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Understanding the costs and benefits of introducing a 'fair use' exception

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Executive summary

In 2012-2013 the Australian Law Reform Commission (ALRC) undertook an inquiry into copyright law in Australia and its ability to weather the challenges of the digital age. The inquiry focussed on the legal ramifications of '*whether the exceptions and statutory licences in the Copyright Act 1968, are adequate and appropriate in the digital environment*'.[1]

The ALRC report recommended that the *Copyright Act* should be amended to introduce a new copyright exception, based on the United States 'fair use' exception, which would allow the use of copyright material for any purpose if the use is 'fair' having regard to four factors.

The terms of reference for the current inquiry by the Productivity Commission into intellectual property arrangements require the Commission to have regard to the ALRC's report, and the Commission's issues paper asks for submissions on the role of fair dealing and fair use provisions.[2]

Current Australian copyright law has a large range of exceptions for particular purposes. They include the 'fair dealing' exceptions, which allow the use of copyright material for specified purposes – such as research, study, criticism, review, parody, satire and reporting news – provided the use is 'fair'. The exception for research or study includes factors to determine 'fairness' that are similar to those in the United States 'fair use' exception.

The ALRC report states that its recommendations are intended to facilitate a copyright framework which promotes innovation and productivity and helps all Australians participate in the digital economy.[3] This comment implies that:

- there will be greater productivity and innovation benefits for the economy as a whole as a result of fair use; and
- these productivity and innovation benefits will more than offset any negative impact to copyright owners and their incentive to produce new copyright works (e.g. through innovative new products for consumers or expanding new markets).

The ALRC's recommendation in favour of fair use is based predominantly on a legal analysis and did not include an economic cost-benefit analysis (CBA).

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1 Australian Law Reform Commission 2013, *Copyright and the Digital Economy*, ALRC Report 122, p.7

2 Productivity Commission 2015, *Intellectual Property Arrangements – Issues Paper*

3 Australian Law Reform Commission 2013, *Copyright and the Digital Economy*, ALRC Report 122, p.61

Economic theory is clear in demonstrating that there are net benefits in having some exceptions to copyright law.[4] The task then becomes one of determining what scale and form of exceptions maximise net welfare.

Application of standard economic theory tells us that introducing a new 'fair use' exception will likely have a number of consequences:

- A reduction in the incentive for professional creators of copyright works[5] as activities that currently require a licence will no longer require a licence, or users will at least assert that a licence is no longer required. This will create a loss of producer surplus, exacerbated by the uncertainty regarding how Australian courts will interpret the new exception.

- A gain in consumer and producer welfare resulting from new and transformative uses for secondary copyright materials (to the degree that fair use is more permissive than the current exceptions and the risk of subsequent application of fair use does not undermine incentives for transformative use).

As a result, the core task of this analysis is to determine, based on the available evidence, whether it is likely that the economic benefits arising from secondary use will more than offset the economic loss for original local producers.

This report provides some insights into elements that should be considered in any formal CBA of the proposed introduction of fair use.

Distinguishing between costs, benefits and transfers

A challenge in preparing a CBA is distinguishing financial impacts from economic impacts. The key point of differentiation between the two is the treatment of transfers (between parties); an economic perspective treats the change in the payment between the parties (i.e. the licence fee) as a transfer rather than a benefit or a cost.

Thus, upon the introduction of fair use, any direct reduction in fees paid to copyright owners by existing users for existing uses would be neither a cost to the owners nor a benefit to the users of the copyright works. That is, if secondary derivative works are not truly transformative, then fair use would merely represent a transfer of supply and demand between various groups within society and would not represent 'net new' economic growth.

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4 See discussion in The Allen Consulting Group 2003, *Economic Perspectives on Copyright Law*, pp.94-101

5 By 'copyright works' we mean all things protected by the *Copyright Act 1968*.

What is the impact on incentives to create original copyright works?

Given the underlying drivers of the content creation market, it is likely that a transition to fair use will create disincentives to create new original copyright works.

The extension of the fair dealing exceptions in Canada and Singapore provides two case studies that highlight the potential implications of introducing an exception for 'fair use' into Australian copyright law:

- In Canada the introduction of a new exception of fair dealing for education reduced licensing revenues (i.e. by 98 per cent) in the education sector,[6] triggered the closure of a major local publisher (i.e. Oxford University Press Canada) and a copyright collecting society[7]

- In Singapore the extension of the fair dealing exceptions to cover all uses is associated with a more than 50 per cent decline in the growth rate (i.e. falling from growth of 14.16 per cent to 6.68 per cent) for Singapore's copyright industries.[8]

It is also important to note that the loss of producer surplus will likely reduce the incentive to invest in copyright works over the long term. In turn, lower investment due to lower expected revenues would potentially reduce future copyright output (i.e. not just reduce industry revenues, but also reduce the number and quality of works created), and hence reduce economic welfare more generally (e.g. fewer original works from professional creators).

In practice, the impact of reduced production should be felt almost entirely on domestically produced works. A reduction in revenues in Australia is unlikely to reduce incentives for the production of globally consumed works. However, the impact will be material for domestic production and hence the marginal impact will be a loss of Australian professional creative output.[9]

With a reduction of the supply of original works, economic theory also suggests that there will be an increase in administration costs for copyright holder and creators of original works, and a corresponding reduction in administration costs for users of copyright works. Within the context of a CBA framework, administration costs belong to one of three categories:

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6 PwC 2015b, *Economic Impacts of the Canadian Educational Sector's Fair Dealing Guidelines*, p.68

7 Ibid.

8 See George R Barker 2013, 'Agreed Use and Fair Use: The Economic Effects of Fair Use and Other Copyright Exceptions' paper presented to the 2013 Annual Congress of the Society for Economic Research on Copyright Issues (SERCI), MINES ParisTech, Paris (France)

9 Based on Canada's experience, if all Australian secondary licensing agencies were to lose revenue similar to the losses in Canadia when fair use was introduced then this would represent a loss of GDP in the order of $1.3 billion in Australia

1. transaction costs — transaction costs reflect costs associated with connecting copyright holders and copyright users, establishing satisfactory terms and conditions, and facilitate the transaction between both parties for the use of the copyright material. Australian copyright collecting societies save copyright owners and professional content creators a combined $940 million in administrative and transaction related costs annually.[10]

2. compliance costs — compliance costs reflect ongoing costs to monitor compliance with the agreed terms and conditions associated with use of the materials (e.g. both the copyright holder and user). Similar to transaction costs, it is likely that fair use would increase compliance costs through a loss of economies of scale related to surveillance and monitoring that would individually have to be borne by professional content creators, owners, and some users. In some cases, copyright users might not take on compliance activities reflecting their genuine belief that they have a lower duty of compliance.

3. enforcement costs — enforcement costs reflect costs borne in litigating to clarify and enforce rights. Experience from the United States suggests that fair use will create additional legal uncertainty and that there will be a consequent increase in litigation. Conservatively, this could result in an increase in annual litigation costs from $26.6 million to $133 million[11].

As these collective administration costs increase the CBA should reflect both the increased inefficiency in the Australian economy and the further reduction in incentives for exiting professional creators.

Is there evidence of improved economic outcomes under fair use?

While a transition to fair use could likely reduce producer welfare for initial copyright creators (discussed above), this would be offset if new uses are stimulated that are greater than the initial producer welfare costs.

We have tested these offsetting benefits of fair use in two ways:

- At the aggregate national economy level – applying World Bank economic data with Consumers International[12] rankings of the flexibility of countries' copyright exceptions.

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[10] Derived from PwC 2011, *An economic analysis of copyright, secondary copyright and collective licensing*

[11] Derived from research conducted by Lateral Economics, the Standing Committee of Legal and Constitutional Affairs, and PwC. See page 28.

[12] See http://a2knetwork.org/watchlist/grades

- At the 'copyright exceptions' industries level – standardising analysis of the economic contribution of exceptions industries in Australia[13] and the United States.[14] This test reveals that the Australian exceptions industries constitute a larger portion of the Australian economy (12.9 per cent) than the equivalent United States industries do in the United States (10.5 per cent).

Both quantitative analyses suggest that there is no firm evidence supporting a direct causational relationship between fair use and improved economic outcomes for the Australian economy as a whole; the linkages between economic growth and innovation are likely a confluence of factors that interact to support a country's economic outcomes.

13 Lateral Economics 2012a, *Exceptional Industries: The Economic Contribution to Australia of Industries Relying on Limitations and Exceptions to Copyright*, p.23

14 Thomas Rogers and Andrew Szamosszegi 2010, *Fair Use in the U.S. Economy: Economic Contribution of Industries Relying on Fair Use*, Computer & Communications Industry Association

Contents

1 Context

In 2012-2013 the Australian Law Reform Commission (ALRC) undertook an inquiry into copyright law in Australia and its ability to weather the challenges of the digital age. The inquiry focussed on the legal ramifications of '*whether the exceptions and statutory licences in the Copyright Act 1968, are adequate and appropriate in the digital environment*'.[15]

In Australia, the *Copyright Act 1968* protects the categories of material set out in the legislation (such as literary, dramatic, musical, and artistic works) and assigns economic rights for each category that require authorisation for uses such as:

- copying (i.e. reproduction)
- adapting
- publishing
- communicating (e.g. broadcast, make available online)
- public performance.[16]

Copyright is an important enabler of innovation and economic growth. At its core, copyright law is concerned with 'motivating the creation and distribution of material, by giving rights holders a limited monopoly over the use of their material'.[17]

In 2014 copyright law underpinned $73.4 billion of value add created by Australia's 'core' copyright industries,[18] and a total of $111.4 billion across all Australia's industries which rely to some degree on copyright (see Figure 1).[19]

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15 Australian Law Reform Commission 2013, *Copyright and the Digital Economy*, ALRC Report 122, p.7

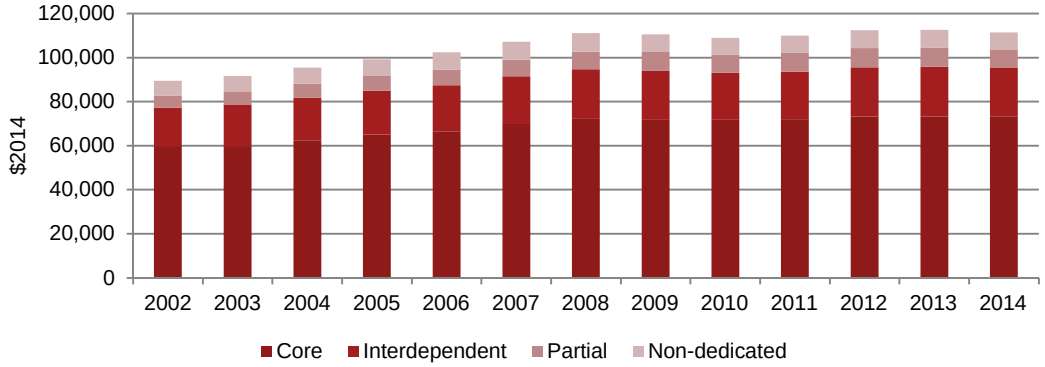
16 Furthermore, copyright creators also have a number of non-economic rights referred to as 'moral rights'. Moral rights referred to a copyright holder's right of integrity of authorship, the right of attribution, and right against false attribution

17 Australian Law Reform Commission 2013, *Copyright and the Digital Economy*, ALRC Report 122, p.59

18 'Core' copyright industries are primarily involved in the creation, manufacture, production, broadcast and distribution of copyrighted works and have a substantial level of copyright activities. These are industries that would not be in existence if not for the copyright subject or matter.

19 PwC 2015a, *The Economic Contribution of Australia's Copyright Industries 2002-2014*, p.11

Figure 1 Value add of copyright industries



Source: PwC 2015, The Economic Contribution of Australia's Copyright Industries 2002-2014, p.11

Copyright law has to strike a balance between the continued creation and dissemination of creative content for the longer term against the immediate term interests of consumers.

To try and balance these competing needs, the *Copyright Act* provides a number of exceptions to the general rules regarding copyright infringement.[20]

> *[The] economic justification for permitting … [an excepted] use is that, on the one hand, it may detract very little from the profit of the copyright holder (and thus not reduce by very much incentives to create), and on the other hand, it may add substantially to the utility of users.*[21]

Despite broad agreement on this rationale for the existence of some form of exceptions to copyright, the scope of these exceptions has been an ongoing matter for debate.[22]

Australian copyright law has a large number of exceptions for particular purposes. They include the 'fair dealing' exceptions, which allow uses for specified purposes:

- research or study
- parody or satire
- criticism or review
- reporting on the news

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[20] The economic justifications for exceptions to copyright are explained in The Allen Consulting Group 2003, *Economic Perspectives on Copyright Law*, pp.94-101

[21] Steven Shavell 2004, *Foundations of Economic Analysis of Law*, pp.158-159

[22] See The Allen Consulting Group 2004, *Copyright Exceptions in a Digital Environment: Matching Outcomes with Rationales*, November, p.v

- use for the purposes of judicial proceedings or legal advice.

Hence, whether a use of copyright material is 'fair' depends on the circumstances of the copying, and in general, requires the two-step analytical process:

- Is the use one of the prescribed purposes?
- Is it fair?

In assessing whether copying a work for research or study is permitted there are five factors[23] to take into account.

In contrast, in the United States the 'fair use' exception allows for a use for any purpose, provided the use is 'fair' having regards to four factors:

- the purpose and character of your use
- the nature of the copyrighted work
- the amount and substantiality of the portion taken
- the effect of the use upon the potential market.

The ALRC report recommended that the *Copyright Act* should be amended to provide an exception for fair use rather than fair dealing. Specifically, the report recommended the *Copyright Act 1968* should contain:

- an express statement that a fair use of copyright material does not infringe copyright
- a non-exhaustive list of the factors to be considered in determining whether the use is a fair use
- a non-exhaustive list of illustrative uses or purposes that may qualify as fair use.[24]

While the ALRC encouraged stakeholders to provide it with an evidentiary base upon which it could form its analysis, the ALRC's report was notable for its lack of reliable evidence in discussing the costs and benefits of alternative options before it.[25]

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[23] The five factors include the purpose and character of the dealing, the nature of the material, the possibility of obtaining the material commercially, the effect of the dealing, and the amount copied.

[24] The ALRC report went on to suggest that if fair use is not enacted, the *Copyright Act* should be amended to expand the scope of fair dealing to include additional specific exceptions - Australian Law Reform Commission 2013, '*Copyright and the Digital Economy*', ALRC Report 122, p.13

[25] See discussion in George R Barker 2013, 'Agreed Use and Fair Use: The Economic Effects of Fair Use and Other Copyright Exceptions' paper presented to the *2013 Annual Congress of the Society for Economic Research on Copyright Issues* (SERCI), MINES ParisTech, Paris (France)

As such, the specific question that this report will attempt to answer is, ‘what is the net economic impact of introducing a new exception that allows fair use for any purpose, modelled on the United States exception?’

2 Methodological challenges

The Australian Government requires that proposals to create or amend legislation are subjected to a cost-benefit analysis (CBA), which forms part of a regulatory impact statement (RIS).[26]

CBA is a tool designed to place the benefits and costs of particular actions or proposals on a common basis so that they can be compared and understood. In the current case, CBA provides a common basis on which the Australian Government can assess the net public benefits of exceptions from copyright for permissible uses.

Optimally, a CBA allows for quantification and valuation of a range of potential impacts that might arise from changes in the exceptions. It involves aggregation of these impacts across the various types of costs and benefits and through time into a single metric – the expected present value of net benefits from a change relative to a base case.

A CBA framework is focused on the social and economic welfare of the community as a whole. Thus, the policy option that delivers the highest net social welfare is considered to be the best for society. The challenge is to ensure that the CBA framework is appropriately applied to the subject matter at hand (i.e. a comparison of current law and fair use).

There are three specific observations that frame how to apply the CBA framework in this instance, as discussed below.

2.1 The base case

An important step in any CBA is to clearly specify the base case against which options are considered.

First, given that one option is no legislative change (i.e. the *status quo*), we suggest that this be the base case against which the introduction of fair use should be assessed. This avoids the potential problem of having to justify the existence of copyright itself and the current fair dealing exception.[27]

Second, a challenge in considering broad legal change is whether to specify the base case as it is:

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[26] Australian Government 2014, *The Australian Government Guide to Regulation*, p.4

[27] For a discussion of the economic rationales that have been applied to justify the fair dealing exception see The Allen Consulting Group 2003, *Economic Perspectives on Copyright Law*, pp.94-101. While there are economic justifications for exceptions to copyright such as fair dealing/use it is important to note that such justifications cannot be assumed to apply in all circumstances: 'Although uses that are deemed fair seem in a rough and implicit way to reflect such economic reasoning, some of the legal tests used to decide fair use are inconsistent with the reasoning.' - Steven Shavell 2004, *Foundations of Economic Analysis of Law*, p.159

- applied in practice
- documented in legislation.

We suggest that the base case should reflect the actual behaviours of the community (i.e. as demonstrated by copyright owners and users in practice) rather than what could be inferred by a simple reading of the *Copyright Act*.

2.2 Financial versus economic impacts

The challenge in a CBA is to distinguish financial impacts from economic impacts. The key point of differentiation between the two is the treatment of transfers (between parties) in terms of the overall net impact of a proposal. We have developed a stylised example to illustrate this point. For example, let's assume that under current arrangements:

- a copyright owner incurs $3 in transaction costs to receive $10 in licence fees
- a copyright user incurs $3 in transaction costs and pays $10 in licence fees
- a law firm receives $6 dollars in fees to facilitate all aspects of the transaction.

Assuming the law changes to allow for fair use, the copyright user is now no longer potentially liable for copyright fees (where previously they were), thus the result is that there are no transaction costs for either party. In financial terms:

- the copyright user is $13 better off
- the copyright owner is $7 worse off
- the law firm is $6 worse off
- net overall financial impact of zero.

The CBA, however, takes an economic approach rather than a financial approach and tries to understand the net overall impact. Hence, the payment between the parties (i.e. the licence fee) is a transfer rather than a benefit or a cost. Hence, in the context of a CBA, there will be:

- benefits of $6, made up of reduced transaction costs to both parties[28]
- opportunity costs to society and some content creators from a reduction in new original works (resulting from decreased incentives for creation)

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[28] Transfers can only be regarded as enhancing community wellbeing if a decision is made that one group derives more value from the resources than the other - Victorian Competition and Efficiency Commission 2013, *Adjusting the Balance: Inquiry into Aspects of the Wrongs Act 1958*, draft report, Victoria, November, page 5.

- benefits to society and some content creators resulting from the supply of substantially transformed works (based on currently protected works).

A challenge in distinguishing between benefits/costs and transfers is the normative (i.e. value judgement) discussion that often accompanies the analysis. It is important to note that if secondary derivative works are not truly transformative, then it would merely represent a transfer of supply and demand between various groups within society and would not represent 'net new' economic growth.

Some would contend that education and knowledge are presumed to be inherent public goods and thus deserving of special exception under copyright law. Yet on face value this claim can be hard to sustain given other owners of inputs to education are not expected to provide their inputs for free. For example, electricity suppliers are not forced to supply schools with electricity free of charge despite electricity being an important input into the education/knowledge process.

Thus, the important question that must be answered is whether changes to copyright exceptions result in a demonstrable net benefit to the economy and society as a whole or whether they merely transfer benefits between groups.

2.3 Data availability

Once a view is formed as to the nature of the costs, benefits and transfers, it is then necessary to gather the relevant data to flesh out the analysis. This is a significant task as:

> *It is easy enough to identify the fundamental policy issue as being whether the conferral of property rights will work as an incentive or disincentive to appropriate forms of investment in creativity. It is quite another matter to answer that question with any confidence.*[29]

A challenge faced by the ALRC and this study is that:

- there is no single government body or official body that compiles statistics on the extent of copyright use and enforcement in Australia[30]

- industry statistics are not always comprehensive[31] and, where such statistics rely on confidential information, cannot be scrutinised.[32]

The issue of inadequate data in the copyright space is widely appreciated:

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[29] Jill McKeough and Andrew Stewart 1997, *Intellectual Property in Australia*, 2nd ed, p.20

[30] The Australian Bureau of Statistics (ABS) collects very limited information on copyright usage (and often bundles copyright statistics with trademark statistics) - Australian Bureau of Statistics 2014, *81670DO001_201213 Selected Characteristics of Australian Business, 2012-13*

[31] Australian Institute of Criminology 2008, *Intellectual Property Crime and Enforcement in Australia*, p.38

[32] Ibid.

> *The heart of the problem can easily be seen to reside in the fact that, by its very nature, an optimal copyright law requires information that law-makers typically do not have, and may not even be able to approximate to any reasonable degree of accuracy. On the one hand, we require knowledge on the market demand curve for copyright products, and on the other, we require information on the private costs (both financial costs and opportunity costs) of creators of copyright products. Coming to grips with either of these concepts is an inherently empirical issue that has yet to be properly and fully addressed in the literature.*[33]

Hence, where there are data gaps it is necessary to:

- develop assumptions/proxies. For example, the identification of costs and benefits associated with changes in incentives is generally a very problematic exercise in copyright analysis. However, in this case there are two countries where recent changes to the law provide two case studies as to the potential impacts (i.e. Singapore via legislative change and Canada by judicial reinterpretation and legislative change).[34]

- acknowledge that we do not have the information to quantify the impact. In such cases, application of economic theory may be able to identify the relative scale of the benefits, costs and transfers.

Despite these drawbacks, the process of preparing a CBA (even in a highly modified form) can still be useful. In cases where all costs and benefits cannot be valued in dollars terms, it is possible to present information about the likely extent of non-monetised costs and benefits (i.e. why they are large or small relative to monetised effects).

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33 Richard Watt 2009, 'An empirical analysis of the economics of copyright: How valid are the results of studies in developed countries for developing countries?' in World Intellectual Property Organization, *The Economics of Intellectual Property: Suggestions for Further Research in Developing Countries and Countries with Economies in Transition*, pp.65-108 at p.65

34 See discussion in: Michael Geist 2013, 'Fairness Found: How Canada Quietly Shifted from Fair Dealing to Fair Use' in *The Copyright Pentalogy*, University of Ottawa Press, pp.157-186; George R Barker 2013, 'Agreed Use and Fair Use: The Economic Effects of Fair Use and Other Copyright Exceptions' paper presented to the *2013 Annual Congress of the Society for Economic Research on Copyright Issues* (SERCI), MINES ParisTech, Paris (France); PwC 2015b, *Economic Impacts of the Canadian Educational Sector's Fair Dealing Guidelines*

3 Application of a stylised model for copyright works

3.1 A stylised model of the market for copyright works with fair dealing/fair use

To appreciate the nature of the costs and benefits associated with a move from fair dealing to fair use, it is useful to use standard economic theory to explain the drivers of supply and demand for copyright works under fair dealing and fair use.

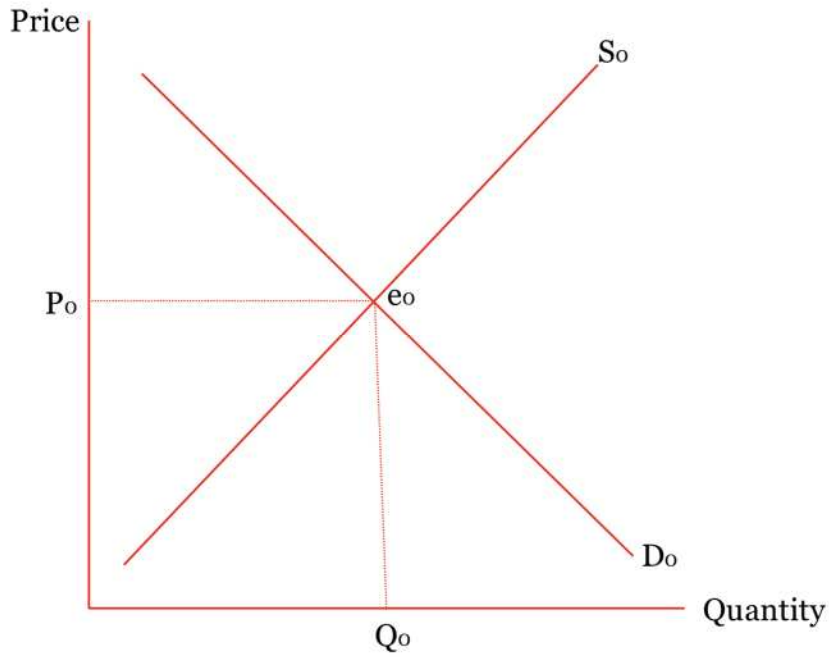
> *Although economic analysis may not be able to determine the best copyright regime in terms of fairness or other norms of society – it cannot, for example, identify which group(s) should gain and which should lose as a result of any revision in copyright law – it can provide insights into how private incentives and social benefits in markets for creative works might be structured.*[35]

Figure 2 (next page) presents a standard stylised economic model of how the market for copyright works under fair dealing (i.e. under current legal arrangements), with the:

- horizontal axis representing the quantity of copyright material demanded by and supplied to consumers
- vertical axis representing the price of copyright material, which is a function of the available supply and relative to demand.

35 Congressional Budget Office 2004, *Copyright Issues in Digital Media*, Congress of the United States, p.viii

Figure 2 Stylised supply and demand for copyright works under fair dealing



Economic theory suggests that the quantity of copyright materials demanded:

- will be higher the lower the price
- will fall as price rises.

By contrast, the quantity of copyright materials supplied will:

- be low so long as the price is low
- increase as prices rise.

In theory, the market will come to reach an equilibrium where demand equals supply at e_o (i.e. with Q_o copyright works supplied at price P_o).

This stylised model is, we suggest, broadly accepted as a means of assessing copyright:

> *The basic economic theory of copyright has been well understood for quite some time (see, for example, Landes and Posner (1989)). … It is normally hypothesized that the supply of copyright material should be increasing in copyright protection, while the demand for copyright material should be decreasing in copyright protection. Thus, too much protection leads to an excess supply of copyright products (over-production and under-consumption), while too little*

leads to an excess demand for copyright products (under-production and over-consumption).[36]

Hence, this conventional economic model allows us to consider the nature of the impact of a change in the market associated with the introduction of fair use.

The introduction of fair use will have two separate immediate impacts:

- Fair use will likely increase the direct costs of supply as copyright owners need to negotiate and monitor compliance with the expanded exceptions (i.e. shifting the supply curve S_0 to S_1).

- Demand will fall as potential users reassess the value they place on copyright materials at the new price (i.e. shifting the demand curve inwards from D_0 to D_1). This will be exacerbated to the degree that there is any strategic positioning by existing licensees (i.e. whereby they may seek to withhold licence fees to test the copyright owner's ability to enforce their rights).

The result will be a new equilibrium intersection of demand and supply at e_1 in Figure 3 (next page), resulting in a lower price and lower quantity sold, causing harm to copyright owners in the form of foregone revenues (i.e. an opportunity cost).[37]

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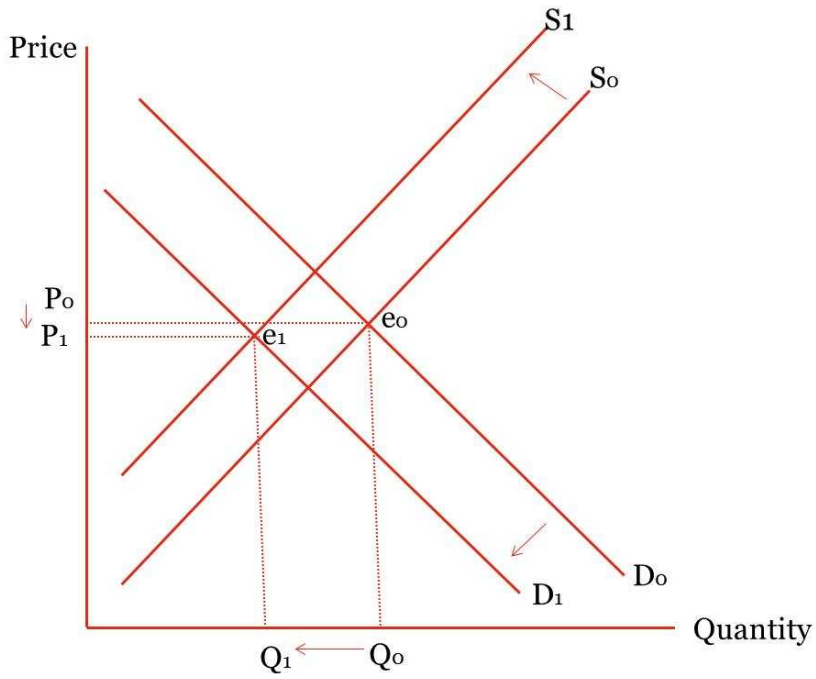
[36] Richard Watt 2009, 'An empirical analysis of the economics of copyright: How valid are the results of studies in developed countries for developing countries?' in World Intellectual Property Organization, *The Economics of Intellectual Property: Suggestions for Further Research in Developing Countries and Countries with Economies in Transition*, pp.65-108 at p.65. Also see: William M Landes and Richard A Posner 1989, 'An Economic Analysis of Copyright Law' 18(2) *Journal of Legal Studies* pp.325-363; George R Barker 2013, 'Agreed Use and Fair Use: The Economic Effects of Fair Use and Other Copyright Exceptions' paper presented to the 2013 Annual Congress of the Society for Economic Research on Copyright Issues (SERCI), MINES ParisTech, Paris (France); Joel Waldfogel 2012, 'Music Piracy and Its Effects on Demand, Supply, and Welfare' in Josh Lerner and Scott Stern (eds), *Innovation Policy and the Economy, Volume 12*; William M Landes & Richard A Posner 2013, *The Economic Structure of Intellectual Property Law*

[37] The loss of revenue equals the area (P_0-P_1) multiplied by Q_1 plus the area (Q_0-Q_1) multiplied by P_0

Figure 3 Stylised supply and demand for copyright works under fair use



The economic model also suggests that some of this lost producer surplus could be offset by a gain in consumer and producer welfare resulting from new and transformative uses for secondary copyright materials. In this regard, assuming that fair use is more permissive than Australia's current exceptions, the introduction of fair use could also have two separate impacts:

Supply will increase due to lower direct costs faced by secondary copyright users who no longer need to negotiate, monitor compliance, or pay for licences for some copyright works. This would shift the supply curve outward from S_1.

Demand will increase for transformative new works as people are willing to pay for new materials, shifting the demand curve outward from D_1.

It is important to note that if secondary derivative works are not truly transformative, then it would merely represent a transfer of supply and demand between various groups within society and would not represent 'net new' economic growth.

The degree to which these second round benefits offset the initial contraction is an empirical issue. As a result, the core task of this analysis is to determine, based on the available evidence, whether it is likely that the benefits arising from secondary use will more than offset the initial loss.

It is also important to note that the loss of producer welfare would reduce the incentive to invest in copyright works over the long term. In turn, lower investment due to lower expected revenues would reduce future copyright output (or the quality of works created)[38] and hence reduce welfare more generally.

3.2 The identified costs and benefits

The ALRC's recommendation in favour of fair use is based predominantly on a legal analysis and did not include an economic benefit cost analysis. The ALRC report states that its recommendations are intended to facilitate a copyright framework to promote innovation and productivity and help all Australians participate in the digital economy.[39] This comment implies that:

- there will be greater productivity and innovation benefits for the economy as a whole as a result of fair use
- that these productivity and innovation benefits will offset any negative impact to copyright owners and their incentive to produce new copyright works (e.g. through innovative new products for consumers or expanding new markets).

To properly test this suggestion, it is important to first separate cost and benefit categories, and then evaluate each. The following costs and benefits – derived from the application of the economic model described above and from the ALRC's report – have been identified as the key potential cost and benefit categories associated with a shift from fair dealing to fair use:

- Costs:
  - **Reduced supply of professional original works**: opportunity costs related to a reduced supply of newly created materials.
  - **Transaction costs:** costs required to connect a copyright holder with copyright users, to establish satisfactory terms, and to facilitate the transaction between both parties for the material.
  - **Compliance costs:** ongoing costs to monitor compliance with the agreed terms and conditions associated with use of the materials (e.g. both the copyright holder and user).
  - **Enforcement costs:** costs to resolve disagreements or violations of copyright terms and conditions through formal or informal proceedings in the event these cannot be resolved through ordinary compliance activities.

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[38] In theory, a reduction in content revenues could incentivise the creation of the same number (or potentially a greater number) of much lower quality works. In turn, consumers might actually demand a greater number of low quality works at the same price to be adequately compensated for lesser quality

[39] Australian Law Reform Commission 2013, *Copyright and the Digital Economy*, ALRC Report 122, p.61

- Benefits:
  - **Enhanced use of currently protected works:** benefits to consumers who can more easily create new products, new processes, services and/or business models inspired by existing copyright material.
  - **Reduced transaction costs**: creators making transformative use of copyright material gain quicker and lower cost access without needing prior approval or licence.
  - **Market growth**: benefits to society of new or expanded markets that can result from innovations inspired by existing copyright material.

In the following chapters these potential costs and benefits are assessed and, where possible, quantified in an Australian context.

4 Costs

4.1 Supply of original works

The standard economic model employed in Chapter 3 suggested that the supply and demand changes will reduce the production and use of professional original works, which is effectively an opportunity cost of using copyrighted materials.

4.1.1 Evidence from overseas

Canada

The Allen Consulting Group previously noted that 'Probably the most significant fair dealing exception relates to research or study.'[40] It is this category of copyright use that correspondingly has the most evidence regarding potential impacts from moving from fair dealing to fair use.

Until recently Canada also had a fair dealing system similar to that of Australia. However, fair dealing exceptions have recently been expanded in Canada as a result of both judicial interpretation and the introduction of new fair dealing purposes, including education. [41] Following these changes, the Canadian education authorities issued guidelines that had the practical effect of 'authorising' the copying of works as 'fair dealing', which were previously covered under licences with the Canadian collecting society.

At the macro level, between 2011 and 2013, Canada's education publishing sector saw its share of GDP decline by 16 per cent from $740 billion to $620 billion (i.e. both an absolute and relative decline). This decline directly aligns with the implementation of the Fair Dealing Guidelines adopted in 2012 by the Canadian Council of Education Ministers.[42]

More specifically, licence fees administered by the relevant collecting society were drastically curtailed with the introduction of following the Canadian Fair Dealing Guidelines. For example, the total licence fees paid by primary and secondary schools fell 98.6 per cent in 2013 despite consistently steady fees ranging from $17-$18 million over the previous seven years.[43] This is a consequence of:

- Canadian primary and secondary public schools ceasing to pay Access Copyright for licensing fees

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40 The Allen Consulting Group 2003, *Economic Perspectives on Copyright Law*, p.95

41 See Michael Geist 2013, 'Fairness Found: How Canada Quietly Shifted from Fair Dealing to Fair Use' in *The Copyright Pentalogy*, University of Ottawa Press, pp.157-186

42 PwC 2015b, *Economic Impacts of the Canadian Educational Sector's Fair Dealing Guidelines*, June, p.10. The Ministers of Education adopted new Fair Dealing Guidelines (the Guidelines) as a means of providing some certainty given the implications of the decision

43 Ibid., p.59

- a number of independent primary and secondary public schools terminating their licences.[44]

Taken together, primary, secondary and tertiary license fees generated over $40 million to Access Copyright. Adjusting for operating costs, the loss to content creators was estimated to be roughly $30 million.[45]

These impacts, while significant for the industry, represent transfers (i.e. from creators to users) rather than economic costs.

However, the loss of these revenues appears to also have had an impact on the supply of works. McGraw Hill Education notes that:

> *Taking the Canadian experience from 2012, revisions to 'fair dealing' directly contributed to an unprecedented decline in Access Copyright revenue for McGraw-Hill Education in Canada, with the Schools division heavily impacted. There has been a subsequent loss of jobs and a shift to a US structure, damaging not only the local industry but by extension the publications of Canadian-specific cultural and curricula content.*[46]

R.I.C Publications notes:

> *… our partners in Canada and the USA are increasingly having less to offer us as they either fall by the wayside or elect to create non-IP resources in a market affected negatively by fair use legislation and decisions. These publishers, who have historically been strong resource publishers, no longer have the level of protection under copyright legislation that they need and should have, and have moved to create other product types that do not have an IP issue, such as classroom decoratives and stickers—hardly innovative but more self-preservation.*[47]

Finally, Cambridge University Press notes:

> *Since the introduction of the 'fair dealing' guidelines in Canada, Oxford University Press withdrew from the market, Nelson, the largest pre-2012 publisher, declared a form of bankruptcy, local publishers such as Emond have ceased publishing and McGraw Hill and Pearson have scaled back. Protection of IP and adequate and fair compensation for*

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44 Ibid., pp.59-61

45 Ibid., p.62

46 McGraw Hill Education 2015, *Submission in response to Intellectual Property Arrangements Productivity Commission Issues Paper,* October 2015, p.2

47 R.I.C. Publications Pty Ltd 2015, *Submission to: Productivity Commission Issues Paper Intellectual Property Arrangements*, p.8

copying are a significant factor in making local publishing for local school curriculums a viable proposition.[48]

Singapore

Singapore undertook sweeping reform of their copyright legislation, including extending the fair dealing exception to apply to any use (similar to the United States fair use exception).

Advocates of fair use[49] point to Ghafele and Gibert's analysis of the Singaporean introduction of fair use[50] to challenge the view that fair use reduced the incentives for Singapore's copyright industries. Ghafele and Gibert report that, following the introduction of fair use in Singapore:

- Singaporean copyright industry revenue growth slowed from 14.16 per cent to around 6.68 per cent per annum[51]
- but this slowed growth in the copyright industries was offset by substantially higher growth rates in private copying technology industries, which grew by 10.18 per cent (i.e. adding €2.27 billion of additional value add after the reforms).[52]

Barker and Png are critical of this analysis,[53] arguing that the increase from 1.97 per cent growth rate per annum to 10.18 per cent per annum in private copying industries was driven by a number of factors unrelated to Singaporean copyright law, and that the analysis suffered from three specific flaws:

- Singapore introduced a number of reforms at the same time[54], making it impossible to isolate the impacts of any one reform.
- Singapore is a small economy that exports over 95 per cent of its electronic goods, meaning that fair use law would likely have had no impact on domestic production of copying technology as demand is driven by overseas purchasers.

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48 Cambridge University Press 2015, *Submission: Response to Intellectual Property Arrangements Productivity Commission Issues Paper,* October 2015, p.2

49 Including the ALRC itself - Australian Law Reform Commission 2013, *Copyright and the Digital Economy*, ALRC Report 122, p.77

50 Roya Ghafele & Benjamin Gibert 2012, *The Economic Value of Fair Use in Copyright Law Counterfactual Impact Analysis of Fair Use Policy On Private Copying Technology and Copyright Markets in Singapore*, Oxfirst Limited, October

51 Ibid., p.5

52 Ibid., p.6

53 George Barker & Ivan Png 2013, *Unfair Evidence on Fair Use*, 3 June, available at https://law.anu.edu.au/news/cle/unfair-evidence-fair-use; and George R Barker 2013, 'Agreed Use and Fair Use: The Economic Effects of Fair Use and Other Copyright Exceptions' paper presented to the *2013 Annual Congress of the Society for Economic Research on Copyright Issues* (SERCI), MINES ParisTech, Paris (France)

54 Ghafele and Gibert focus mainly on amendment to clause III 35 of the Singapore legislation, which reflects §107 limitations in the USA. The Singapore Copyright Act was amended several times and consolidated into a revised edition in 2006. A number of amendments were introduced including fair dealing provisions for purposes of criticism or review, the reporting of current events, and judicial proceedings. See Ghafele and Gibert page 3.

- There are concerns with how the study defined the 'private copying technology' industry in Singapore, which contained potentially sub-sectors that are not necessarily dependent or reliant on the secondary use of copyright materials.[55]

Thus, the Ghafele and Gibert analysis should be seen as supporting the observation that the introduction of fair use reduced the incentives for professional copyright creators in Singapore, as evidenced by a decline in Singaporean copyright industry revenue growth of about 50 per cent,[56] and that any broader benefits associated with the change in the copyright exceptions are indeterminate.

4.1.2 The potential Australian impact

Currently, the Australian educational book sector generates:

- direct sales of around $734 million in 2014/15, with expectations that this will grow (under existing copyright laws) to $943 million in nominal terms in 2019/20[57] (see Table 1)

- secondary licensing under the statutory licence for education purposes of around $101.06 million.[58]

Table 1 Size of Australian educational book market (nominal $million)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Print/audio	585	585	583	561	559	558	557	556	555	554
Digital/electronic	25	45	80	140	175	215	258	302	347	389

Note: Shaded values are forecasts
Source: PwC 2015c, Australian Entertainment and Media Outlook 2015-2019, p.70

Given the similarity of the Canadian and Australian economies and legal regimes it is reasonable to expect that the outcome of a shift to fair use in Australia would produce similar impacts as those in Canada.

Particularly concerning, in the Australian context, could be the loss of financial incentives for creators and publishers to develop new Australian content,[59] and in turn impacting the education curriculum more broadly.

In practice, while the sales impact will likely be shared across the industry, the impact of reduced incentives for production would be felt almost entirely

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55 George R Barker 2013, 'Agreed Use and Fair Use: The Economic Effects of Fair Use and Other Copyright Exceptions' paper presented to the *2013 Annual Congress of the Society for Economic Research on Copyright Issues* (SERCI), MINES ParisTech, Paris (France), pp.22-23

56 Ibid., p.5

57 PwC 2015c, Australian *Entertainment and Media Outlook 2015-2019*, p.63

58 Copyright Agency 2015, *Annual Report 2014-15*, p.9

59 PwC 2015b, *Economic Impacts of the Canadian Educational Sector's Fair Dealing Guidelines*, p.62

on domestic creators and their works. A reduction in industry revenues in Australia is unlikely to reduce incentives for the production of globally consumed works. However, the impact will be material for domestic production and hence the marginal impact will be a loss of Australian production.

In this respect, the revenues for authors from licensing are important drivers of incentives for creation. Three overseas surveys reinforce this view:

- Roughly 70 per cent of all content creators affiliated with Access Copyright (the Canadian equivalent of Copyright Agency in Australia) suggested that the licensing revenue they received from Access Copyright was either 'extremely important' or 'very important'.[60] Further, between 34 and 37 per cent of creators affiliated with Access Copyright indicated that they would reduce the number of works, and time spent creating, if Canada's new fair dealing guidelines reduced income.[61]

- A survey of the United Kingdom Authors' Licensing and Collecting Society (ALCS) member authors suggests that a 20 per cent fall in collective licensing income could likely trigger a shift in behaviour.[62] More importantly, 20 per cent of authors surveyed suggested that they would reduce the amount of time on educational writing or reduce the amount they produced (see Figure 4).[63]

- PwC interviews with major United Kingdom education publishers suggests that ongoing licensing incomes are very important to their long term ability to invest in the United Kingdom education market.[64]

60 Ibid., p.79

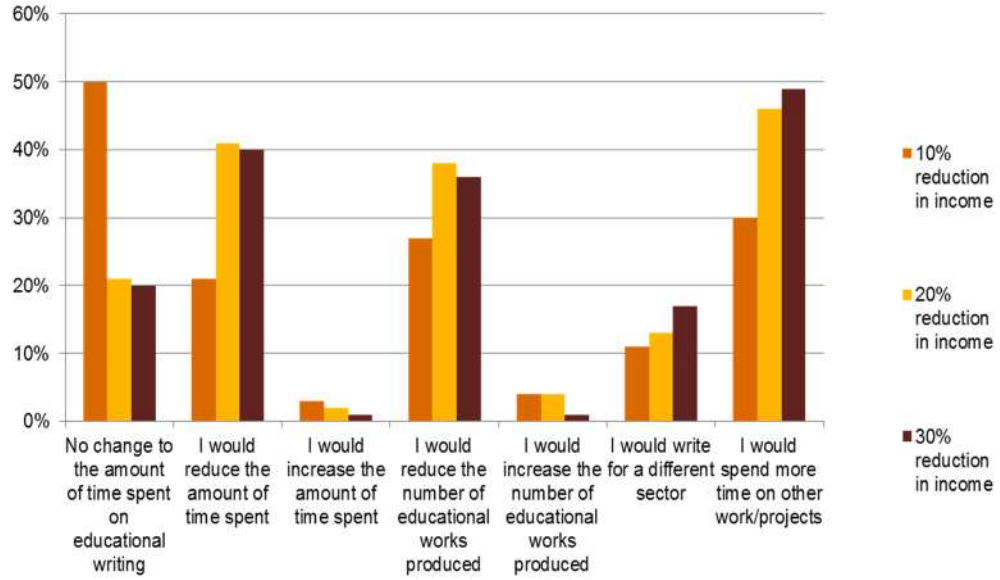
61 Ibid., p.80

62 PwC 2011, *An Economic Analysis of Copyright, Secondary Copyright and Collective Licensing*, p.62

63 PwC 2012, *An Economic Analysis of Education Exceptions in Copyright*, p.62

64 PwC 2011, *An Economic Analysis of Copyright, Secondary Copyright and Collective Licensing*

Figure 4 Effect of a fall in statutory licensing income on the behaviour of United Kingdom authors



Source: PwC 2012, An Economic Analysis of Education Exceptions in Copyright, p.62

The Canadian experience enables us to estimate the broader economic impact on the Australian economy should similar copyright law changes be adopted.

- Prior to the introduction of the Guidelines for Fair Dealing, in 2011 the Canadian education publishing sector generated $767 million in value add. Following the introduction of the Guidelines in 2012, the education sector contribution to value add declined to $643 million.[65] This reduction stems from contracting output of the education sector from $1,492 million in 2011 to $1,243 million and reduction in employment from roughly 7,650 jobs to 6,400 jobs. The total loss in licensing income across the education sector for collecting agencies amounted to $41 million per annum and subsequent loss in payments to creators of $31 million, after administration costs. This implies an indicative multiplier effect of approximately three for each dollar of licence fee reduced on the GDP in the education sector.

- Based on published annual reports from the 2014 Financial Year, Australian collecting societies received roughly $437.7 million in licensing fees.[66] Assuming a similar proportional decline as in Canada, this implies a potential loss of Australian GDP of $1,312.9 million with the introduction of fair use.

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65 PwC 2015, *Economic Impacts of the Canadian Educational Sector's Fair Dealing Guidelines*, p.46

66 These include data from Copyright Agency, Screenrights, PPCA, APRA/AMCOS, ASDACS, and AWGACS

4.2 Administration costs for copyright owners

With a reduction of the supply of original works, economic theory also suggests an increase in administration costs for copyright holders and creators of original works, and a corresponding reduction in administration costs for users of copyright works. Within the context of a CBA framework, administration costs belong to one of three categories:

- transaction costs
- compliance costs
- enforcement costs.

4.2.1 Transaction costs

Transaction costs reflect costs associated with connecting copyright holders and copyright users, establishing satisfactory terms and conditions, and facilitating the transaction between both parties for the use of the copyright material. For a copyright owner, transaction costs manifest themselves in a few different ways:

- once contacted by the potential user, costs associated with understanding the usage and settling on acceptable terms of use
- time and effort (perhaps legal expenses) with negotiating and agreeing acceptable commercial terms (to both parties)
- administrative processes to record agreements in computer systems and receive payment for use of copyright material.

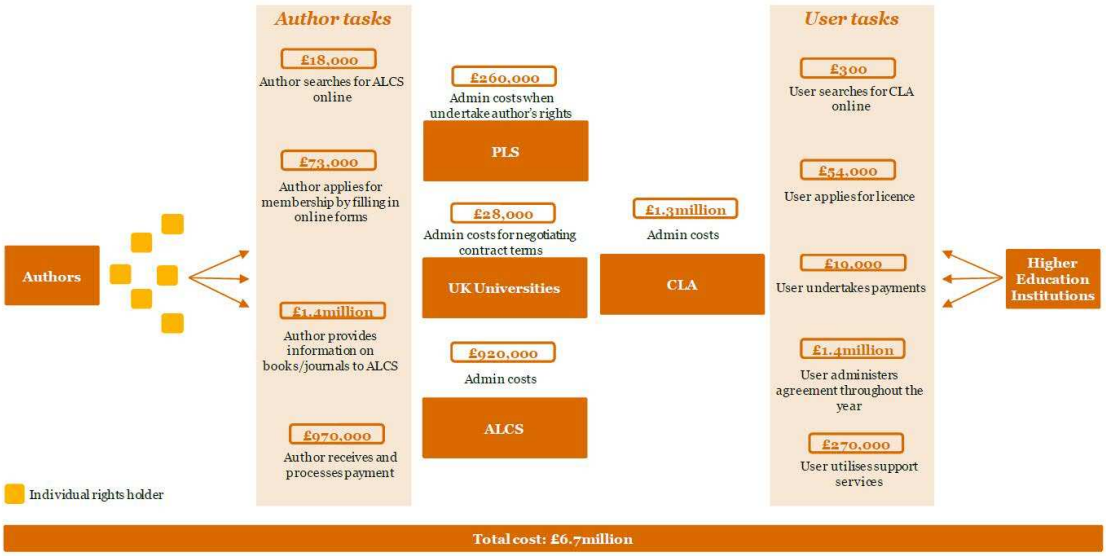
A prospective user of copyright material faces several transaction costs associated with secondary licensing:

- search costs to identify copyright owners or their agents
- time and effort to explain the use and settle on an agreed scope and terms of use
- administrative processes to record agreements in computer systems and facilitate payment for use of copyright material.

Collecting societies play an important role in reducing transaction costs by centralising administrative functions, thereby creating scale and capacity. A likely consequence of moving to fair use in Australia is lost economies of scale, especially for professional creators, resulting in overall higher transaction costs for creators and users.

For example, administration costs for higher education sector licensing in the United Kingdom has been estimated to be around £6.7 million a year (i.e. $10.4 million per year) (see Figure 5),[67] but would increase to between £145 million and £720 million per year under a fragmented model (i.e. an atomised model without economies of scale) (see Figure 6).[68]

Figure 5 Estimated transaction costs associated with a collecting society framework



Source: PwC 2011, An economic analysis of copyright, secondary copyright and collective licensing, p.77

Figure 6 Estimated transaction costs associated with an atomised framework

Source: PwC 2011, An Economic Analysis of Copyright, Secondary Copyright and Collective Licensing, p.77

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67 Using March 2011 AUD to £ conversion rate

68 PwC 2011, *An Economic Analysis of Copyright, Secondary Copyright and Collective Licensing*, p.43

Excluding user costs from the estimate, and taking only a conservative estimate, the results from the study imply that collecting societies reduce administrative duplication by over 18 times. To put it another way, if copyright creators and owners were to all perform the required administrative tasks themselves, duplication and overlap of effort would increase compliance costs to the sector by 18 times than if a single organisation centralised the same functions.

For example, to perform the same tasks as a collecting society, each copyright owner would have to potentially:

- receive inquiries from potential users
- negotiate acceptable terms
- setup accounting and payment systems to manage transactions
- monitor the market for potential violations
- liaise with other creators, owners, and government about potential policy issues that would impact their work
- seek legal advice and/or pursue violators where a voluntary resolution could not be reached with copyright violators.

Based on published annual reports from the 2014 Financial Year, Australian collecting societies received $437.7 million in licensing fees.[69] On average, administration costs represented roughly 15 percent of total fees collected, which translates into $65 million in administration costs to facilitate transactions on behalf of content creators and copyright owners.

Based on management estimates from Australian collecting societies, roughly 78.3 percent of operating costs are related to supporting purely transaction related functions.[70] Using this estimate as the basis for an industry-wide assumption, this implies that $52 million of collecting society costs are related to purely transactional activities. Applying the derived multiple noted above implies that Australian collective societies save copyright owners and professional content creators a combined $940 million in administrative and transaction related costs annually.

Using public data available for a number of collecting societies in Australia, there are at least 126,113 members registered in 2014,[71] representing both professional creators and potential users of copyright materials. Taking

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69 These include data from Copyright Agency, Viscopy, Screenrights, PPCA, APRA, ASDACS, and AWGACS

70 This is based on information provided by Copyright Agency, APRA/AMCOS, PPCA and Screenrights, and excludes any exceptional legal expenditure. Individual estimates of the percentage of costs devoted to transaction related functions ranged from 70 per cent to 80 per cent

71 This figure is derived from public annual reports and website data. We selected 2014 as a comparator year to balance the need for currency of the data against data availability

together costs to creators this would result in roughly an additional $7,454 per member.

By far a much larger cost driver relates not to the administrative tasks *per se*, rather the negotiation required to settle on appropriate commercial terms. In economic terms this cost would likely have to be paid by a transfer in overall value from royalties or other fees and charges.

4.2.2 Compliance costs

Compliance costs reflect ongoing costs to monitor compliance with the agreed terms and conditions associated with use of the materials (e.g. both the copyright holder and user).

Compliance costs manifest themselves in a few different ways:

- administration costs to review terms and conditions for each licensed work
- time and effort to locate new works (based on copyrighted works) and assess compliance relative to the agreed terms and conditions
- costs to locate copyright users to discuss potential instances of non-compliance
- potential costs to mediate and resolve disputes satisfactorily to both parties.

Compared to transaction costs, compliance costs are more difficult to assess and quantify because fair use (as a standard) introduces considerable ambiguity as to whether a secondary derived work is 'substantially similar' to the original or not.[72] This judgement is often very subjective and requires court proceedings to resolve the matter.

In addressing this question as to whether a secondary use is similar, one has to distinguish whether use of a secondary work is a productive use or a reproductive use. In the case of the former, the effect is to create a new and original work that lowers the cost of use or increases the benefit experienced by users. The latter is simply an increase in the number of 'copies' (e.g. similar but not so innovative as to stimulate new works or lower costs); thereby reducing the incentive for new works or lowering producer surplus.[73]

A good example of this inherent difficulty (that can be found both in fair use and fair dealing) is parody. In the case of parody, a copyright user must make explicit reference to the original work, or portions thereof, otherwise the newly created work will not be understood as parody. The audience might not be interested in paying for the original work, but certainly willing to pay for a

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72 William M Landes and Richard . Posner 1989, 'An Economic Analysis of Copyright Law' 18(2) *Journal of Legal Studies* pp.325-363

73 Ibid., pp.325-363

new parody resulting in no loss to the original author and an economic gain, having paid to see the new work.[74] If the audience did not know the work was a derivative (or simply didn't get the joke), they would not be willing to attend the performance.

This problem is further compounded by recent advances in internet sampling, aggregation, and search technology over the internet. This relates to situations where content users take small portions of copyright works and combine then with other small portions to create an overall content experience, which is then used to attract new customers to purchase goods or services from the vendor, including the sampled works.

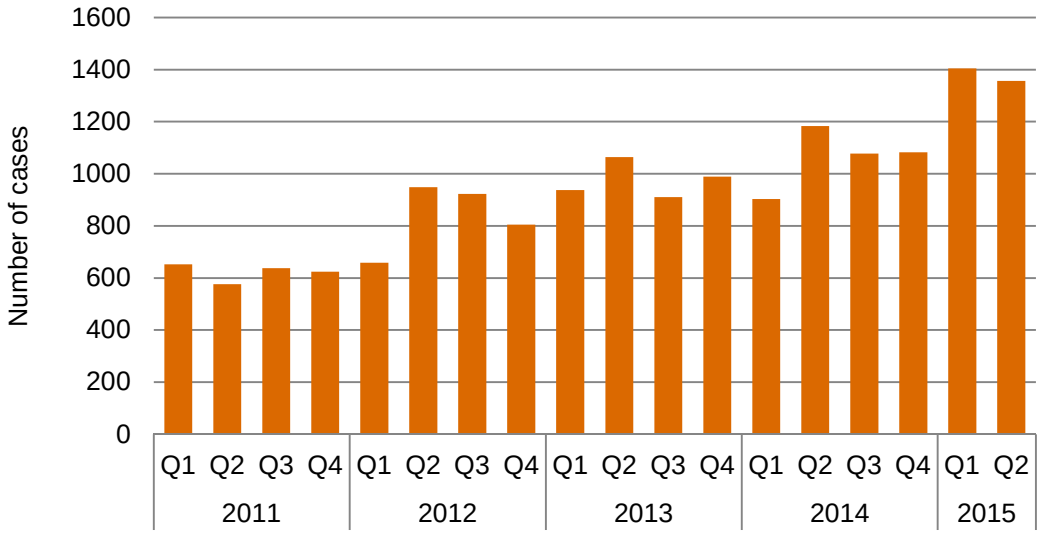
Similar to the transaction cost analysis (above), it is likely that fair use would increase compliance costs through a loss of economies of scale related to surveillance and monitoring that would individually have to be borne by professional content creators, owners, and some users. In some cases, copyright users might not take on compliance activities reflecting their genuine belief that they have a lower duty of compliance.

4.2.3 Enforcement costs

Lastly, economic theory suggests that copyright owners and content creators would experience higher enforcement costs related to unresolved compliance issues.

For example, as shown in Figure 7, the number of copyright cases in the United States has been increasing over time.

Figure 7 Number of copyright cases in United States



[74] Ibid.

Source: Brian Howard 2015, Copyright Litigation Report, Lex Machina, p.1

In the United Kingdom context:

> *The British Copyright Council (BCC) has gathered available data on both the number of UK and US legal cases on fair dealing and fair use. This research shows that in the UK there have been 67 fair dealing decisions in the courts since 1978 (an average of two per year). The data on the United States were drawn from an article in the Pennsylvania Law Review, which identified 306 opinions from 215 cases between 1978 and 2005, an average of around eight cases and eleven opinions per year. The BCC has also produced indicative estimates of the average cost of defending a copyright case. These suggested that the average legal costs in a US fair use were around twice that of a UK fair dealing case.*[75]

Further, research shows that copyright cases when compared to general litigation and (more specifically) trademark cases tend to end in a settlement or voluntary dismissal but take longer and are more substantial decisions. Further, on the whole, copyright cases tend to result in a higher percentage of trials.[76] Both points taken together suggest that copyright law is a more complex and uncertain area of the law generally, requiring litigants and courts to expend far greater money and time to reach a conclusion.[77]

Previous Australian research into copyright enforcement suggests that some content creators cannot enforce their rights due to the costs of the proceedings.[78] This might be especially important for small content creators and publishers given limited resources, particularly domestic Australian creators. For example, an 'indie' author with independently published creative work noted:

> *I can't find any legal support in order to protect myself and my creative work from copyright infringement. I have stumbled upon several sites with clear breaches of my copyright and there seems to be no legal or financial choice for me but to just let it go.*[79]

From a user's perspective, according to Manne and Morris, there will be uncertainty on whether specific uses will be considered 'fair' or if the user will be in breach of the law[80] under a fair use regime. Other users, on the other

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75 PwC 2011, *An Economic Analysis of Copyright, Secondary and Collective Licensing*, p.54

76 Christopher A Cotropia & James Gibson 2014, 'Copyright's Topography: An Empirical Study of Copyright Litigation', 92 *Texas Law Review* pp.1981-2027 at p.2006

77 Ibid.

78 Standing Committee of Legal and Constitutional Affairs 2000, *Cracking down on copycats: enforcement of copyright in Australia*, Commonwealth of Australia, p.26

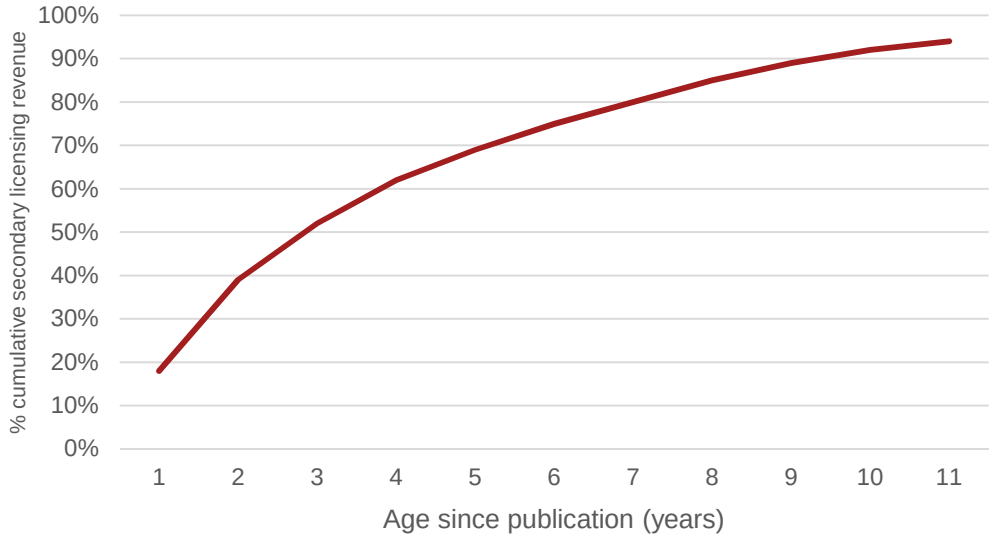
79 Quoted in Jan Zwar, David Throsby & Thomas Longden 2015, *Australian Authors - Industry Brief no. 7: Rights Sales, Translations and Piracy*, p.5

80 Geoffrey A Manne & Julian Morris 2015, *Dangerous Exception: The Detrimental Effects of Including "Fair Use" Copyright Exceptions in Free Trade Agreements*, International Center for Law & Economics Intellectual Property Research Program White Paper 2015-1, p.15

hand, may be encouraged under the belief that their use will be classified as 'fair' if challenged in court. This divide will be further reinforced by the relative wealth of each user group in favour of the 'wealthier individuals and firms'.[81]

Court actions can take considerable time to resolve, yet the work itself has a limited 'shelf life' of value that declines over time. For example, research from the United Kingdom suggests that over time secondary payments of a work remain significant for up to a decade. However, almost 60 per cent of lifetime secondary revenues is earned by roughly the third or fourth year post-publication (see Figure 8). This means that ongoing payments from secondary copyright have a role to play in smoothing the profile of expected income, and providing content creators with a portfolio of incomes from different works.[82]

Figure 8 Illustrative secondary licensing revenue profile



Source: PwC 2011, An Economic Analysis of Copyright, Secondary Copyright and Collective Licensing, p.33

Australian data from the education publishing sector adds to the suggestion that an author's work has a limited shelf life. Figure 9 illustrates the percentage of titles copied by Australian schools and universities. On average, schools and universities purchase titles over a period of seven or eight years. From then on, they replace older titles with newer editions over time. This suggests that there is a window of opportunity where education institutions are 'in the market' for published works, likely balancing the competing pressures of currency of the works against cost constraints (e.g. both the institutions' and the students').

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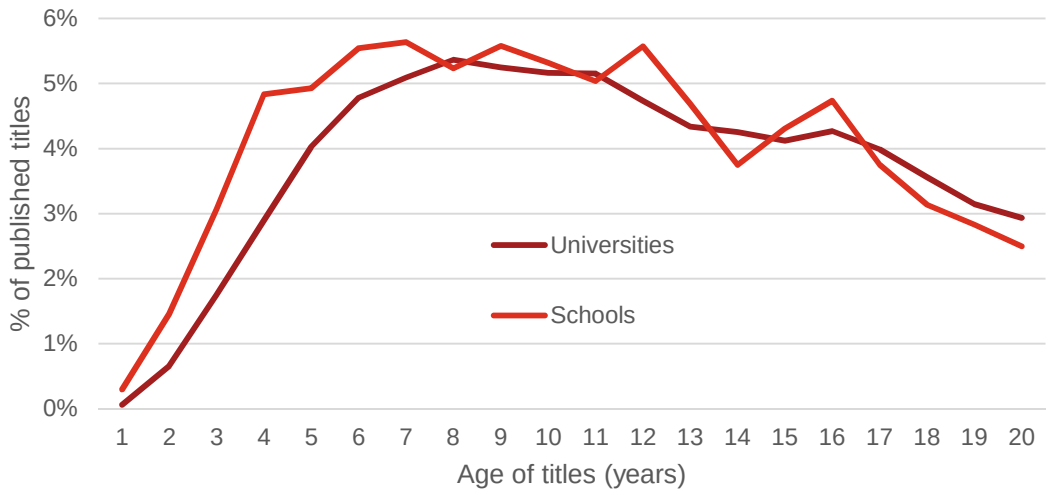
81 Ibid, p.15

82 PwC 2011, *An Economic Analysis of Copyright, Secondary Copyright and Collective Licensing*, p.33

Figure 9 Age of published titles copied in Australian education institutions



Source: Copyright Agency, PwC analysis

Taking both points together suggests that economic analysis of copyright must also consider time when assessing the impacts of fair use. Indeed some studies suggest that only five to 10 per cent of cases will go to trial. This implies that of the roughly 70 Australian copyright cases that proceed to trial in a given year, another 1,400 do not, despite incurring a range of costs related to enforcement, administration, and seeking legal advice (see Box 1). These costs would likely be internalised and extremely difficult to distinguish from other cost drivers meaning that cost estimates of litigation are likely to be under reported.

Box 1: Potential legal impacts from fair use

The legal process to resolve copyright cases can vary considerably. Large more complex cases can be quite lengthy in nature and can take years to find a resolution.

Lateral Economic cites research that indicates copyright related cases cost on average $144,000 each. The report then extrapolates this figure across roughly 70 Australian copyright related cases a year to suggest legal costs in Australia of $10 million a year.

According to the report 'Cracking down on copycats', estimates of infringement costs range from (adjusting for inflation) $50,000-$250,000 depending on the case. Adjusted for inflation, the upper end of this range would be closer to $380,000 (in today's dollars) implying costs closer to $26.6 million.

Based on stakeholder input, for the complex cases which linger in the legal system for years, the costs involved can be around $1 million to $2 million in legal costs, meaning only a handful of complex cases would account for a large portion of this overall cost estimate. Furthermore, this estimate excludes opportunity costs associated with trading or lost investment while the matter sits in legal limbo.

There were approximately five times more cases from fair use in the United States than from fair dealing in the United Kingdom. This implies an increase in legal costs to $133 million for 350 cases per year.

The above could increase to approximately $350 million assuming each case averages $1 million in costs.

Sources: Lateral Economics 2012b, Excepting the Future: Internet intermediary activities and the case for flexible copyright exceptions and extended safe harbour provisions, p.35; Standing Committee of Legal and Constitutional Affairs 2000, Cracking down on copycats: enforcement of copyright in Australia, Commonwealth of Australia, p.26; PwC 2011, An Economic Analysis of Copyright, Secondary and Collective Licensing, p.54

5 Benefits

The most immediate benefit of a transition to fair use is that some consumers might enjoy reduced costs associated with using copyright material, which may foster the creation of new works (i.e. enhanced consumer surplus).

This will occur if:

- fair use expands the exception beyond the current fair dealing exception; or
- the change to fair use allows the user to assert that they are covered but rely on inadequate enforcement by the copyright owner to test the claim.

These claimed benefits are, by their nature, transfers (i.e. from copyright owners to secondary users) and not benefits per se under a CBA framework.

Benefits will arise if and when the reduced costs stimulate new innovation and subsequent creations using previously protected copyright works.

5.1 Innovation impacts

The fundamental claim underlying the ALRC review is that fair use will

- 'foster an entrepreneurial culture which contributes to productivity'; and
- 'assist in making Australia a more attractive market for technology investment and innovation'[83]

These claims are asserted in the ALRC report rather than demonstrated.

Copyright and other intellectual property protections are positively associated with innovation.[84] Specifically in the context of developing countries, the Organisation for Economic Co-operation and Development (OECD) found that:

> *The results for the base model for copyrights are also encouraging and follow the same pattern as the ones for patents. We observe a positive relationship between the Copyright Index and FDI [foreign direct investment]. For a 1% increase in copyright protection there was a 6.8% increase in FDI. Likewise for a 1% increase in FDI, there was on average a 0.075% increase in copyright protection by the host country. There appears to be a virtuous cycle related to FDI and protection of IP. When countries experienced a marginal increase in*

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83 Australian Law Reform Commission 2013, *Copyright and the Digital Economy*, Discussion Paper 79, pp.79-80

84 See, for example, Jeffrey L Furman, Michael E Porter & Scott Stern 2002, 'The Determinants of National Innovative Capacity' 31 *Research Policy* pp.899-933

> *IPR protection, this drew a more than proportional amount of FDI; as they further increased the protection within the ranges covered in the time period of this study, they experienced further inflow of FDI. This positive relationship is again seen with respect to R&D, where a 1% increase in copyright protection was associated with a 3.3% increase in domestic R&D.*[85]

That is, firms that use intellectual property succeed better than those that do not. Further, these firms attract investment in technology-related industries, both at the macro level (foreign direct investment) and micro level (venture capital). It is inadequate copyright and intellectual-property protection that undermines innovation.

According to Hargreaves, certainty, business risk, and investor culture are key influencing factors in driving innovation as well as copyright law.[86]

Within the context of innovation, the ALRC cited previous Australian market analysis[87] and stated:

> *innovation provides emerging and expanding opportunities for creators and owners of copyright material. In a generally vibrant and growing entertainment and media economic outlook, the print consumer and educational book market is expected to decline by 5.2% and 1.5% respectively over 2013–2017, with 19.1% and 19.2% growth in digital/electronic books in those sectors respectively over the same period.*[88]

The ALRC report concludes the discussion on innovation and productivity by saying:

> *The recommendations in this Report are intended to facilitate a copyright framework in which innovation and productivity are enhanced as Australians participate in the digital economy and diversify areas of economic development for the future.*[89]

In economic terms, when a copyright owner does not allow someone to use their material it does not necessarily hinder a welfare maximising outcome because it may be worth more to one party not to have their copyright exploited by another for a range of reasons. For example, they may wish to exploit it themselves or they may perceive a risk of brand dilution/harm if someone else uses their creation.

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85 Ricardo H Cavazos Cepeda, Douglas C Lippoldt & Jonathan Senft, *Policy Complements to the Strengthening of IPRs in Developing Countries*, OECD Trade Policy Working Paper No. 104, p.21

86 Ian Hargreaves 2011, *Digital Opportunity: A review of Intellectual Property and Growth*, p.45

87 Looking at updated data from the entertainment and media sector, the print and print consumer and education book markets, while in decline, are projected to flatten from 2015 onward, while the growth in digital media is expected to continue growing - PwC 2015c, Australian *Entertainment and Media Outlook 2015-2019*, pages 69-70

88 Australian Law Reform Commission 2013, *Copyright and the Digital Economy*, ALRC Report 122, p.60

89 Ibid., p.61

Copyright law is a weak form of intellectual property in that, unlike patent law, it does not stop independent creation, and only protects the expression and not the idea within the copyright work. Hence individual copyrights will almost always lack any real market power on their own.

In the United Kingdom review of intellectual property Hargreaves also noted that:

> *the economic benefits imputed to the availability of Fair Use in the US have sometimes been over stated. When the Review briefly visited Silicon Valley in February, providing the opportunity to meet companies such as Google, Facebook, Yahoo and Yelp, along with investors, bankers, lawyers and academics, a consistent story emerged, namely that Fair Use is (from the viewpoint of high technology companies and their investors) just one aspect of the distinctiveness of the American legal framework on copyright, albeit in the view of most an important part. …*
>
> *We were told repeatedly in our American interviews, that the success of high technology companies in Silicon Valley owes more to attitudes to business risk and investor culture, not to mention other complex issues of economic geography, than it does to the shape of IP law. In practice, it is difficult to distinguish between the importance of different elements in successful industrial clusters of the Silicon Valley type.*[90]

Similarly, the Irish Copyright Review Committee noted that to 'assert that only one group of copyright stakeholders can drive innovation, to the exclusion of innovation from any other quarter, simply claims too much'.[91]

Importantly, some studies suggest that the *certainty of regulation* may play a significant role in driving innovation. A recent United States study found that 80 per cent of the investors surveyed said they are uncomfortable investing in an area with an ambiguous regulatory framework.[92] Further, the same investors indicated they would consider increasing their investment in a particular digital content industry by nearly 111 per cent if copyright regulations were clarified to allow for quick resolution of legal disputes (thereby lowering their cost to comply with regulations).[93]

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90 Ian Hargreaves 2011, *Digital Opportunity: A review of Intellectual Property and Growth*, p.45

91 Copyright Review Committee (Ireland) 2013, *Modernising Copyright*, Department of Jobs, Enterprise and Innovation, p.73

92 Booz & Co. 2011, *The Impact of U.S. Internet Copyright Regulations on Early-Stage Investment: A Quantitative Study*, p.16. This study has been presented to support the idea that certainty is valuable to investors, and not as a comment on the merits of fair use or fair dealing. The study was targeted at 'angel investors' in digital content industries and not necessarily content owners. Further, the survey appears to target United States investors which means fair use is the assumed legal approach and the study cannot be taken as a comparative analysis

93 Ibid., p.17

5.2 Evidence of increased economic activity under fair use

One of the key arguments for fair use is that it drives more innovation and transformative uses. A key difference between a reproductive use and a transformative use is that transformative use changes the purpose and/or character, to express a different meaning or message.[94] The newly transformed work becomes something more than it was previously; inspiring new creative solutions to problems or inventing new markets.

Drawing on economic theory, a reduction in costs associated with accessing secondary work would mean a potential increase in the supply of new and innovative works. While consumers and producers will potentially lose from a reduction in original professional works, this loss under fair use will be offset to some extent by consumers' ability under fair use to bypass the legitimate market and benefit from acquiring the right to copy copyright goods. This complicates the analysis and makes the consumer position ambiguous.

One of the principal arguments advanced in favour of fair use is that, by broadening the existing exceptions, there may be new transformative uses that would not otherwise occur under a fair dealing regime, with consequent improved economic outcomes.

In this chapter we assess whether there is clear evidence of a relationship between fair use and improved economic outcomes.

5.2.1 National economic activity

A recent key study undertaken by the Lisbon Council concluded that:

> *Countries that employ a broadly 'flexible' regime of exceptions in copyright also saw higher rates of growth in value-added output throughout their economy.*[95]

The Lisbon Council report received considerable criticism on methodological and interpretative grounds.[96] Economic theory suggests that a variety of other factors working together are likely required to fully explain a country's economic performance rather than copyright flexibility alone (e.g. governance, investment, infrastructure, etc).

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94 Matthew Sag 2012, 'Predicting Fair Use', 73(1) *Ohio State Law Journal* pp.47-91, p.55

95 Benjamin Gibert 2015, *The 2015 Intellectual Property and Economic Growth Index: Measuring the Impact of Exceptions and Limitations in Copyright on Growth, Jobs and Prosperity*, Revised May 2015, The Lisbon Council and Innovation Economics, p.3

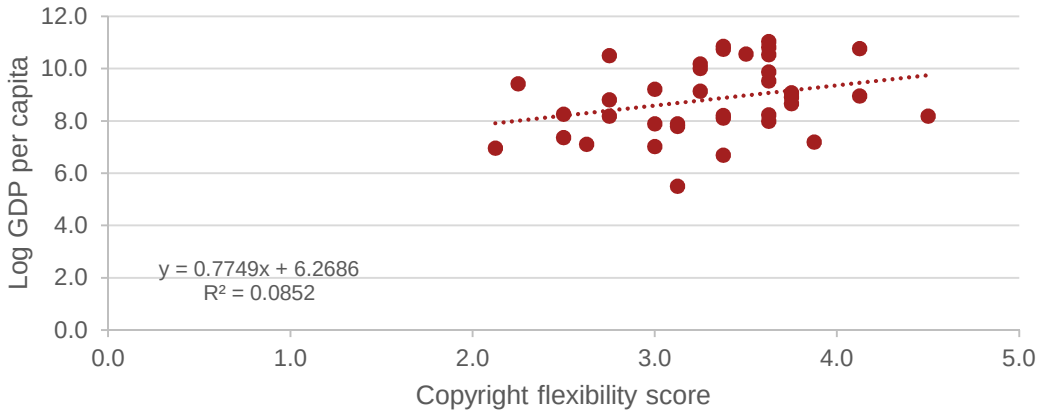
96 Lucie Guibault 2015, *Flexibility. Is it all a matter of methodology and assumptions?* 14 April, available at http://kluwercopyrightblog.com/2015/04/14/flexibility-is-it-all-a-matter-of-methodology-and-assumptions/; George S Ford 2015, 'The Lisbon Council's 2015 Intellectual Property and Economic Growth Index: A Showcase of Methodological Blunder', *Perspectives*, Phoenix Center, 29 June

Conscious of the criticism of the Lisbon Council work, we have sought to further test the claim that there is a relationship between a country's economic outcomes and the flexibility afforded to its copyright exceptions.

We selected publicly available data compiled by Consumers International (CI) that ranks 44 countries on a scale from A (best) to F (worst)[97] in terms of whether a country's copyright regime facilitates 'freedom to access and use' copyright material.[98]

We then applied basic econometric techniques to assess the relationship between copyright flexibility, GDP and capital investment. Our analysis of the relationship between copyright flexibility and GDP per capita suggests that it is more likely that a host of other factors[99] explain GDP per capita than copyright flexibility alone.

Figure 10 Relationship between copyright flexibility and GDP per capita (2012, $USD)



Source: Derived from http://a2knetwork.org/watchlist/grades and http://data.worldbank.org/indicator/NY.GDP.PCAP.CD

We further tested the relationship between copyright flexibility, economic outcomes and innovation by assessing the relationship between copyright flexibility and investment per capita. This analysis suggests there is a positive relationship between copyright flexibility and investment, but that again copyright flexibility is only one factor and does not explain the key investment outcomes.[100]

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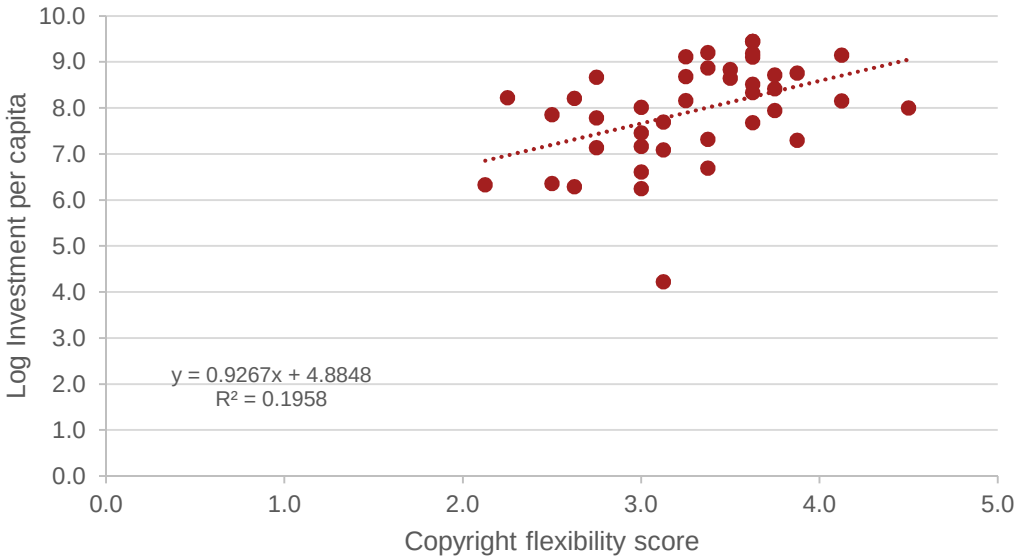
97 We have represented these values as 5 (best) and 1 (worst) within this report for ease of reading and presentational purposes

98 The methodology applied and the results are presented in Table 2 in Appendix A

99 The regression outputs indicate a p-value of 0.07 and an adjusted R^2 of 0.09

100 The regression outputs indicate a p-value of 0.005 and an adjusted R^2 of 0.17

Figure 11 Relationship between copyright flexibility and investment per capita (2012, $USD)



Source: Derived from http://a2knetwork.org/watchlist/grades and http://data.worldbank.org/indicator/NY.GDP.PCAP.CD

These results are not surprising and are broadly consistent with similar analysis; the Commonwealth Department of Innovation, Industry, Science and Research has previously noted that:

> *The creation and protection of Intellectual Property (IP) is one of the pillars of a successful national innovation system. Protection of IP is important so inventors and producers of original work have economic incentives to begin or continue innovating.*
>
> *In the long term, this may have an important economic impact because innovative firms and foreign investors prefer locations with stronger IP laws. A joint research project of the World Intellectual Property Organisation (WIPO) and the United Nations University which measured the impact of IP systems on six Asian countries found "a positive correlation between the strengthening of the IP system and subsequent economic growth."*[101]

Both quantitative analyses suggest that there is no concrete evidence supporting a direct causational relationship between copyright flexibility and improved economic outcomes for the Australian economy as a whole. The linkages between economic growth and innovation are likely a confluence of factors that interact to support a country's economic outcomes.

5.2.2 Economic activity in 'exceptions industries'

If, as expected, fair use would expand the permissible uses of another's copyright works then the claim is that there will be growth in the 'exceptions

[101] Department of Innovation, Industry, Science and Research 2011, *Australian Innovation System Report 2011*, p.67

industries' (i.e. industries that rely on copyright exceptions).[102]

Consistent with this view, a series of studies have been undertaken that have sought to estimate the economic contribution of those industries that rely on exceptions to copyright.[103]

International comparisons can often be difficult because of differences between national economies and statistical classifications used in different studies.[104] However, these exceptions studies have applied similar approaches, and adjustments can be made to ensure comparability of included industries, hence providing a useful basis for testing whether fair use can be shown to have stimulated demonstrably additional economic activity in secondary uses differently under United States and Australian copyright regimes (see Box 2).

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[102] See Lateral Economics 2012a, *Exceptional Industries: The Economic Contribution to Australia of Industries Relying on Limitations and Exceptions to Copyright*; and Lateral Economics 2012b, *Excepting the Future: Internet intermediary activities and the case for flexible copyright exceptions and extended safe harbour provisions*

[103] In the United States see: Thomas Rogers and Andrew Szamosszegi 2010, *Fair Use in the U.S. Economy: Economic Contribution of Industries Relying on Fair Use*, Computer & Communications Industry Association; Thomas Rogers and Andrew Szamosszegi 2011, *Fair Use in the U.S. Economy: Economic Contribution of Industries Relying on Fair Use*, Computer & Communications Industry Association. In Australia see Lateral Economics 2012a, *Exceptional Industries: The Economic Contribution to Australia of Industries Relying on Limitations and Exceptions to Copyright*

[104] Lateral Economics 2012a, *Exceptional Industries: The Economic Contribution to Australia of Industries Relying on Limitations and Exceptions to Copyright*, p.10

Box 2 Comparison of value add generated in United States and Australian 'copyright exceptions industries'

While it would be best to compare the latest United States and Australian studies, the United States analysis does not include details of the values used on an industry by industry basis.[105]

As a second-best outcome (noting that the digital environment has changed significantly since 2007), it is useful to compare the detailed industry data available from 2007 for the United States[106] and Australia.[107]

The key difference between the United States and Australian studies is that the Australian study 'does not include finance and insurance, retail and wholesale trade. There are also some other relatively minor differences in the coverage of professional and technical services'.[108] With this understanding we can make adjustments to place the study estimates on the same basis.

The starting point for the United States analysis is US$2.2 trillion of value added, which constituted 16.2% of total United States GDP. From this, to make the analysis on a consistent basis with the Australian study, we subtract value add estimates for:

- Core industries – Securities and Commodity Contracts Intermediation and Brokerage; Other Financial Investment Activities; Insurance Carriers; Other Investment Pools and Funds.[109] Collectively this reduces the estimated value generated by core copyright exceptions industries by US$577 billion.
- Non-core industries – Computer & peripheral equipment merchant wholesalers; Computer software (packaged) merchant wholesalers; Electrical and Electronic Appliance, Television, and Radio Set Merchant Wholesalers; Communications equipment merchant wholesalers; Electrical & electronic goods agents & brokers; Radio, Television, and Other Electronics Stores; Computer and Software Stores; Book, Periodical, and Music Stores; Securities and Commodity Exchanges; Agencies, Brokerages and Other Insurance Related Activities; Insurance and Employee Benefit Funds.[110] Collectively this reduces the estimated value generated by non-core copyright exceptions industries by US$209 billion.

These adjustments leave a total value add for United States exceptions industries of US$1.456 trillion, or 10.5% of total United States GDP.

In comparison, in Australia in 2007, estimated on the same basis, it was estimated that there was $155 billion of value added,[111] which constituted 12.9% of total Australian GDP.[112]

The analysis presented in Box 2 reveals that the Australian exceptions industries constitute a larger portion of the Australian economy (12.9 per cent) than the equivalent United States industries do in the United States (10.5 per cent). This finding is inconsistent with the hypothesis that fair use is necessary for the success of industries that rely on the existence of copyright exceptions.

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105 The report notes that 'The data appendices for this report are available online at http://www.ccianet.org.' - Thomas Rogers & Andrew Szamosszegi 2011, *Fair Use in the U.S. Economy: Economic Contribution of Industries Relying on Fair Use, Computer & Communications Industry Association*, p.14. No such data appendices are evident on the specified website

106 See Thomas Rogers & Andrew Szamosszegi 2010, *Fair Use in the U.S. Economy: Economic Contribution of Industries Relying on Fair Use*, Computer & Communications Industry Association

107 See Lateral Economics 2012a, *Exceptional Industries: The Economic Contribution to Australia of Industries Relying on Limitations and Exceptions to Copyright*, p.23

108 Ibid., p.10

109 See Thomas Rogers & Andrew Szamosszegi 2010, *Fair Use in the U.S. Economy: Economic Contribution of Industries Relying on Fair Use*, Computer & Communications Industry Association, pp.66-69

110 See Ibid., pp.70-73

111 Lateral Economics 2012a, *Exceptional Industries: The Economic Contribution to Australia of Industries Relying on Limitations and Exceptions to Copyright*, p.23

112 Australian Bureau of Statistics 2012, *1301.0 - Year Book Australia, 2012*

Appendices

Appendix A Notes

This appendix provides detail on Consumers International's (CI's) cross-country assessment of the degree to which copyright law in different countries promotes 'freedom to access and use' copyright material.[113]

While not vouching for the CI ratings *per se*,[114] taking CI's A (best) to E (worst) rating across a range of domain by country we converted these to a 1 (best) to 5 (worst) rating and then averaged the results. The results of this transformation are shown in the table below.

Table 2 'Freedom to access and use' under copyright law (1=best & 5=worst)

	Online	By libraries	By home users	For Education	By disabled users	In public affairs	By content creators	By the press	AVERAGE
Albania	3	2	2	1	5	3	4	1	2.6
Argentina	3	5	5	4	3	3	5	2	3.8
Armenia	2	1	2	3	3	3	3	2	2.4
Australia	1	2	2	2	3	4	3	2	2.4
Bangladesh	2	2	2	1	5	4	3	2	2.6
Belarus	2	1	2	2	1	3	4	3	2.3
Brazil	3	4	5	5	1	3	1	2	3.0
Cameroon	1	4	4	3	3	3	2	4	3.0
Canada	2	2	3	2	1	5	3	3	2.6
Chile	1	2	5	2	1	5	1	2	2.4
China (PRC)	2	2	3	1	3	2	3	2	2.3
Costa Rica	1	2	3	2	3	4	2	1	2.3
Egypt	2	3	2	2	5	3	5	2	3.0
Fiji	1	3	4	4	5	4	4	1	3.3
France	3	4	2	2	1	3	2	2	2.4
India	2	2	3	2	3	3	1	1	2.1
Indonesia	1	1	1	1	1	3	3	1	1.5

113 Detail on the methodology employed can be seen in: Consumers International 2012, *IP Watchlist 2012*, p.2

114 Such broad categorisations are always open to debate and interpretation. For example, it is interesting that Australia is given a '2' on freedom to access and use education given the access provided by the statutory licencing arrangements. Similarly, in New Zealand educational institutions can copy from broadcasts and the internet yet have only been accorded a '3'. Despite such concerns the original scores of provided by CI have been used so that the assessment is provided by a party independent to this study.

	Online	By libraries	By home users	For Education	By disabled users	In public affairs	By content creators	By the press	AVERAGE
Israel	2	2	1	1	3	3	2	1	1.9
Japan	3	2	2	2	1	3	5	2	2.5
Jordan	3	3	2	2	5	4	5	2	3.3
Kenya	3	4	4	4	5	3	4	4	3.9
Lebanon	1	2	3	3	3	1	2	1	2.0
Malawi	2	2	1	1	5	3	5	2	2.6
Malaysia	4	2	1	1	3	3	3	1	2.3
Mexico	2	2	2	2	5	3	3	2	2.6
Moldova	2	2	2	2	1	3	3	1	2.0
Morocco	3	2	2	2	5	3	3	1	2.6
New Zealand	3	2	3	3	1	3	3	2	2.5
Nigeria	1	4	3	3	3	4	5	1	3.0
Pakistan	5	3	1	1	5	3	5	1	3.0
Philippines	1	3	4	4	5	3	4	1	3.1
Romania	1	4	3	3	1	3	3	1	2.4
Serbia	2	2	4	2	1	3	3	2	2.4
Slovenia	1	3	1	4	1	3	2	4	2.4
South Africa	3	4	3	3	5	3	4	1	3.3
South Korea	3	2	3	1	3	4	4	2	2.8
Spain	1	4	2	4	3	2	3	3	2.8
Sweden	1	4	1	5	1	3	3	1	2.4
Thailand	5	4	1	2	5	5	4	1	3.4
Ukraine	2	1	2	4	3	3	3	3	2.6
United Kingdom	1	4	5	4	1	5	3	3	3.3
United States of America	1	1	2	3	1	2	2	3	1.9
Vietnam	3	4	5	2	3	2	4	1	3.0
Zambia	3	4	2	4	5	3	5	2	3.5
AVERAGE	2.1	2.7	2.6	2.5	3.0	3.2	3.3	1.9	2.7

Source: Derived from http://a2knetwork.org/watchlist/grades

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