works to emerge is to prevent its collapse. This collapse could result, under a more liberal interpretation of the fair dealing exception than is desirable, from the withdrawal of the object for which such blanket licenses are or could be issued.³ Hence, it is important to consider among the effects of the dealing on the works the possibility that a liberal interpretation of the

³Hence this article could be viewed as an example in the field of economic design: “Economists are increasingly being called on to give advice about how to design new economic institutions. They have been consultants in the design of auctions, power exchanges, financial exchanges and a variety of other market and market-like mechanisms. In these applications, economics looks more like engineering than it does pure science. Just as a civil engineer applies principles of physics and mechanics to design bridges, economists apply principles of economic analysis to design exchange mechanisms” (Varian, 2002).

exception might lead to the destruction in whole or in part of the emerging market-like mechanisms and institutions.

The contribution of this article is therefore limited in scope and should not be amalgamated with comprehensive overviews of the fair dealing/fair use compact.⁴ There is an extensive and conflicting literature (mainly legal in scope) on the nature, role and desirability or necessity of fair dealing and fair use exceptions in copyright laws. This literature is comprised of academic articles as well as analyses of (best) practices related to these exceptions, through case law and jurisprudence. Besides the fact that simply reviewing the most important seminal contributions would require a whole paper, it would make us lose sight of the limited and specifically economic scope of this article. It will not be pursued here.

2. THE PROBLEM

The normative goals and roles of economics are, on the one hand, the analysis and research into the mechanisms that can contribute to meeting at best 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 implementing the mechanisms.

In order to meet their needs, people consume goods and services whose nature and characteristics play a major role in the choice of the efficient mechanisms for producing, distributing, and using them. Works are particular goods whose characteristics are, however, well known to economists. They may be described as goods or products of “information.” Unlike typical ordinary products such as farm or manufacturing products, information goods – whether they take the form of entertainment, legal knowledge, technological information, ideas, software or expertise – are such that they can,

⁴For such more comprehensive overviews, see in particular Gordon (1982), Landes and Posner (1989), Africa (2000), D’Agostino (2008) and the many references therein.

once produced or created, be reproduced, distributed, or disseminated at zero cost. Likewise, once the information product has been produced or created, identical or nearly identical copies can be made available at virtually zero cost in competition with the original version in the marketplace: producing a work requires significant fixed costs, but the *marginal* reproduction cost is close to zero.

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, equal to the total value of consumption less the total cost, is positive. Otherwise, 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 with marginal cost pricing. This level corresponds to what economists call a first-best optimum.

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 enough revenue to cover all costs involved in production and distribution, and in particular the significant fixed costs. A competitive market (price = marginal cost) cannot therefore provide an optimal allocation of resources. Under those conditions, too few individuals would be prepared to take up a career as an author or creator and to devote the time and resources needed to produce quality original works.

In response to this problem, two streams of thought have developed. The first argues that one ought to assign property rights to creators 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 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. The other stream of thought argues that the strict attainment of a first best optimum must be promoted with (re)production free of charge. Authors would then be compensated in various ways from government subsidies. Each of these approaches poses problems.

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 previous works: “A dwarf sitting on a giant’s shoulders can see much farther than the giant.”⁵ Overly punitive copyright royalties might lead to a level of use that is less than optimal because of an overly limited access to and distribution of the works.

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. Which

⁵Jean de Salisbury (1159): “Bernard of Chartres used to say that we are like dwarfs on the shoulders of giants, so that we can see more than they, and things at a greater distance, not by virtue of any sharpness of sight on our part, or any physical distinction, but because we are carried high and raised up by their giant size.”

author or creator would spend time and resources to produce quality works whose valuation depends on the goodwill of the government bureaucracy?

Fair dealing lies at the heart of this issue. It 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 (intellectual) property rights for the benefit of the community. Seen from the confiscation viewpoint, we can see the risks involved in an inappropriate use of this tool. At what point does fair dealing tilt the balance from wealth creation toward wealth destruction?

Economic analysis can provide answers to these questions. The problem is complex, as Cooter and Ulen (1998) suggested: “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.” Obviously, solutions will not be completely efficient or first-best optimal. The whole art lies in finding a solution that can be useful and be implemented at low cost while at the same time coming close to an optimal allocation.

Before describing in some detail the solution that economic analysis suggests, it is useful to briefly review in the following two sections the key factors involved. It is important to remember that as soon as one enters the realm of severely constrained solutions, the best becomes the enemy of the good: things never work out well when you run with the hare and hunt with the hounds.

3. THE ALLOCATION OF RESOURCES TO THE PRODUCTION AND DISSEMINATION OF WORKS

The concepts of public and private goods lie at the core of economic analysis of fair dealing. 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 price and levels of production: exclusion and rivalry. 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. For public goods, the very opposite is the case. They are characterized by the properties of non-exclusion and non-rivalry: it is technically or economically impossible to exclude an individual from consuming the good or service in question even if the individual refuses to contribute to financing it, and all individuals can consume the *same* unit at the same time. Unlike private goods, public goods are non-additive or indivisible.

To illustrate these concepts, we can use national defence and tomatoes. 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 s/he refuses to pay the asking price (exclusion). A tomato is a private good. On the other hand, I can benefit from the security provided by national defence and “consume” it implicitly in its entirety, but this does not prevent my neighbour from consuming the same level of national defence (non-rivalry). I may contribute to the financing of the government-determined level of national defence through my taxes. If my neighbour refuses to do so (let us assume that it is possible to refuse to have one’s taxes used to pay for national defence), s/he would nevertheless continue to benefit from the *same* level and quality of security as mine (non-exclusion).

What is the best way of determining the socially efficient quantity (level, quality) of a product? What is the best way of determining the quantity that each individual should consume?

For private goods, competitive markets are the most efficient tool. Through a trial and error process, it is possible to reach an equilibrium price that generally meets supply and demand requirements (no buyer and no seller wants to change the amount supplied or demanded at the price in question). This equilibrium price also means that all exchanges that generate an enhancement of well-being (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.

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 an efficient mechanism. 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.⁶

Some goods are partly private and partly public. At a concert, the seats are private goods, but the performance itself is a (local) public good. I can consume the whole performance without preventing my neighbour from also consuming it (the concert performance as a “product” has the properties of non-rivalry and non-exclusion). On the other hand, it would not be a good idea for me to sit in or on another person’s seat (the concert seat as a “product” has the properties of rivalry and exclusion). The concert experience thus consists of two complementary goods: a public good and a private good.

⁶It is worth noting that public goods and services are not necessarily produced by the State and that the State can produce private goods. 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.

Some goods possess only one of the two properties, either exclusion or rivalry. These may be considered private-public goods. Goods with properties of exclusion and non-rivalry, such as cable television networks, can thus be distinguished from goods with properties of non-exclusion and rivalry, such as public parks (which may become congested). It is difficult for the market to optimally allocate resources to the production and distribution of 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. 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? 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. Lastly, the exclusion is economic if it is possible not only to identify the users technically or legally but also set a price that establishes the level of exclusion (the dividing line between users and non-users). Generally speaking, when technical and legal exclusions are followed

by economic exclusions, it becomes possible to directly finance, in whole or in part, the production of private-public goods or services.

As we shall see, at the outset, works constitute public goods that benefit from becoming private-public in order to ensure their existence, emergence, and development. 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 copying works, exclusion has virtually always been envisaged and applied. However, the forms and means of this exclusion have evolved considerably. 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 were sold on markets: those who refused 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.

The basic problem involved in the efficient or optimal allocation of resources (how many resources? which resources?) to the production and dissemination of works, as for many other products and services, results from the fact that information about costs (total and marginal) and values (total and marginal) is *imperfect* and *incomplete*. It is therefore within such a universe that we must characterize the institutions most likely to successfully achieve a proper level of production and distribution of the works. Let us first consider the simpler case of perfect and complete information.

3.1. Perfect and Complete Information. 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.

In a perfect and complete information universe, one in which it is possible to observe the work and 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.

Indeed, once a work has been created, possibly at considerable expense to the creators – the costs incurred are fixed, as the costs to create the work are independent from the number of copies or future users, and sunk or unrecoverable, as the costs incurred that cannot be recovered if it is ever decided to destroy or withdraw the work in question – the reproduction and distribution of the work are possible at virtually zero marginal cost. This amounts to a framework in which there would be neither rivalry nor any purpose to exclusion. This is the 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.

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 disseminate the works produced to all citizens as users. The benevolent State in doing so would make the maximum possible dissemination of these works and ideas, would thereby

promote the emergence of a situation described by Justice Binnie⁷ 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 contribute to the optimal development of the arts and sciences. To use the language of economic theory, this situation corresponds to a first-best optimum.

3.2. Imperfect and Incomplete Information: Second-best Optimum.

We are not living in a perfect and complete information universe. Each economic agent, whether an author or a user, has private information (incomplete or asymmetric information), which s/he can and generally does use in order to pursue and achieve one's own objectives. Furthermore, the available information is generically imperfect or uncertain. Under such conditions, the State, however benevolent it may be, is not in a position to establish a level of compensation that would encourage authors to produce and disseminate a "socially optimal" portfolio of works on the basis of the relative total and marginal values assigned to them by the 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 improper production and quality levels.

To avoid these traps caused by the unavoidable context of imperfect and incomplete information, it is essential to devise alternative mechanisms, necessarily imperfect and sub-optimal but nevertheless relatively efficient. This leads us to a solution that economists call a second-best optimum.

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

⁷In *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 par. 10.

and inescapable loss of optimality will be as small as possible. In this second-best optimum, the producers/sellers/suppliers and the 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 SCC itself spoke.⁸

It is appropriate to sacrifice one of the two properties of a public good to ensure production and dissemination. The “rights” solution has thus been to give authors a property right, that is, an exclusive or exclusionary right over their works. Thus although non-rivalry exists and is admitted as obvious and unavoidable, non-exclusion can be circumvented and mothballed, at least in part, to favor the emergence of a resource allocation compatible with the value of creators’ works and to encourage the best production possible. 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] 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 creation and dissemination, if not optimal creation or maximal dissemination. From being public goods 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.

The creation of copyright is what makes exclusion possible. In the short term (statics), the level of exclusion to which copyrights lead generates inefficiency and sub-optimality. Indeed, once a work has been produced, it becomes effective to multiply the copies in order to disseminate it as widely

⁸The Court cited David Vaver (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 par. 48]

as possible. However, this full dissemination solution would allocate only a minimal portion of the rewards derived from the works to their authors, thereby necessarily reducing the incentive to creation, leading over time (dynamics) to chronic underproduction of quality works to everyone's detriment, whether authors/producers/suppliers or users/consumers/buyers.

It seems therefore appropriate to give owner rights to authors (copyright) *and* to encourage the development of a set of mechanisms and institutions favoring trade between willing sellers and willing buyers, namely authors/producers/suppliers and users/consumers/buyers. Indeed, copyrights can be traded, bought, and sold. They thus make it possible to allow exchanges 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. As in other competitive markets, the interests of authors and users are likely to be balanced in terms of price, quality, and quantity.

4. LIMITS ON THE EXPRESSION OF COPYRIGHT

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: 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).

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. 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.

The *Copyright Act* assigns sole rights to the copyright holder such as: to reproduce the work, to perform or present the work in public, to convert or adapt the work, to translate it, to publish it, to make any recording, film or other contrivance by means of which the work may be reproduced, to communicate the work to the public by telecommunication, etc. The Act also gives the copyright holder the sole right to authorize any of those.

The *Copyright Act* nevertheless contains several exceptions to sole rights of copyright holders, including the provisions on fair dealing: fair dealing for the purpose of (i) private study or (ii) research does not infringe copyright (s. 29); under certain circumstances, fair dealing for the purposes of criticism or review does not infringe copyright (s 29.1), but some specific factors pertaining to the work must be mentioned such as the source and the name of the author, performer, maker, or broadcaster; fair dealing for the purpose of news reporting does not infringe copyright if the above factors are mentioned (s 29.2). 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.

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. 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 SCC in CCH.

In CCH, the SCC specifically addresses the concept of fair dealing. 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.

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.⁹ The case went to trial

⁹The publishers were 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" (Chapter 13 in *Forensic Evidence in Canada*, 1991). According to the publishers, the Law Society infringed copyright when the Great Library reproduced a copy of each of the works through its photocopying service. The case went to trial in the fall of 1998 and a first decision was handed down November 9, 1999. 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 Court 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. On appeal from the Federal Court, the SCC, through McLachlin C.J. took the concept of a work's originality under consideration. The SCC 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

in the fall of 1998 and ended up before the SCC, which found (2004) 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 SCC 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. 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 below as follows: CCH par. NN]

than a mere copy. For other courts, a work needed to be creative to be original. In CCH v. Law Society of Upper Canada, the SCC 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. The SCC 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.

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” [CCH par. 48]. 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 SCC 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 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.”

The SCC 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 “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, in fact corresponds to “fair dealing” given the particular facts involved. Thus, the SCC concludes that the right to use the fair dealing exception must be recognized in a rather broad and liberal manner, but argues also 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.

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. In the next section, we will delineate conditions for the implementation or application of the criteria that could benefit from the clarification provided by economic theory and analysis. These conditions appear to be essential if the principle of balance and respect for the rights of all concerned along with the principle of efficiency as put forward by the SCC are to be respected, realized, and implemented. The six factors discussed by the SCC to define the analysis framework for fair dealing are the following:

- (1) 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]
- (2) 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]
- (3) 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]

- (4) 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]
- (5) 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]
- (6) 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]¹⁰

¹⁰With respect to the latter point, it is useful to recall here that the SCC adds the following comment [CCH par. 72]: “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

5. ECONOMIC ANALYSIS OF THE CONCEPT OF FAIR DEALING

The six factors referred to by the SCC to provide a framework for fair dealing may benefit, for the purposes of interpretation, from the light shed on them by modern economic theory and analysis. The purpose of the analysis here is to characterize the desirable mechanics for applying these criteria to ensure that they lead to a satisfactory framework for fair dealing, as desired by the SCC.

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) the observance of rights for individuals and groups, as much from the producer/seller/supply side as from the author/buyer/demand side, with respect to the market for a property such as a work.

Although research (including “for profit”) 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, the SCC asserted with respect to the first criterion: “some dealings, even if for one of the allowable purposes, may be more or less fair than others” (CCH par. 54). One such case would seem to be the photocopying of a textbook whose market is necessarily limited to educational institutions. It is difficult to understand how one could allow fair dealing for the purpose of research or private study without jeopardizing “obtaining a just reward for the creator.” Insofar as the allowed acts or dealings are not specifically defined, all six factors are at best difficult to measure and implement in the absolute without a case-by-case analysis, and

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.” 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.”

the 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. The SCC attributes a great deal of importance to maintaining this balance between the rights of the users and those of the creators. Hence the need for a fair dealing framework, relatively liberal at the outset, 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. It is therefore with this in mind that each of six factors could be considered from the viewpoint of modern economic theory and analysis. Of all factors, two are of particular interest in this regards namely the fourth factor “alternatives to the dealing” and sixth factor “the effect of the dealing on the work.” Those are the factors we are concerned with here.

5.1. Factor #4: “alternatives to the dealing”. The SCC stated that the existence of alternatives to the dealing in the work 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, which could justify fair dealing as an exception to copyright. That is what we will do below. But it is safe to say at this point that the SCC gives only examples of alternatives to dealing in the protected work (“non-copyrighted equivalent,” “alternatives to the custom photocopy service”), whereas an examination of alternatives to using the fair dealing exception would also be needed. The difference is important and crucial: the existence of an efficient and inexpensive *mechanism* that could allow users to acquire copyrights without relying

on the fair dealing exception is a relevant alternative not to the dealing in the work but to the reliance on the fair dealing exception.

Indeed, what is at issue is the relative cost of alternatives and substitutes. It is clear that the alternative to the photocopy service that was considered by the SCC [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. An alternative must be thoroughly feasible and affordable practically, physically, and technologically. Otherwise, the Court agrees that patrons should exercise the fair dealing exception.

In this context, giving users the opportunity to have access to works while paying the relevant copyrights, for example by subscribing directly or indirectly through the Library to a licence made available indiscriminately to all users, would appear to be of the first importance. However, the SCC states “The availability of a licence is not relevant to deciding whether a dealing has been fair” [CCH par. 70], a statement that must be understood in relation to another statement *in the same paragraph* saying “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. The ultimate goal being to control the monopoly power of copyright owners, then in the absence of such monopoly power the availability of a licence might become relevant, in particular if it

is a blanket licence issued by a copyright collective at a price determined by a market-surrogate process such as a copyright board.

The market structure in question matches what economists call “monopolistic competition.” Monopolistic competition, when adapted to the present 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. In view of the four characteristics, it can clearly be seen that monopolistic competition is not a monopoly. The market power of creators 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. 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 and creators. Hence, the availability of a licence in this context, most likely different from the one the SCC had in mind, would appear relevant to deciding whether a dealing has been fair.

5.2. Factor #6: “the effect of the dealing on the work.” 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.

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 governing 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” [CCH par. 72]. 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 SCC is claiming.

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. It must be understood to mean more than the direct impact on the current buyers and sellers. It comprises also 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 in an imperfect and incomplete information universe.

Three main economic rationales can therefore be identified in connection with a relatively liberal and 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). The first have been discussed above. Let us consider the last two.

5.2.1. *Promoting the Dissemination of Ideas and Knowledge.* The second argument for a liberal 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! The main argument here is that a high level of protection for authors and creators would generate less dissemination than desired, that is, lead to what economists call “the tragedy of the anticommons.”

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 common resources such as air, water, and biodiversity. This vision postulates that all common resources that are free and available to everyone are doomed to disappear because of inevitable chronic overutilization.

The “tragedy of the anticommons” characterizes the reverse situation where several individuals own a veto over the use of a common resource. The (high) number of veto rights inevitably ends in making it impossible to exploit the resource, each individual wanting as much compensation as possible for their veto right over the resource. 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 inventions because it involves negotiating so many different licences at such high cost.

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 portions of dozens of works in university libraries. If the student had to contact each author to obtain approval and negotiate the price of the photocopy with the author, it is reasonable to expect that few students would ever complete their assignments. 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, with the marginal value of one work increasing with the use of other works.

Is broadening the fair dealing exception the best way to combat the possibility of a tragedy of the anticommons? In other words, should private-public goods, which are non-rivalrous and exclusive, be converted into quasi-pure public goods on grounds that there is a risk of under-utilization? This conversion would be effected by 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 original works? 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 SCC.

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 necessary to develop a given technology or to produce specific goods. The objective of patent pools is to make available on the market a single licence for all the patents in question.¹¹

Licences for the reproduction of works may be considered analogous to the licences issued by patent pools. The same reasons that are given to justify patent pools may be given to justify the development of blanket licences for the reproduction and photocopying of works protected by copyright.

5.2.2. *Countering the Negative Effects of the Absence of Efficient Markets.*

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 efficiently 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

¹¹The firms involved, namely those that place their patents in the pool, but other firms as well, may then purchase the licence in question to make available the goods that can be produced from 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 as defined for instance by Lerner et al. (2007, pp 610-625): “Patent pools can be defined as formal or informal organizations where for-profit firms share patent rights with each other and third parties.” Examples of this 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 (the MPEG pool for instance). See among others Merges (1999): “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 ... MPEG LA is essentially a licensing agent; it administers the pool on behalf of the members. MPEG LA licenses the group’s patent portfolio to third parties who will manufacture products to meet the MPEG-2 standard.” See also Bittlingmayer (1988).

would be virtually impossible to accomplish this at reasonable cost. If the “transaction” costs are too high, the desired dissemination for the work could require that users be able to avail themselves of the fair dealing exception.

The absence of market mechanisms, or the failure for such market 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. 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 fair dealing. This would all lead to a vicious circle that could be harmful to the production and dissemination of original works.

In order 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.

6. THE EMERGENCE OF “EFFICIENT MARKETS”

There are many different definitions of the concept of a market 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, financiers, regulations, institutions, technology, etc. 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 or coordinated with the decisions of the others.

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.

The SCC'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 an indicator that infringing copyrights had no impact on the market for the works in question. 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 favorable. Hence the *non sequitur*.

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 of (broadened) market and hence of value. Thus the effects on all 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 SCC.

There are several possible reasons why efficient markets do not emerge. Three reasons appear to play a major role in the context and case of copyright: (i) the problems involved in setting a price for copyrights and the reproduction of works in particular, (ii) the high transaction costs, and (iii) the vague definition of property rights.

6.1. The Problems Involved in Setting a Price. 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 set and agreed upon reflecting the value of the good or service to be exchanged. The absence of a method for determining the value of the good or service in question means that supply and demand remain latent, on standby.

The goods or services whose value is difficult to assess are often complex goods and services whose value is unclear. The market for financial options is one of the most striking examples of a market coming into existence after the development of a method for determining value and hence a price.¹² 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. The sometimes significant effort involved in establishing the value of complex goods such as options and other derivatives in general must

¹²An 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 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."

not be underestimated. In 1973, two mathematical economists developed a convincing formula for calculating the price of an option: the market could and did emerge (see Black and Scholes, 1973). 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.

In the case of copyrights, in particular 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. 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: hence the importance of the efforts being exerted to attempt to determine such prices in different contexts.

6.2. Transaction Costs. A transaction cost is a cost tied to an economic exchange, more specifically, to a market transaction. The concept of transaction cost makes it possible first of all to explain why not all transactions are market transactions. For example, firms may 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.

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 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.

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.

6.3. Property Rights. 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 laureate in Economics, in his famous proposition, 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.¹³

Furthermore, the institution of property, accompanied by strict control over rights and the exercise of these rights, including the right to exclude, is

¹³See Coase (1960). For a different view of the role of transaction costs in economic theory, see Schlag (1989).

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.

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 excluded lack capital, but rather that they do not have well-defined property rights over their goods and assets: they own “dead capital”; they have homes, land, and crops, but no rights or titles to property; they have businesses, but no corporations.

In the production of works, copyright in its various forms has favoured a phenomenal outburst of literary and artistic production. The emergence of efficient markets or alternative mechanisms to the markets can only be assured if rights are affirmed and respected. A broader, liberal, and relatively unrestrictive interpretation of fair dealing, which amounts to a relatively 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 or market-like institutions in the field of copyright.

7. CONCLUSION

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 inefficient.

To promote a socially efficient allocation of resources, now and in the future, to the creation, production, and dissemination of works, it would be preferable for fair dealing to be defined in a manner consistent with the SCC decision in *CCH*, but in such a way as to prevent unintended harm to copyright and to foster the emergence of efficient exchange mechanisms and processes (market-based or market-like 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 requirements, 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. However, 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.

It is important to be aware of the economic reasons (problems in determining the prices at which transactions could have occurred; overly high transaction costs; property rights poorly defined, poorly stated, and poorly protected) that explain the absence of efficient market-like 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 SCC stated its application criteria to characterize proper use of the fair dealing exception.

In order to achieve the objectives stated in the Canadian Copyright Act and reaffirmed by the SCC, the alternatives criterion, which is particularly

relevant as a framework for the fair dealing exception, must cover not only alternatives to dealing in works, but also alternatives to fair dealing itself. 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 (copyright collectives and copyright boards and tribunals) whose role is to organize and facilitate fair exchanges based on copyright. This disappearance could result from the withdrawal of a large percentage of the works and hence of the rights covered by blanket licences, following an overly liberal interpretation of the fair dealing exception.

To counter these harmful effects, the approach that ought to be encouraged, in keeping with the SCC judgment in *CCH*, is a policy to create efficient market and market-like mechanisms and institutions with an emphasis on simplicity and low cost as well as on promoting the production and dissemination of quality original works in a manner consistent with the rights of both authors and users.

We described the characteristics of a first-best optimum implementation as follows: 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.

The characteristics of a second-best optimum 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 to provide incentives and rationales for exerting their creative efforts (labour and intellectual effort, talent and judgment). The possibility of reproducing original works at virtually zero cost makes it difficult to enforce property rights, thereby further increasing transaction costs: the potential market thus collapses with ultimately harmful effects on the creation of quality original works. To counter these harmful effects, a way must be found to reduce transaction costs.

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 blanket licence for access to a large pool of works; to encourage the search for a generally acceptable way of establishing the competitive price of reproducing works; and finally 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.

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 under a more liberal interpretation of the fair dealing exception than is desirable.

In the current technological and institutional context, the third-best optimum probably represents the best that can be done. For this, we need four elements : first, a method for determining the competitive price for the reproduction of original works protected by copyright, with fair and balanced protection of the rights of both authors and users; second, an effective (inexpensive) rights management mechanisms to promote the maximal distribution and dissemination of works; third, a significant reduction in exclusion by marketing a single set of similar but differentiated and appropriately designed licences for access to a vast pool of works and this, without broadening the fair dealing exemption; and fourth, a requirement that specific organisations pay for their appropriately designed licence(s) on behalf of their respective constituencies. Such organisations might include schools and universities (Departments of Education) for their students, Internet service providers on behalf of their clients, libraries (national and municipal governments) for their patrons, commercial TV and radio operators and broadcasters on behalf of their customers, etc. Assuming full coverage through public and private payers, there would be no need for individuals to pay directly for licences or copyrights; hence, in exchange for what would be a small (fixed) subscription cost, individuals could de facto reproduce (download and store) at close to zero marginal cost all contents in all forms from all sources and thereby increase their creativity as well as the scope of their free speech expression.¹⁴

¹⁴In this context, the internalization maze is avoided and users could free themselves from the burden of negotiating with creators for the betterment of all. Problems that both strict property rights advocates (full compensation for spillovers) and incomplete property rights advocates (less than full compensation for spillovers) à la Frischmann and Lemley (2007) raise are properly taken care of through surrogate competitive market-like institutions. Indeed, a competitive price does not in general allow the seller to fully capture the benefit (total value) of the good for the buyer, hence leaving uncompensated a significant spillover value.

Designing those licenses and fixing their respective prices represent certainly significant and difficult tasks, but nevertheless feasible undertakings if appropriate resources could be gathered to make them a reality, thereby fulfilling the goals of copyright protection while ensuring maximal dissemination of works and providing information efficient incentives for creators and innovators.

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