

Contracting around Copyright: The Uneasy Case for Unbundling of Rights in Creative Works

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The Copyright Act grants authors and users a set of entitlements in copyrightable works. It is questionable whether and to what extent authors and users can reallocate these rights by entering into legally enforceable contracts. The Seventh Circuit's historic decision in ProCD, Inc v Zeidenberg, which held that contracts are usually not preempted by the Copyright Act, produced an extensive debate in the copyright literature regarding the enforceability and desirability of such contracts. Many participants in this debate, both supporters and critics of the court's holding, assume that the ProCD rule enhances economic efficiency by allowing authors to unbundle the set of rights prescribed by the Copyright Act.

In this Article, I claim that, from an economic efficiency perspective, it is difficult to defend the ProCD rule. I argue that the prevailing belief that this rule reduces the wasteful deadweight loss associated with copyright is oversimplified and inaccurate. A more persuasive argument is that the ProCD rule increases the incentive to create in the long run. Such an efficient outcome, however, is desirable only when it allows society to mitigate the harm caused by other damaging components of the copyright system, and this was not achieved by the ProCD decision.

INTRODUCTION

Copyright law provides authors¹ and users of information goods with a bundle of entitlements. When Anna sells a book she wrote to Ben, copyright law divides the entitlements and possible usages of the book between the two.² Ben can keep the book, read it aloud to his children, sell the book, destroy it, cite a short passage in a written review, photocopy a page to help him in teaching a class, and more. At the same time, without Anna's authorization, Ben cannot copy the

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¹ I loosely use the terms "author," "publisher," and "producer" to refer to the single entity that created the work, had full possession of it before publication, published it, and holds the copyright (if such exists) to it. Needless to say, sometimes one entity creates the work, another publishes it, and a third holds the copyright to it, and each of these entities might have different interests and incentives. The conflicts that arise between the interests of these entities are beyond the scope of this Article.

² See William W. Fisher III, *Property and Contract on the Internet*, 73 Chi Kent L Rev 1203, 1204-06 (1998).

entire book and sell it, read it aloud in public, translate it for commercial purposes, and more.³ This initial division of entitlements is the starting point determined by the Copyright Act, but the question is whether it should also be the ending point. In other words, to what extent should the parties be permitted to use legally enforceable contracts to trade these entitlements that were initially assigned to them? Can Ben, for example, trade his right to cite parts of the book for permission to read it aloud in public? Can he trade it for a discount on the book's price? Put differently, should copyright's initial allocation of entitlements be treated as a default rule that the parties can contract around, or as a mandatory and inalienable allocation?

In *ProCD, Inc v Zeidenberg*,⁴ the Seventh Circuit implicitly held that parties are allowed to trade their initially allocated rights.⁵ The decision used both doctrinal and economic reasoning and held that a contractual cause of action is substantially different from a copyright infringement cause of action and, therefore, is not preempted by the Copyright Act.⁶ A few years later, a split panel of the Federal Circuit adopted this reasoning and explicitly ruled that an author can force a licensee to waive the right of fair use, even in a standard form contract.⁷ While most courts that have dealt with this issue since the *ProCD* decision adopted a similar rule,⁸ the *ProCD* decision came under harsh criticism in the copyright literature.⁹ Most of the debate

³ See 17 USC §§ 106–07, 109(a), 110(4).

⁴ 86 F3d 1447 (7th Cir 1996).

⁵ See *id* at 1449.

⁶ See *id* at 1454–55.

⁷ *Bowers v Baystate Technologies, Inc*, 320 F3d 1317, 1326 (Fed Cir 2003) (holding that shrinkwrap terms prohibiting reverse engineering of software are enforceable even though reverse engineering is considered fair use and therefore does not constitute copyright infringement).

⁸ See, for example, *Davidson & Associates v Jung*, 422 F3d 630, 639 (8th Cir 2005); *Altera Corp v Clear Logic, Inc*, 424 F3d 1079, 1089–90 (9th Cir 2005); *Lipscher v LRP Publications, Inc*, 266 F3d 1305, 1318 (11th Cir 2001). But see *Ritchie v Williams*, 395 F3d 283, 287–88 (6th Cir 2005) (holding that a state court action, arising from a contract, is preempted by the Copyright Act under the doctrine of “complete preemption”); *Kabehie v Zoland*, 125 Cal Rptr 2d 721, 731–34 (Cal App 2002) (stating that “[t]he majority of courts that have considered the breach of contract/federal copyright preemption issue have used a fact-specific analysis” and that therefore acceptance of contract terms does not, in itself, preclude a finding of preemption pursuant to the Copyright Act).

⁹ See, for example, Wendy J. Gordon, *Intellectual Property as Price Discrimination: Implications for Contract*, 73 Chi Kent L Rev 1367, 1378–86 (1998) (criticizing *ProCD* for, among other things, comparing price discrimination to monopoly power rather than to a regime that permits free copying); David Nimmer, Elliot Brown, and Gary N. Frischling, *The Metamorphosis of Contract into Expand*, 87 Cal L Rev 17, 42–63 (1999) (criticizing *ProCD* for, among other things, extending quasi-copyright protection to works that are not copyrightable and for the court's alleged failure to consider broader constitutional issues); Mark A. Lemley, *Beyond Preemption: The Law and Policy of Intellectual Property Licensing*, 87 Cal L Rev 111, 147–51 (1999) (arguing that *ProCD* wrongly focused on preemption under 17 USC § 301 and did not consider other relevant preemption doctrines, and that the type of contracts that are enforceable

surrounding this ruling focuses on doctrinal issues, including the proper way to interpret the preemption provision of the Copyright Act and the applicability of other constitutional preemption doctrines. This Article does not try to add to this doctrinal debate but instead examines the *ProCD* rule from an economic efficiency perspective. The analysis explores the two possible economic justifications for the *ProCD* decision and suggests that the efficiency of the *ProCD* rule might be questionable.

The *ProCD* decision allows parties to trade rights that are part of the partial-bundling regime created by the Copyright Act. Therefore, in this Article, this *unbundling regime* is compared with the *forced bundling regime* that some commentators favor. Part I of this Article explores the features of the unbundling regime as an imperfect, non-exclusive, second-degree price discrimination scheme.

Because unbundling of rights allows publishers to price discriminate among their consumers, Judge Frank Easterbrook, who wrote the *ProCD* decision, and numerous commentators concluded that it is an efficient regime that will reduce the deadweight loss caused by the copyright system. Professor Randal Picker, for example, argued that the type of regime that the *ProCD* decision fosters allows an author to “march down the demand curve for a particular work,”¹⁰ which means that it allows authors to serve consumers who cannot afford the uniform monopoly price that is charged under a forced bundling regime. Part II of this Article closely examines this justification for unbundling and concludes that while these arguments might be intuitively appealing, they are inaccurate. Indeed, while the producer surplus increases under an unbundling regime, it has an ambiguous effect on the deadweight loss created by the copyright system and, therefore, questionable efficiency.

In Part III, the long-term economic justification for the unbundling regime, which focuses on incentives for creation, is analyzed. I argue that, in comparison to other rules that are current cornerstones of our copyright regime, unbundling might be a more efficient way to

under *ProCD* can create “rights against the world” that might be contrary to public policy); Yochai Benkler, *Free As the Air to Common Use: First Amendment Constraints on Enclosure of the Public Domain*, 74 NYU L Rev 354, 429–35 (1999) (“The practical effect of the decision to enforce mass market information licenses is that more uses of information will be prohibited to more people.”); Julie E. Cohen, *Copyright and the Perfect Curve*, 53 Vand L Rev 1799, 1812 (2000) (criticizing contractual price discrimination because it raises the price of inputs for new inventions, thus skewing incentives for creation in favor of works that produce large private gains at the expense of works intended primarily to benefit the public). See also Randal C. Picker, *Easterbrook on Copyright*, 77 U Chi L Rev 1165, 1178 (2010) (“*ProCD* is the opinion that the copyright casebooks love to hate.”).

¹⁰ Randal C. Picker, *From Edison to the Broadcast Flag: Mechanisms of Consent and Refusal and the Propertization of Copyright*, 70 U Chi L Rev 281, 295 (2003).

incentivize creation *ex ante*. Thus, for example, a legal system that offers authors a short protection period in which unbundling is permitted is likely superior to a system that prescribes a long protection period during which unbundling is not allowed. However, because this type of balancing cannot be achieved by a court decision, the *ProCD* decision might disturb the delicate balance between conflicting interests that is reflected in the Copyright Act in a way that is not necessarily efficient.

I. UNBUNDLING AS A SOLUTION TO THE DIVERSITY IN THE DEMAND FOR LICENSING AGREEMENTS

A. The Diversity in the Demand for Information Goods

The group of those who are willing to pay for rights in a specific copyrightable work is typically heterogeneous. The members of this group have different preferences, needs, wealth, and constraints, and therefore they differ in their willingness to pay for various rights.

To illustrate this diversity in demand, let us look at a few typical potential buyers of a copyright treatise. The *autodidact* is a layperson who wants to learn about copyright doctrines. She is willing to pay for the right to read specific chapters once but has no need to use the treatise in any other way and is unwilling to pay for additional and unnecessary rights. The *law student* is taking a copyright course and is willing to pay for the right to access various chapters of the treatise during the semester. The *law professor* has a higher willingness to pay, but only if she can access and keep the treatise in perpetuity, quote and possibly criticize it in her work, and make copies of small segments of the treatise to use in class. Like the *law professor*, the *lawyer*, who has a higher willingness to pay, would like to access and keep the work in perpetuity, quote it, copy a few pages, and possibly criticize it in her briefs. The *library* has low elasticity of demand and a high willingness to pay, as long as it is given all of the rights that its patrons need in addition to the right to lend the book and assign these rights to its patrons.

Copyright law may not be sensitive to the differences in the customers' willingness to pay for various entitlements in a work. The buyer of a book, for example, receives a preset bundle of rights in it. This bundle includes the right to read the book, keep it in perpetuity, resell and lend it, create a parody of it, and more. At the same time, this bundle does not include the right to translate the book, read it aloud in public, or receive a newer version of that book once it is published. If the author is not allowed to unbundle—that is, offer licenses

that include sets of rights that are different from the one provided for by the Copyright Act¹¹—then her only remaining decision is to set a monopoly price. The author will take into account the demands of the various users and will try to set a price in a way that will maximize her revenues. Thus, in the above example, the *autodidact* will need to buy the bundled product, which includes rights for which she has no need. Moreover, because *libraries* and *lawyers* have a high willingness to pay, their participation in this market can cause the uniform price to soar, which will price out of the market many other users. On the other hand, if the author is allowed to unbundle the rights, she can use the differences in preferences to segment the market, offer different potential consumers licenses with different sets of rights, and thus achieve price discrimination.

B. First-, Second-, and Third-Degree Price Discrimination

Defining the term “price discrimination” is not a trivial task. As a leading economic treatise puts it, “It is hard to come up with a satisfactory definition of price discrimination. Roughly, it can be said that the producer price-discriminates when two units of the same [] good are sold at different prices This definition is unsatisfactory.”¹² The problem is not just one of definitions. “Price discrimination” is a term that is used to describe various pricing strategies, and confusion about them is prevalent in the literature. In this section, I clarify some of these strategies and their application to an unbundling-of-rights regime.

When price discrimination is not used, a producer facing a downward-sloping demand curve (that is, a producer who has at least partial monopoly power) must choose a uniform monopoly price that will maximize her total revenues. The consequences of setting this monopoly price, which is typically higher than the marginal cost of production, are an increase in producer surplus, a decrease in consumer surplus, and, most importantly, the creation of a deadweight loss. Consumers who are willing to pay more than the marginal costs of production but less than the monopoly price will be priced out of the market, and the potential surplus that could have been extracted by dealing with them will be wasted.

¹¹ It is beyond doubt that the Copyright Act, 17 USC § 101 et seq, allows unbundling with respect to rights that are not included in the bundle it prescribes. For example, a seller can sell a book with or without the right to make additional copies. The bundling regime discussed in this Article is therefore actually a partial bundling regime, which prohibits only the unbundling of those rights that the Copyright Act gives to buyers. See Gordon, 73 Chi Kent L Rev at 1370–75 (cited in note 9).

¹² Jean Tirole, *The Theory of Industrial Organization* 133 (MIT 1988).

Under a first-degree price discrimination scheme, also known as perfect price discrimination, the producer sells the product to each consumer at a price equal to that consumer's reservation price.¹³ Under this scheme, the entire consumer surplus and, more importantly, all of the deadweight loss, is transformed into producer surplus. In other words, every customer who is willing to pay at least the marginal costs of production will be able to buy the product, and society will not experience the reduction in quantity that is the hallmark of monopoly pricing.

While first-degree price discrimination is commonly referred to in the literature, including in the literature on transactions in information goods, it can rarely be achieved because producers cannot know their customers' willingness to pay. Therefore, producers have developed pricing schemes that allow them to indirectly assess those reservation prices. In both second- and third-degree price discrimination schemes, the producer uses an approximation method to sort the consumers into subgroups and match a different price to each subgroup. Second- and third-degree price discrimination schemes differ in the ways in which this sorting and estimation is done.

Simply put, a second-degree price discrimination scheme, also called versioning,¹⁴ means that the producer offers slightly different versions of its product for different prices to *all* consumers.¹⁵ The small variations between the versions are evaluated differently by different consumers and constitute a tool of self-selection to help the producer identify those with higher willingness to pay and lower elasticity of demand.

Airline companies, for example, extensively use second-degree price discrimination. While all travelers fly in the same airplane, on the same route, and at the same time, they differ substantially in their reservation prices and elasticity of demand. Airlines therefore use a variety of self-selection tools to help them identify consumers with lower elasticity (and offer them more expensive tickets). For example, buyers who purchase tickets at the last minute or those who choose not to stay at their destination for a weekend indicate that they are probably business travelers and will be charged more. Here, as is typical of second-degree price discrimination schemes, the differences in the prices of the tickets sold to those travelers are attributed primarily to the differences in their willingness to pay and not to the costs to the airline.

¹³ See *id.* at 135–37.

¹⁴ See Carl Shapiro and Hal R. Varian, *Information Rules: A Strategic Guide to the Network Economy* 39, 53–82 (Harvard Business 1999).

¹⁵ See Tirole, *Industrial Organization* at 135, 142–43 (cited in note 12); Michael E. Wetzstein, *Microeconomic Theory* 419 (Oxford 2005).

When using a third-degree price discrimination scheme, the producer offers the *same* product to different subgroups of consumers for different prices.¹⁶ The producer uses some *exogenous*, known information about its consumers (for example, age, occupation, location, and so on) to estimate their reservation prices. For example, because students and senior citizens have, on average, a lower willingness to pay and higher elasticity of demand, movie theaters sometimes offer them cheaper tickets.¹⁷

C. Unbundling of Rights as Second-Degree Price Discrimination

It seems that when some commentators use the term “price discrimination” to refer to unbundling of rights in information goods, they might be envisioning a perfect price discrimination scheme.¹⁸ Unbundling of rights, however, is typically just one way¹⁹ in which the producer tries to achieve second-degree price discrimination.²⁰ The product being sold is the copyrighted work together with a license, and price discrimination is achieved by the different terms in each license offered. The differences in the prices of the licenses cannot be attributed primarily to differences in costs, but rather to the differences in consumers’ preferences and to the producer’s attempt to create a self-selection mechanism.

There are numerous examples of this practice. ProCD, for example, offered its clients two licenses: a limited cheap one for private users and a broader and more expensive one for commercial users.²¹

¹⁶ See Tirole, *Industrial Organization* at 135, 137 (cited in note 12); Wetzstein, *Microeconomic Theory* at 423 (cited in note 15).

¹⁷ In many cases, producers use a variety of second- and third-degree price discrimination tools at the same time. For example, some airlines use third-degree price discrimination by offering cheaper student fares, while some movie theaters use second-degree price discrimination by offering cheaper tickets for Tuesday morning screenings.

¹⁸ See notes 33–34 and accompanying text.

¹⁹ There are many ways to segment the market and create a second-degree price discrimination scheme without unbundling rights. For example, the publisher can offer versions that differ in the accessibility of updates, prestige (hardcover versus paperback versions), comprehensiveness, and so on. See Shapiro and Varian, *Information Rules* at 55–61 (cited in note 14). Moreover, the producer can also use third-degree price discrimination and, for example, offer a special “law student version” of its product. While the possibilities are numerous, in some cases the most efficient way, and maybe the only practical way, to segment the market is by unbundling rights.

²⁰ This Article focuses on licenses that create second-degree price discrimination, like the licenses created by ProCD. Other licenses, probably less common, can create third-degree price discrimination. For example, LexisNexis allows law students to access its databases for free but contractually binds them not to transfer this right, or the information extracted by using it, to others. See LexisNexis, *Terms & Conditions* (Nov 11, 2009), online at <https://www.lexisnexis.com/terms/> (visited Oct 21, 2010).

²¹ In fact, ProCD offered a third license that included an online subscription through AOL. *ProCD*, 86 F3d at 1449.

Similarly, iTunes used to offer some songs in two versions: a limited-license version for \$0.99 and an unlimited personal-use license for \$1.29.²² Movie studios offer “self-destructing” DVDs that the buyer can use for a few days for \$5²³ and “regular” DVDs that can be used permanently for approximately \$20.

LexisNexis, which uses third-degree price discrimination schemes (for example, student licenses), also uses second-degree price discrimination schemes by offering cheaper licenses that limit the user’s right to print or download information from its database.²⁴ Several copyright treatises, such as *Nimmer on Copyright*, are offered by LexisNexis. Thus, the publisher of the treatise can first separate those who prefer to buy an expensive hardcopy from those who prefer the online version and then rely on LexisNexis’s ability to create a fine-tuned price discrimination scheme within the latter group.

D. Enforcing the Licenses and the Costs of Separation

From the producer’s perspective, unbundling of rights, like other second- and third-degree price discrimination schemes, is far from perfect. It has limited benefits, and it is costly. The producer uses unbundling to try to estimate her consumers’ reservation prices based on their usage, and such estimation can never be precise. Customers with similar needs might have different reservation prices. Unbundling of rights does not allow the producer to separate them.

Moreover, even if the consumers differ in their needs and separation is possible, unbundling might be too expensive to implement and enforce. When the producer segments the market and creates licenses, she must make many choices (for example, how many licenses to create, for which subgroups, and at what prices) that require collecting information on potential consumers. The publisher must therefore take into account the costs of collecting this information. Separation costs also include the transaction costs associated with implementing the corresponding licenses (for example, increases in the costs of

²² See Apple, *Apple Unveils Higher Quality DRM-Free Music on the iTunes Store* (Apr 2, 2007), online at <http://www.apple.com/pr/library/2007/04/02itunes.html> (visited Oct 21, 2010).

²³ Those movies are protected by FlexPlay technology. See Flexplay, *How It Works*, online at http://www.flexplay.com/how_it_works/ (visited Oct 21, 2010) (describing how Flexplay’s patented disc technology reacts once removed from its sealed packaging—the user can watch the DVD for a limited time, but exposure to oxygen renders the disc unreadable after forty-eight hours).

²⁴ For a listing of various LexisNexis pricing options for certain (governmental) customers, see LexisNexis, *Federal Supply Schedule Price List*, online at http://www.lexisnexis.com/gsa/76/GSASched76_PriceList.pdf (visited Oct 21, 2010).

drafting, the consumers' search costs, and so on).²⁵ Finally, the publisher must keep in mind that licenses, like any other contract, are not always performed, and the publisher must therefore implement costly measures to discourage breaches.²⁶

In some situations, license agreements are breached in public. For example, reviewing a library's catalog might allow a publisher to detect whether it lends DVDs in breach of a license. Similarly, most transformative uses, whether considered fair use or not, are made in public. Reducing the number of breaches in these situations requires a monitoring system backed by a reliable threat of litigation.

Encryption is a self-enforcing tool that prevents consumers from using a product in a way that is inconsistent with a license and can reduce the likelihood of breaches, including nonpublic breaches.²⁷ Encryption, however, is not always practical, and it is neither costless nor immune to circumvention. When circumvention happens, it is typically difficult to detect and even more difficult to bring to an end. A reliable threat of litigation is therefore typically required to reduce such circumvention.

Finally, the publisher must deal with the problem of privity.²⁸ As contracts do not create rights in rem, the publisher must be able to prove that the defendant consented to the license in order to establish a contractual cause of action. The publisher cannot always condition the transfer of the product on acceptance of the terms, especially when it is being transferred from one consumer to another, which increases the risk of a break in the privity chain.

Producers of information goods try to solve this privity problem by attaching the license to the goods in a way that prevents usage prior to

²⁵ See Shapiro and Varian, *Information Rules* at 67–72 (cited in note 14) (discussing how many versions of an information good the producer should offer); Michael J. Meurer, *Copyright Law and Price Discrimination*, 23 *Cardozo L Rev* 55, 76–77 (2001) (discussing sorting costs).

²⁶ It should be noted that unbundling of rights does not create an arbitrage problem because the licenses are offered at the same price to everyone and therefore no secondary market can exist.

²⁷ Encryption became popular in the digital era and especially after Congress enacted the Digital Millennium Copyright Act (DMCA), Pub L No 105-304, 112 Stat 2860 (1998), which prohibits circumventing certain technical protection measures and criminalizes the production and dissemination of technology, devices, or services that are used for such circumvention. 17 USC §§ 1201, 1204.

²⁸ See Robert P. Merges, *The End of Friction? Property Rights and Contract in the "Newtonian" World of On-Line Commerce*, 12 *Berkeley Tech L J* 115, 119–21 (1997) (discussing the problem of contractual privity in cyberspace and how it affects a publisher's ability to sue downstream infringers). For examples in which the lack of privity harmed the copyright owner's case, see *Vernor v Autodesk, Inc.*, 555 F Supp 2d 1164, 1176 (WD Wash 2008) (holding that a license between the copyright holder and the first licensee does not bind subsequent purchasers); *Soft-Man Products Co v Adobe Systems, Inc.*, 171 F Supp 2d 1075, 1087 (CD Cal 2001) (holding that a purchaser of software is not bound by an end user license agreement that it did not accept by installing the software).

acceptance of the terms. Clickwraps, which are widely used in the software industry, are an example of such a technique.²⁹ Such a scheme, however, is not only costly and legally questionable³⁰ but in some cases (for example, books or music recordings) is also quite difficult and expensive to implement, if possible at all.

Therefore, while there are several tools that encourage customers to abide by license terms, these tools are costly and cannot guarantee that the license will always be accepted and never breached. Consequently, even when two users have different needs and willingness to pay, the producer might not be willing to offer them different licenses, as the private costs of segmentation might be higher than the private benefits.

II. UNBUNDLING AND COPYRIGHT'S DEADWEIGHT LOSS

The previous Part shows how authors of information goods can use contracts to unbundle the rights in their work and thus to price discriminate among their customers. In the rest of this Article, I analyze the economic effects of such a pricing scheme. In this Part, I consider the effects of unbundling on total welfare, while in the next Part I consider its effects in the long run.

Authors of information goods are better off under an unbundling regime. In some (rare) cases in which unbundling does not increase producer surplus, it will not be used, and therefore producer surplus can never decrease under unbundling—it will, in most cases, increase. While this conclusion is somewhat obvious, in this Part I focus on the more complex effects of unbundling and explore whether it enhances efficiency by reducing the deadweight loss created by the copyright regime.

²⁹ ProCD's software, for example, required the user to click "I agree" to the terms of the license every time the software was used. See *ProCD*, 86 F3d at 1450.

³⁰ It is unclear whether the terms of a contract that the buyer cannot read prior to payment, as is typically the case, are binding. Compare *Hill v Gateway 2000, Inc*, 105 F3d 1147, 1149 (7th Cir 1997) (holding that the terms of an agreement that was sent with a computer that was purchased over the phone are binding), with *Klocek v Gateway, Inc*, 104 F Supp 2d 1332, 1340 (D Kan 2000) (holding that the terms of an agreement that was sent with a computer that was purchased over the phone are not part of the contract between the parties and therefore not binding). Furthermore, some have argued that when the producer attaches the license to a copy of the work, the contract "runs with" the tangible property and is therefore a servitude. Such classifying raises several legal issues that are beyond the scope of this Article. For example, should this servitude comply with the touch and concern doctrine? If so, does it? More generally, should private parties be allowed to create new enforceable property rights? See, for example, Molly Shaffer Van Houweling, *Cultural Environmentalism and the Constructed Commons*, 70 L & Contemp Probs 23, 40 (2007); Niva Elkin-Koren, *What Contracts Cannot Do: The Limits of Private Ordering in Facilitating a Creative Commons*, 74 Fordham L Rev 375, 379–80 (2005); Glen O. Robinson, *Personal Property Servitudes*, 71 U Chi L Rev 1449, 1478 (2004); Lemley, 87 Cal L Rev at 119–21 (cited in note 9).

A. The Conflicting Effects of Unbundling on the Deadweight Loss

Most commentators on unbundling of rights in information goods have suggested, or at least assumed, that this regime enhances efficiency, as it increases access to the work and reduces deadweight loss.³¹ There is an appealing logic to this claim. Copyright law accords authors a monopoly power that prevents free entry into the market. This power allows the author to charge a price higher than the marginal costs of production, which makes recovering the fixed costs of creation possible. A side effect of this monopoly pricing scheme is deadweight loss—the pricing out of the market of consumers whose reservation prices are higher than the marginal costs of production but lower than the monopoly price. If, instead, authors were able to price discriminate by continuing to charge the high monopoly price to the high-paying consumers while offering a cheaper, limited license to the low-paying users, everyone would be better off. Differently put, the intuition is that unbundling of rights, like perfect price discrimination, allows the producer to sell the product to additional segments of the market that would otherwise be priced out and thus reduces the deadweight loss.

This conjecture is quite prevalent. In his *ProCD* decision, Judge Easterbrook drew on this logic when he stated that “[i]f ProCD had to recover all of its costs and make a profit by charging a single price . . . it would have to raise the price substantially The ensuing reduction in sales would harm consumers.”³² Other commentators agree. For example, Professor Picker argued that unbundling allows the producer to “march down the demand curve for a particular work.”³³ Professor Picker referred to the producer’s ability to serve consumers with low reservation prices who are priced out of the market under uniform monopoly pricing—in other words, to serve customers located on the “lower” end of the demand curve. Even commentators who are critical of the *ProCD* decision, like Professor Wendy Gordon, concede that “a monopolist charging a single price imposes a higher deadweight loss on society than one who does not.”³⁴

In this Part, I argue that this supposition is incomplete and inaccurate, and that unbundling of rights has a more ambiguous effect on

³¹ See notes 33–34 and accompanying text.

³² 86 F3d at 1449.

³³ Picker, 70 U Chi L Rev at 295 (cited in note 10). This phrase was later cited by Judge Easterbrook. See Frank H. Easterbrook, *Contract and Copyright*, 42 Houston L Rev 953, 967 (2005).

³⁴ Gordon, 73 Chi Kent L Rev at 1390 (cited in note 9). See also Fisher, 73 Chi Kent L Rev at 1238–40 (cited in note 2) (arguing that the use of contracts and technological protections increases access to information goods and decreases deadweight loss). But see Meurer, 23 Cardozo L Rev at 90–94 (cited in note 25).

the deadweight loss. In fact, unbundling of rights creates two counter-effects. I will call one *the new markets effect* and the other *the poor-among-the-rich effect*. The new markets effect, which reduces deadweight loss and resembles the aforementioned argument made by Judge Easterbrook and Professor Picker, occurs because unbundling allows the producer to offer a cheaper, limited version of its product and make it accessible to some of the consumers who were priced out of the market under a bundling regime.

When a publisher uses unbundling, she must sort potential consumers into subgroups and set a uniform price for each such subgroup. This price will typically price out of the market the members of the group who have relatively low reservation prices. This is the poor-among-the-rich effect, and it causes an increase in deadweight loss. For example, a public library might be able, under bundling, to buy DVDs on the retail market and lend them to its patrons. Under an unbundling regime, the publisher might create two licenses: one for the general public that will prohibit lending and another, primarily for libraries, that will allow it. Because the libraries subgroup includes rich buyers with low elasticity, such as Redbox and Netflix, the price of this “lending license” might be set too high for public libraries, which will be priced out of this market completely. The poor-among-the-rich effect does not exist under perfect price discrimination (those poor customers are offered licenses for a price equal to their low reservation prices), which might explain why it is usually overlooked in the literature on this issue.

Indeed, for some subgroups—typically those with higher elasticity and lower reservation prices—the price under unbundling is lower, the new markets effect dominates, and the deadweight loss is smaller. For other subgroups, typically those with lower elasticity and higher reservation prices, the price under bundling is higher, the poor-among-the-rich effect dominates, and the deadweight loss is larger. As demonstrated below, the size of these subgroups and the difference in the price charged to each, which are case dependent, will determine whether, in a given case, the total deadweight loss will increase or decrease.³⁵

³⁵ Unbundling probably also has a progressive distributional effect. Generally speaking, under unbundling the price charged to low-paying subgroups typically decreases while the price charged to high-paying subgroups increases. Usually, consumers with higher willingness to pay are relatively richer and, therefore, in most cases, unbundling redistributes wealth from relatively richer consumers to poorer ones. This argument is of course simplified and incomplete. For example, some of those who are priced out of the market under unbundling, such as public libraries, serve a large group of poor customers. See Cohen, 53 Vand L Rev at 1806 (cited in note 9). See also Shapiro and Varian, *Information Rules* at 47–49 (cited in note 14).

B. Unbundling and Deadweight Loss in a Two-Subgroup Market

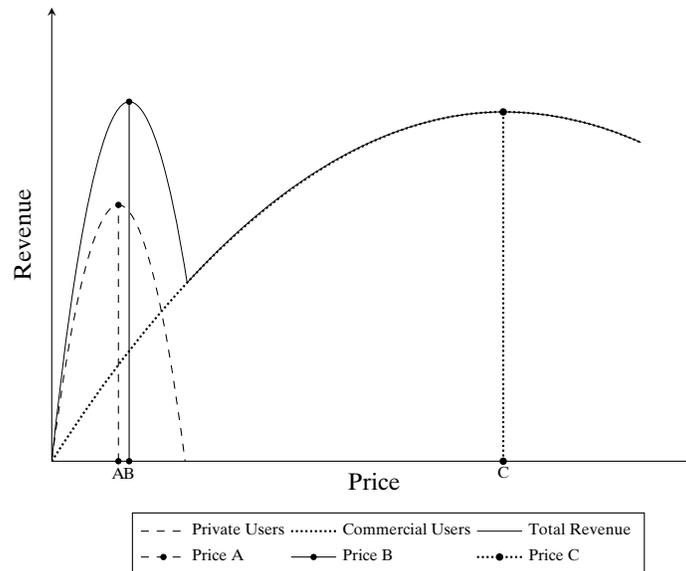
By using unbundling, a producer divides the group of customers into subgroups. In this section, I focus on a simplified example in which the producer decides to separate the group of potential customers into just two subgroups.

Let us assume that the potential consumers of a certain work, like the consumers of ProCD's product,³⁶ can be divided into two distinct subgroups: one big subgroup with limited needs and lower willingness to pay (which will be called *private users*) and another smaller subgroup with more extensive needs and higher willingness to pay (which will be called *commercial users*).

Under bundling, the producer will need to choose one monopoly price. She can choose a low price, serve both subgroups, and thus have a high volume of sales. Alternatively, she can charge a high price, serve only the commercial users and extract a larger surplus from them while pricing out the private users, and experience a decrease in her volume of sales. The producer will need to weigh the private users' numbers against the commercial users' higher reservation prices.

Figure 1 shows the producer's revenues as a function of the price she charges.

FIGURE 1



³⁶ See *ProCD*, 86 F3d at 1449.

The dashed curve on the left represents the revenues the producer can gain from sales to private users. The dotted curve on the right represents the revenues the producer can gain from sales to commercial users. The third curve is the accumulation of those two curves and represents the total revenues from selling to all customers as a function of the price demanded under bundling.

The total revenue curve has two local maximum points, each representing one of the aforementioned prices that the producer can choose. The producer can sell at a low price and serve both subgroups (Price B) or sell at a high price and serve only the commercial subgroup (Price C). Even a small shift in any revenue curve can change the choice that the producer will make. From the producer's perspective, the choice between B and C might be insignificant, but from a social welfare perspective, this choice has a substantial effect on the size of the deadweight loss under bundling and on the relative efficiency of an unbundling regime.

If under bundling the producer decides to serve just commercial users (Price C), then the deadweight loss will be substantial.³⁷ Therefore, under unbundling, the new markets effect will dominate, as private users will be served (Price A). At the same time, the poor-among-the-rich effect will not exist, as commercial users with relatively low reservation prices—the poor among the rich—are not served under either regime. In this case, unbundling does not harm anyone, and it is, therefore, Pareto superior to bundling.

On the other hand, if the producer decides to serve both markets under bundling (Price B), then unbundling might increase the deadweight loss. The new markets effect, which is the result of the small price decrease—from B to A—for the private users subgroup, will be insignificant. But the poor-among-the-rich effect, which is the result of the large price increase—from B to C—for the commercial users subgroup, will be significant, and many commercial users with relatively low reservation prices will be priced out of the market under unbundling.

Actual situations in which producers of information goods must decide whether to serve a large group of private users or a substantially

³⁷ In making this argument, I ignore the effects of piracy. In fact, when the producer sets a high price for a product that can be used, if offered cheaply, by many private users, some members of that subgroup will gain access to the work by using illegal pirated copies, and the deadweight loss will be reduced. A full analysis of the effects of piracy on pricing decisions and deadweight loss is beyond the scope of this Article. For an example of such an analysis, see Mark A. Lemley and R. Anthony Reese, *Reducing Digital Copyright Infringement without Restricting Innovation*, 56 *Stan L Rev* 1345, 1374 n 110 (2004) (“Infringement can fill in for the deadweight loss caused by copyright by, for example, allowing those who are not willing to pay the full retail price for a CD to acquire it illegally for less.”).

smaller group of commercial users are quite common. For example, most DVD producers choose a price that allows many private users to buy DVDs, although, consequentially, commercial users, such as libraries, can purchase them at a price that is significantly lower than their willingness to pay.³⁸ On the other hand, other information goods are clearly targeted at small professional subgroups. For example, Adobe sells its cheaper version of Photoshop for \$699 and, until recently, stated openly that it is “ideal for professional photographers, serious amateur photographers, graphic designers and web designers.”³⁹ Similarly, *Nimmer on Copyright* is sold for \$2,138, which prices out most private users.⁴⁰

It is therefore difficult to generalize about the efficiency of unbundling in decreasing the deadweight loss and increasing the total surplus. In fact, it is difficult to identify even broad categories of cases or some general rule of thumb for cases in which unbundling reduces deadweight loss. The facts of *ProCD*, as described by the district court and the Seventh Circuit, are no exception and do not allow us to decide whether unbundling increased or decreased the deadweight loss.

C. Limitations and Expansions

The model I used in this Part is simpler than many real-life situations. Future research can therefore explore how the relaxation of some of my simplifying assumptions can influence the magnitude of the aforementioned effects and whether some factual situations can be identified in which one effect clearly dominates.⁴¹ In the next few

³⁸ In practice, commercial, for-profit libraries typically enter into specific contractual arrangements with Hollywood studios. See *Eddins v Redstone*, 35 Cal Rptr 3d 863, 871–72 (Cal App 2005); *Redbox Automated Retail LLC v Universal City Studios LLLP*, 2009 WL 2588748, *2 (D Del 2009). See also, for example, Gérard P. Cachon and Martin A. Larivière, *Supply Chain Coordination with Revenue-Sharing Contracts: Strengths and Limitations*, 51 *Mgmt Sci* 30, 42 (2005) (demonstrating the advantages and disadvantages of a revenue-sharing model using the video rental industry as an example). Public libraries, however, typically buy fewer copies and, in some cases, purchase in the general retail market.

³⁹ Adobe Systems, *Photoshop CS5 Editions*, online at <http://www.adobe.com/products/photoshop/compare/> (visited Oct 21, 2010). Adobe changed this description in its latest line of products, although the price did not change materially.

⁴⁰ See LexisNexis, *The Store: Nimmer on Copyright*, online at <http://www.lexisnexis.com/store/catalog/booktemplate/productdetail.jsp?pageName=relatedProducts&prodId=10441> (visited Oct 22, 2010). Those are, of course, simplified examples. In practice, most producers use a variety of second- and third-degree price discrimination schemes to exploit other segments of the market too. DVDs, for example, are released to the public through various channels at different times, which allows the studios to charge more to some commercial users (such as theaters). On the other hand, Adobe offers a cheaper student version of Photoshop that allows it to serve some private users.

⁴¹ In the economic literature, there is an attempt to identify assumptions under which an increase or a decrease in deadweight loss can be expected. See, for example, Richard Schmalensee,

paragraphs, I mention some of these assumptions and their significance and offer some initial thoughts on the effects of their relaxation. This discussion is, by its nature, incomplete. The possibilities are numerous, and a full analysis of them is beyond the scope of this Article.

Some simplifying assumptions should not affect the core argument. For example, the implicit assumption that the cross-elasticity of demand between the subgroups is zero,⁴² or that the demand of the various subgroups is well defined and does not depend on the bundling process itself,⁴³ should not undermine the argument. Even under a more complex model in which these assumptions are relaxed, the total effect of unbundling is expected to remain ambiguous because it causes a price increase for some subgroups and a price decrease for others.

The heterogeneity of demand in each subgroup might have a more profound impact on the deadweight loss. The more homogeneous a subgroup, the bigger the share of the surplus that can be captured by the producer by setting a uniform price for that subgroup, the smaller the poor-among-the-rich effect, and the smaller the deadweight loss. Therefore, sorting the customers into more and more subgroups should reduce the variance among their members' reservation prices and reduce the poor-among-the-rich effect and the deadweight loss, although it will also increase separation costs.

Finally, future research might further explore the impact that changes in separation cost might have on the two effects. For example, it is possible that the marginal costs of separating high-paying consumers into additional subgroups is lower on average than the marginal costs of further separating the low-paying consumers. The reason is that the first subgroup is smaller in size and includes those who are willing to pay more, and thus, for example, the transaction costs in reaching tailored contracts with members of this subgroup might be smaller than the surplus of such transactions. This means that, in some situations, it will be possible to further separate the high-paying subgroups, which might reduce the magnitude of the poor-among-the-rich effect.

Output and Welfare Implications of Monopolistic Third-Degree Price Discrimination, 71 *Am Econ Rev* 242, 246 (1981); Hal R. Varian, *Price Discrimination and Social Welfare*, 75 *Am Econ Rev* 870, 875 (1985); Jerry A. Hausman and Jeffrey K. MacKie-Mason, *Price Discrimination and Patent Policy*, 19 *RAND J Econ* 253, 263 (1988).

⁴² In other words, the assumption is that the price charged to one subgroup does not affect demand in another. In some situations, like *ProCD*, this assumption is reasonable. In other situations, such as the DVD lending license mentioned in Part II.A, a change in the price charged to one subgroup can affect demand in another.

⁴³ There are situations in which this assumption will not hold. For example, regardless of the extra legroom, the willingness of consumers to pay for a business-class ticket might be higher than their willingness to pay for a "bundled" ticket with all other passengers. In this example, unbundling itself increases the reservation prices of business travelers.

Therefore, while the core argument presented in this Part makes doubtful the efficiency of the *ProCD* rule as a deadweight-minimizing rule, further research may shed more light on the pricing strategies used under bundling and unbundling and their effects on the size of the deadweight loss.

III. UNBUNDLING OF RIGHTS AS AN EX ANTE INCENTIVE TO CREATE

While it is unclear if an unbundling regime reduces the deadweight loss associated with copyright monopoly, this Part explores whether it can be defended as a legal rule that incentivizes ex ante the creation of information goods in a relatively efficient way. I start by commenting on the criteria for efficient copyright rules and then explore the relative efficiency of unbundling and compare it to other legal rules. I argue that, under these criteria, unbundling is, subject to certain limitations, efficient.

A. The Long-Term Efficiency of Unbundling of Rights

In the long run, it is wrong to conclude that an intellectual property rule⁴⁴ is relatively efficient or inefficient by only considering its effect on deadweight loss or total surplus.

Deadweight loss is an unavoidable side effect of the monopoly power that allows authors to cover the fixed costs of creation. It is the price that society pays to solve a public-good problem in the creation of information goods. Intellectual property policy should, therefore, aim to provide the optimal incentives for creation while decreasing the harm of the monopoly power and especially the deadweight loss. Suboptimal incentives can worsen the public-good problem and cause suboptimal investment by authors, which will reduce the number and quality of works created. On the other hand, overincentivizing can

⁴⁴ One may question whether *ProCD*, which concerned a work that was not copyrightable, is even relevant to a discussion about legal incentives to create. See Gordon, 73 Chi Kent L Rev at 1385 (cited in note 9); Nimmer, Brown, and Frischling, 87 Cal L Rev at 42–63 (cited in note 9) (criticizing *ProCD* because a publisher of a database was awarded some market power, which allegedly is not allowed under *Feist Publications, Inc v Rural Telephone Service Co*, 499 US 340 (1991)). See also *ProCD*, 86 F3d at 1449. It is wrong, however, to conclude from *Feist* that no legal rule may incentivize the creation of databases. In fact, many legal doctrines allow some publishers of databases to cover the fixed costs of creation. See Miriam Bitton, *A New Outlook on the Economic Dimension of the Database Protection Debate*, 47 IDEA 93, 147–66 (2006) (discussing how certain legal rules outside the realm of copyright law protect the creators of databases against free riding and unlimited copying of their work). From a legal policy perspective, the same challenge exists in both situations: What set of legal rules can efficiently incentivize creation while causing minimal harm?

lead to excessive investment in creation, which is a form of rent-seeking that creates economic waste.⁴⁵

The set of rules included in any copyright regime should promote these goals and should constantly be modified to do so.⁴⁶ While rules that increase the incentives to create also typically increase the deadweight loss (and vice versa), they differ in the ratio between private benefit and social harm.⁴⁷ Therefore, a legal rule that insignificantly reduces deadweight loss while substantially decreasing producer surplus might be undesirable, as it overdiscourages creation. Consequently, a crude criterion for comparing the efficiency of two possible copyright rules is to look at *the ratio of their effects on the producer surplus (the incentive to create) to their effects on the deadweight loss*. A rule that creates a *higher ratio* is typically *more efficient* in the long run.

An unbundling-of-rights regime seems superior to a bundling regime under this criterion, because unbundling typically causes only a minor change in the deadweight loss but increases the producer surplus substantially. As discussed in Part II, unbundling typically causes a price increase for the high-paying subgroups that increases the producer surplus and the deadweight loss (the poor-among-the-rich effect) and a price decrease for the low-elasticity subgroups that increases the producer surplus and decreases the deadweight loss (the new markets effect). The changes in deadweight loss therefore partially cancel each other out, and the total effect of unbundling on deadweight loss is usually modest. On the other hand, the producer surplus increases in all subgroups, which means that the total incentive to create will typically increase significantly. Thus, the ratio between the producer surplus and the deadweight loss is usually higher under unbundling than under

⁴⁵ See William M. Landes and Richard A. Posner, *The Economic Structure of Intellectual Property Law* 16–18 (Chicago 2003) (discussing rent seeking); Christopher S. Yoo, *Copyright and Product Differentiation*, 79 NYU L Rev 212, 260–64 (2004); Michael Abramowicz, *An Industrial Organization Approach to Copyright Law*, 46 Wm & Mary L Rev 33, 71–77 (2004) (arguing that, according to certain models of imperfect competition, overincentivizing can lead to excessive entry into a given market, which wastes resources).

⁴⁶ The relative efficiency of copyright rules depends on extraneous factors, and in particular on the current technologies that allow the creation, copying, and distribution of information goods as well as their costs. From time to time, Congress has to modify this set of rules and tweak the legal protection of information goods in order to achieve this efficiency goal. See, for example, *Sony Corp of America v Universal City Studios, Inc*, 464 US 417, 430 (1984) (“From its beginning, the law of copyright has developed in response to significant changes in technology.”). See also, for example, Digital Millennium Copyright Act of 1998, HR Rep No 105-551, Part 2, 105th Cong, 2d Sess 21 (1998) (noting that the DMCA was enacted “as part of the effort to begin updating national laws for the digital era”).

⁴⁷ See Louis Kaplow, *The Patent–Antitrust Intersection: A Reappraisal*, 97 Harv L Rev 1813, 1821 (1984) (noting in the context of patents that “[i]t is simply not true that all activities generating equal profits impose equal damages upon society”).

bundling. Consequently, an unbundling-of-rights regime is relatively harmless and thus a cheaper price to pay for incentivizing creation.

B. How to Incentivize Creation: Balancing Unbundling of Rights and Copyright Protection Length

There are many elements in our copyright system that can increase or decrease incentives to create and the harm caused by the rightholder's monopoly.⁴⁸ In this section, as an example of the long-term efficiency of unbundling, I compare it to one of the building blocks of any copyright regime—the length of protection.⁴⁹

It seems self-explanatory that the longer the protection period, the larger the incentive to create, and that publishers should therefore prefer a longer protection period. Nevertheless, publishers should be indifferent between a legal regime that offers them long and relatively weak protection (for example, by forcing bundling) and one that offers shorter and stronger protection (by allowing unbundling). From a total welfare perspective, however, the latter regime is preferable because allowing publishers to unbundle the rights in their works is not expected, on average, to create significant harm (as unbundling causes only a modest effect on the deadweight loss), while lengthening the protection period creates more and more deadweight loss over the years.

There are additional reasons that render the short unbundling regime superior to the long bundling regime. The *marginal* increase in the incentive to create decreases as the length of protection increases. This is because the demand for a work typically diminishes over time⁵⁰

⁴⁸ See generally Ian Ayres and Paul Klemperer, *Limiting Patentees' Market Power without Reducing Innovation Incentives: The Perverse Benefits of Uncertainty and Non-injunctive Remedies*, 97 Mich L Rev 985 (1999) (discussing the balance between uncertainty and delays in granting remedies for patent infringement and the length of protection). While I chose to explore the tradeoff between unbundling and the optimal length of protection, future research may explore other possible tradeoffs between other elements in our copyright regime (for example, the scope of the exclusive rights, the scope of the statutory defenses, or the remedies for infringement).

⁴⁹ The length of protection is one of the most discussed aspects of the Copyright Act. In a series of amendments, primarily in the last thirty-five years, Congress has extended the term of protection from fourteen years, which could be renewed for another fourteen-year term, to the current protection period, which is the life of the author plus seventy years. See Melville B. Nimmer and David Nimmer, 3 *Nimmer on Copyright* § 9.01 at 9-3-9-4 (Matthew Bender 2010); William M. Landes and Richard A. Posner, *Indefinitely Renewable Copyright*, 70 U Chi L Rev 471, 471-73 (2003); Lawrence Lessig, *Copyright's First Amendment*, 48 UCLA L Rev 1057, 1065 (2001).

⁵⁰ See Stephen Breyer, *The Uneasy Case for Copyright: A Study of Copyright in Books, Photocopies, and Computer Programs*, 84 Harv L Rev 281, 324-25 (1970) (“[O]nly one book in a hundred is in print after fifty-six years. . . . [M]any of these sell only a few copies. . . . [Publishers] base their publication decision upon an expectation that a book will earn a return within . . . at most ten or twenty years.”); Landes and Posner, 70 U Chi L Rev at 473-74, 496-507 (cited in note 49) (showing that “fewer than 11 percent of the copyrights registered between 1883 and 1964 were renewed at the end of their twenty-eight-year term, even though the cost of renewal

and because authors invest the fixed costs of creation up front and discount their future revenue streams to present value at the time of creation.⁵¹ Consequently, by lengthening the protection period by a certain percentage, the incentives to create are increased by a smaller degree. Finally, transaction costs, and in particular tracing costs, also increase with the length of copyright protection.⁵² Indeed, permitting unbundling will allow society to significantly shorten the protection period and thus substantially reduce economic waste.

C. Possible Limitations

While the analysis suggests that unbundling should typically be included in the set of incentives offered to authors of information goods, in the following paragraphs I mention a few possible factors for which this simple model does not fully account.

1. The costs of separation.

As we have seen, unbundling involves separation costs. Those costs reduce the producer surplus and therefore decrease the relative attractiveness of the unbundling regime. In fact, it is not difficult to envision situations in which unbundling increases the deadweight loss but most of the increase in the producer surplus is wasted on separation costs. In such a case, the producer will still choose to unbundle, but the ratio between the producer surplus and the deadweight loss might be higher under bundling, and therefore unbundling might be relatively inefficient in the long run.

Nevertheless, it seems that, on average, the ratio between producer surplus and deadweight loss will be higher under unbundling even if the separation costs are not negligible. The reason has to do with the average effects of unbundling on the relevant economic factors: an insignificant increase or decrease in deadweight loss, a substantial increase in producer surplus, and the existence of separation costs that may be smaller than the producer surplus, comparable, or, in theory, larger. But, if the separation costs are higher than the producer surplus, then they will not be borne because the producer will choose

was small," and that only 1.7 percent of the books published in the United States in 1930 were still in print in 2001).

⁵¹ See Breyer, 84 Harv L Rev at 324 (cited in note 50); Ayres and Klemperer, 97 Mich L Rev at 1005 (cited in note 48).

⁵² See Breyer, 84 Harv L Rev at 326 (cited in note 50) (observing that, with time, it becomes more difficult to find the copyright owner in order to secure permission). But see Landes and Posner, *Economic Structure* at 213–17 (cited in note 45) (arguing that tracing costs would not be substantial even if the length of protection is long if copyright holders had to register in a searchable database).

not to unbundle. Therefore, in the cases in which unbundling is used, the change in the producer surplus will be larger than the separation costs. Overall, the increase in the producer surplus, while mitigated by the separation costs, will be, on average, more significant than the change in the deadweight loss, and the ratio between the deadweight loss and the producer surplus will be higher under unbundling. Thus, even if the separation costs are significant, in the long run unbundling is an efficient tool to incentivize creation.

2. The costs of creation.

The discussion so far has focused on buyers who consume but do not create information goods. Information goods, however, are not just the product of the creative process but also an input in it. The vast majority of creative works are built upon other works previously published.⁵³ A rule that limits access to information goods can therefore increase the costs of creation. As suggested above, we cannot know a priori whether an unbundling regime will generally increase or decrease access to copyrighted works.

Nevertheless, certain rules in our copyright regime, in particular fair use, bundle together the right to access a work and the right to create certain transformative works. Allowing the producer to unbundle those rights may result in a price increase for the small group of transformative users or otherwise limit their ability to create. Indeed, it seems likely that many producers would offer “no transformative use” licenses (or at least “no parody” licenses) to the general public and much more expensive “transformative use licenses” to potential transformative users.⁵⁴ It is unclear whether the increase in producer surplus will compensate for this increase in the costs of creation.⁵⁵ A complete analysis of this complex problem is beyond the scope of this Article.

⁵³ See, for example, Jessica Litman, *The Public Domain*, 39 Emory L J 965, 1000–12 (1990) (arguing that originality, as required by the Copyright Act, is actually a legal fiction).

⁵⁴ This form of unbundling would reduce the volume of sales because some customers who are interested in transformative use will not buy the product. Because of the small size of this group, however, this decrease should not usually deter the producer from unbundling and separating transformative use.

⁵⁵ For some users, especially those who do not create for profit, the increase in producer surplus might be irrelevant. Thus, allowing the producer to attach a “no transformative work” license to her work might extinguish some types of creation, such as YouTube parodies. See Benkler, 74 NYU L Rev at 401–06 (cited in note 9).

D. The Long-Term Efficiency of the *ProCD* Decision and the *ProCD* Rule

The analysis in this Part suggests that because unbundling creates an immediate substantial increase in the incentives for producing information goods while causing relatively little waste, if any, then when society chooses the set of rules by which to incentivize creation, including the right to unbundle might be desirable. However, adding the right to unbundle to an existing copyright system is desirable only if the increase in producer surplus allows society to eliminate more damaging elements that incentivize creation (for example, a long term of protection). Therefore, although the analysis might support the *ProCD* rule (allowing unbundling), it does not necessarily justify the *ProCD* decision.

As Congress is in charge of putting together the package of incentives that authors receive, a court decision that allows unbundling may not enhance efficiency. If Congress envisioned a world in which rights would be partially bundled, then presumably the other elements of the copyright system give authors proper incentives to create without unbundling.⁵⁶ If this is the case, then a court decision that allows unbundling without balancing the increase in the producer surplus by eliminating other legal tools that incentivize creation (for example, shortening the period of protection, which a court is institutionally incapable of doing) distorts the “delicate balance” that Congress created. Because unbundling increases producer surplus, doing so when the legal system already properly incentivizes creation will create potentially distortionary incentives, which might lead to duplicative and socially wasteful investment.⁵⁷ Therefore, even if unbundling allows society to accord the proper incentives for creation in a manner less harmful than other legal

⁵⁶ Judge Easterbrook might disagree. See Easterbrook, 42 *Houston L Rev* at 961–63 (cited in note 33) (“What is the right length of a copyright? No one knows.”). But see generally Nimmer, Brown, and Frischling, 87 *Cal L Rev* 17 (cited in note 9) (discussing “copyright law’s ‘delicate balance’ between the rights of copyright owners and copyright users” and the ways in which the *ProCD* decision disturbed it). It seems that Easterbrook does not just argue that Congress might “get it wrong” but also implicitly claims that because we cannot assume that Congress made an optimal choice, its choice does not deserve special protection from alteration. See Easterbrook, 42 *Houston L Rev* at 962–63 (cited in note 33). While a full analysis of the separation of powers in this context is beyond the scope of this Article, it seems that, as David Nimmer, Elliot Brown, and Gary Frischling, pointed out, Easterbrook is questioning Congress’s longstanding role in finding this “delicate balance” and courts’ role in preserving it. See, for example, *Stewart v Abend*, 495 US 207, 230 (1990) (“[I]t is not our role to alter the delicate balance Congress has labored to achieve.”); *Sony*, 464 US at 429 (“[I]t is Congress that has been assigned the task of defining the scope of the limited monopoly that should be granted to authors or to inventors in order to give the public appropriate access to their work product.”).

⁵⁷ See note 45.

rules, it seems that this benefit is obtainable only when such a change is initiated by Congress as part of a larger reform.⁵⁸

CONCLUSION

Copyright law bundles certain rights in information goods. Authors of information goods sometimes try to unbundle these rights by using licenses. The enforceability of such licenses is a highly debated issue in the copyright literature.

This Article explores some of the advantages and disadvantages of these contracts from an economic efficiency perspective. It concludes that unbundling of rights has an ambiguous effect on the deadweight loss created by the author's monopoly. Nevertheless, unbundling of rights might be desirable as an *ex ante* tool to incentivize creation if the increase in the incentive to create is balanced by the elimination or reduction of the harm caused by other legal rules that incentivize creation.

The reduction in separation costs, as well as the adoption of the *ProCD* rule by other courts, might create a proliferation of contracts that reallocate rights in creative goods. Consequently, creative work might be distributed in ways that Congress did not envision when it enacted the Copyright Act. As these contracts might disturb the balance that the Copyright Act tries to achieve between the interests of different groups, and in a way that is not necessarily efficient, Congress may need to intervene in order to reestablish the balance in the copyright incentive system.

⁵⁸ One may claim that Congress's action in recent decades should make us doubt its willingness to limit the rights of publishers of copyrightable work, in particular by shortening the length of protection. See Easterbrook, 42 *Houston L Rev* at 962 (cited in note 33) ("A copyright lasts the life of the author plus an additional period that Congress keeps increasing in response to producers' lobbying."); Jessica Litman, *War Stories*, 20 *Cardozo Arts & Enter L J* 337, 350–54 (2002) ("[O]ur copyright laws have been written not by Congress, not by Congressional staffers, not by the copyright office or by any public servant in the executive branch, but by copyright lobbyists."). See also note 49. While this issue is beyond the scope of this Article, the public choice argument cannot, in itself, justify the *ProCD* decision. Assuming that Congress consistently favors the interests of publishers, giving this group a larger incentive, as the *ProCD* decision did, does not balance this bias. On the contrary.