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# MARKET SUBSTITUTION AND COPYRIGHTS: PREDICTING FAIR USE CASE LAW\*

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I. INTRODUCTION .....	33
II. HISTORICAL FOUNDATIONS OF COPYRIGHT AND FAIR USE LAW .....	34
III. PREDICTING THE OUTCOME OF FAIR USE CASES: A RECOGNITION OF ECONOMIC MARKET SUBSTITUTION .....	39
IV. PRACTICAL IMPLICATIONS .....	48

## I. INTRODUCTION

Many lawyers, judges, and academicians who have studied the tension between copyright protection and the fair use<sup>1</sup> defense have concluded that predicting copyright fair use law requires the balancing of numerous equitable factors and a good deal of luck.<sup>2</sup> Many judges and commentators think that fair use case law is largely unprincipled and unpredictable.<sup>3</sup> This orthodox view holds

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1. The fair use doctrine provides an exception to the generally broad protection afforded to authors by copyright. It allows secondary users to use and copy an original work while neither obtaining permission nor paying any fee to the author. For a more complete explanation of copyright and fair use, see *infra* notes 12-49 and accompanying text.

2. See, e.g., MARSHALL A. LEAFFER, 298 UNDERSTANDING COPYRIGHT LAW (1989); MELVILLE B. NIMMER & DAVID NIMMER, 3 NIMMER ON COPYRIGHT § 13.05(A) (1992) [hereinafter NIMMER]; WILLIAM F. PATRY, THE FAIR USE PRIVILEGE IN COPYRIGHT LAW 362-63 (1985) [hereinafter PATRY].

3. See, e.g. Scott M. Martin, *Photocopying and the Doctrine of Fair Use: The Duplication of Error*, 39 J. COPYRIGHT SOC'Y, 345, 392 (1992). See also *Dellar v. Samuel Goldwyn, Inc.*, 104 F.2d 661, 662 (2d Cir. 1939) (referring to the fair use issue as "the most troublesome in the whole law of copyright"); *Time Inc. v. Bernard Geis Assocs.*, 293 F. Supp. 130, 144 (S.D.N.Y. 1968) (claiming the fair use doctrine "is so flexible as virtually to defy definition").

that obtaining a fair use exception in court is simply a matter of marshalling a greater number of emotionally appealing equities for fair use than the creator of the work can offer *against* fair use.

We disagree. The central theme we develop in this Article is that fair use is a predictable, necessary, and principled exception to the general protection offered by copyright law. We propose that the multi-pronged balancing test typically employed in fair use cases, in reality, implicitly recognizes only the principle of market substitution. We contend that the case law exhibits this inner consistency, which for too long has gone misunderstood. The case law exhibits a strong tendency to take one overriding principle into account - the principle of market substitution.<sup>4</sup> We contend that the following simple rule predicts fair use outcomes: the case law supports a finding of fair use only when the secondary use<sup>5</sup> does not act as an economic market substitute for the original. If market substitution is found, then the fair use defense will fail. To support our premise, we examine the history, public policy, case law, and federal copyright and fair use statutes.

## II. HISTORICAL FOUNDATIONS OF COPYRIGHT AND FAIR USE LAW

The term "copyright" literally means the exclusive right to copy, and vests a bundle of rights in the creator of intellectual property.<sup>6</sup> Copyright law, both ancient and modern, is founded on the fundamental notion that adverse economic incentives are created if unrestricted copying of intellectual products is permitted.<sup>7</sup> With such adverse incentives, society will have much less creative innovation than it might wish to encourage. Therefore, the emphasis of copyright law is on the benefits derived by the public from the creative efforts of authors. Reward to copyright owners or authors is necessary, but of secondary consideration.<sup>8</sup> Historically,

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4. For a more detailed discussion of our theory, see Michael G. Anderson and Paul F. Brown, *The Economics Behind Copyright Fair Use: A Principled and Predictable Body of Law*, 24 LOY. U. CHI. L.J. 143 (1993) [hereinafter Anderson & Brown, *Economics and Fair Use*] (discussing the economic principles that support copyright and fair use law); see also James R. Sobieraj and Michael G. Anderson, *Contracting for Alternative Dispute Resolution: An Application to Intellectual Property*, 2 INTELL. PROP. L. INT'L ANALYTICAL REV. J. 8 (forthcoming June 1993) (discussing the federal courts' recognition of the economic elements in copyright law).

5. "Secondary use" in this article refers to the use made of copyrighted material by a second user.

6. The owner of a copyright has the exclusive right to copy the work. See 17 U.S.C. § 106(1) (1976).

7. See Anderson & Brown, *Economics and Fair Use*, *supra* note 4 at 159 n.83.

8. Sony Corp. v. Universal City Studios, Inc., 464 U.S. 417, 429 (1984) ("The copyright

the exception to copyright protection, known as fair use, applied to circumstances where the policy of rewarding an author's creativity would not be undermined.<sup>9</sup>

Leaving intellectual property unprotected produces disincentives for people to create new works. Without protection, as soon as an innovator produced a new creative work, someone else could steal it.<sup>10</sup> This dilemma inherent in intellectual property presents a classic free rider problem.<sup>11</sup>

The common law of copyright and fair use implicitly recognized the tension among the issues of free ridership, disincentives, monopoly, and access to information. The fair use doctrine eventually developed to address this tension: In some limited circumstances, the fair use doctrine permits someone other than the author to copy a copyrighted work without the author's permission.<sup>12</sup>

#### A. *Early Copyright Law in the United States*

Although its roots are found in the early 1700's, the doctrine of fair use did not fully emerge in the United States until the mid-nineteenth century.<sup>13</sup> Based loosely on the English Statute of Anne,<sup>14</sup> each of the original American colonies adopted its own particular variant of copyright law.<sup>15</sup> Later, the Framers of the United States Constitution sought uniform copyright laws for the new nation.<sup>16</sup> Article One of the Constitution empowers Congress to enact laws "[t]o promote the Progress of Science and useful Arts, by securing for limited Times, to Authors and Inventors, the exclusive Right to their respective Writings and Discoveries . . . ."<sup>17</sup> The language used in the Constitution outlines the clear utilitarian purpose of promoting "the Progress of Science and the

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law, like the patent statutes, makes reward to the owner a secondary consideration." (quoting *United States v. Paramount Pictures, Inc.*, 334 U.S. 131, 158 (1948)).

9. See *infra* notes 21-32 and accompanying text.

10. *Id.*

11. See Anderson & Brown, *Economics and Fair Use*, *supra* note 4, at 159-60 (A "free rider" is someone who gains the benefit of an undertaking at the costs of others, without personal cost). See also ROY J. RUFFIN & PAUL R. GREGORY, *PRINCIPLES OF MICROECONOMICS*, at 24-25 (1985) (discussing free goods and free riders).

12. See *infra* notes 20-31 and accompanying text.

13. See *infra* notes 20-31 and accompanying text.

14. 8 Statute of Anne, ch. 19 § 1 (1710). "Books hereafter published shall, before such publication be entered in the register book of the company of stationers. . . ." *Id.* The Statute of Anne was the first copyright act passed by the Parliament in England.

15. See Howard B. Abrams, *The Historic Foundations of American Copyright Law: Exploding the Myth of Common Law Copyright*, 29 WAYNE L. REV. 1119, 1172-73 (1983).

16. *Id.*

17. U.S. CONST. art. I, § 8, cl. 8.

useful Arts."<sup>18</sup> The constitutional reward of a copyright monopoly gives authors an incentive to create works for the public good.<sup>19</sup>

### B. *Folsom v. Marsh*: The Cornerstone of the Fair Use Doctrine

*Folsom v. Marsh*<sup>20</sup> represents the classic exposition of the fair use doctrine and is still authoritatively cited as valid law.<sup>21</sup> In *Folsom*, the plaintiffs were printers and publishers who had purchased a valid copyright from the author of *The Writings of George Washington*.<sup>22</sup> The defendants were a book-selling company and the author of *The Life of Washington in the Form of an Autobiography*.<sup>23</sup> The defendants admitted at trial that in writing their version of Washington's autobiography, they had copied 388 pages, or 5.7 percent, from the plaintiffs' treatise verbatim.<sup>24</sup>

The Supreme Court found the defendants guilty of infringement, and dismissed the defendants' fair use claim.<sup>25</sup> In *Folsom*, Justice Story explained that large portions from an original work may be cited in a critical review, if the clear purpose of the copying is for the purpose of criticism.<sup>26</sup> However, if a third party cited the most important parts of a copyrighted work, "with a view, not to criticise, but to supersede the use of the original work," that use was an infringement and would not be permitted.<sup>27</sup>

Justice Story reasoned that allowing unlimited copying, when the secondary copying competed with the first use of the original work, would discourage the creation of future works.<sup>28</sup> He then stated the now-famous test of fair use: "[W]e must often . . . look to the nature and objects of the selections made, the quantity and

18. *Id.* See Anderson & Brown, *Economics and Fair Use*, *supra* note 4, at 160-61 (describing the economic and utilitarian motives behind the copyright provision in the Constitution).

19. Anderson & Brown, *Economics and Fair Use*, *supra* note 4, at 160-61.

20. 9 F. Cas. 342 (C.C.D. Mass. 1841) (No. 4,901).

21. *Folsom* was the first American case to recognize the fair use exception to copyright law, which developed in England in the mid-eighteenth century. See also Harper & Row, Publishers, Inc. v. Nation Enterprises., 471 U.S. 539, 550 (1985); Sony Corp. of America v. Universal City Studios, Inc., 464 U.S. 417, 475 (1984).

22. *Folsom*, 9 F. Cas. at 343. The work, 6,763 pages bound into 12 volumes, consisted of both private and public letters of the first president. The plaintiffs were the only known publishers of some of this material. *Id.* at 343-44.

23. *Id.* at 343.

24. *Id.*

25. *Id.* at 349.

26. *Id.* at 344.

27. *Id.* at 345 (emphasis added).

28. *Id.* at 347.

value of the materials used, and the degree in which the use may prejudice the sale, or diminish the profits, or supersede the objects, of the original work."<sup>29</sup>

Relying on the common law principles of fair use articulated by Justice Story in *Folsom*, Congress passed the Copyright Act of 1976.<sup>30</sup> In passing the Copyright Act, Congress recognized the importance of the fair use case law. In fact, the Act was passed to "restate the present judicial doctrine of fair use, not to change, narrow, or enlarge it in any way."<sup>31</sup>

Contrary to the opinion of many commentators,<sup>32</sup> the fair use cases do not serve to confuse rather than resolve the issues.<sup>33</sup> Fair use need not be understood as an unorganized collection of exceptions to the rules of copyright. Instead, fair use should be understood as a rational and necessary part of copyright law, the observance of which is essential to achieve the goals of that law.<sup>34</sup> The cases reveal an underlying rationality. They also show that economic substitution is the appropriate standard by which to analyze fair use.

### C. Fair Use Under the Copyright Act of 1976

Congress codified the copyright and fair use case law in the Copyright Act of 1976.<sup>35</sup> Section 107 of the Act governs fair use. The preamble to section 107 lists several examples of what might be successful assertions of the fair use defense.<sup>36</sup> Drawing on *Folsom*, Congress enumerated four factors for determining whether a use qualifies as a fair use. The four factors are formulated in section 107 as follows:

- (1) the purpose and character of the use, including whether such use is of a commercial nature or is for nonprofit educational purposes;
- (2) the nature of the copyrighted work;
- (3) the amount and substantiality of the portion used in relation to the copy-

29. *Id.* at 348.

30. 17 U.S.C. §§ 101-801 (1976).

31. H.R. REP. No. 1476, 94th Cong., 2d Sess. at 66 (1976).

32. See *supra* note 3.

33. See Martin, *supra* note 3, at 347.

34. Pierre N. Leval, *Toward a Fair Use Standard*, 103 HARV. L. REV. 1105, at 1107-09 (1990).

35. 17 U.S.C. §§ 101-801 (1976).

36. The statute states that: "[use] for purposes such as criticism, comment, news reporting, teaching (including multiple copies of classroom use), scholarship, or research, is not an infringement of copyright." 17 U.S.C. § 107 (1976). These purposes can be regarded as uses that will not compete with the author's original work. See also Anderson & Brown, *Economics and Fair Use*, *supra* note 4, 163-76.

righted work as a whole; and (4) the effect of the use upon the potential market for or value of the copyrighted work.<sup>37</sup>

Fair use cases decided after the 1976 Act focus their analysis on the four statutory factors of section 107. Although Congress had hoped that the Copyright Act would clarify the existing law and lead to a more uniform and predictable body of case law,<sup>38</sup> courts frequently have had difficulty articulating the four-factor analysis. Despite the expressed intent of Congress not to enlarge the fair use law,<sup>39</sup> some courts have accorded each of the four factors equal weight and applied a balancing test. Because of the ambiguity of section 107, many courts look to the section's legislative history for guidance in balancing the four factors.<sup>40</sup>

#### D. Public Policy in Favor of Copyright Fair Use

The Constitution explains that copyright protection is unmistakably tied to serving the utilitarian goal of progress in science and the useful arts.<sup>41</sup> The Supreme Court still acknowledges the original utilitarian principle underlying copyright law. In *Harper & Row v. Nation Enterprises*,<sup>42</sup> the Court stated that "[t]he rights conferred by copyright are designed to assure contributors to the store of knowledge a fair return for their labors"<sup>43</sup> and "to motivate the creative activity of authors . . . by the provision of a special reward."<sup>44</sup> Therefore, copyright law "rewards the individual author in order to benefit the public."<sup>45</sup> The Supreme Court has also confirmed that fair use limitations exist when exclusive intellectual property rights will not serve the progress of the useful arts. In *Sony Corp.*, the Court explained, "The copyright law, like the patent statutes, makes reward to the owner a secondary consider-

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37. 17 U.S.C. § 107 (1976). These factors closely parallel those announced by Justice Story in *Folsom v. Marsh*, 9 F. Cas. 342, 344-45 (C.C.D. Mass. 1841). See *infra* notes 20-31 and accompanying text.

38. See H.R. REP. NO. 1476, 94th Cong., 2d Sess. at 65-66 (1976).

39. See *supra* note 31 and accompanying text.

40. See Anderson & Brown, *Economics and Fair Use*, *supra* note 4, at 146-47 (discussing the legislative history and the "Agreement on Classroom Guidelines" and their applicability to fair use law).

41. U.S. CONST. art. I, § 8, cl. 8. See Anderson & Brown, *Economics and Fair Use*, *supra* note 4, 163-64.

42. 471 U.S. 539 (1985).

43. *Id.* at 546 (citing *Twentieth Century Music Corp. v. Aiken*, 422 U.S. 151, 156 (1975)).

44. *Id.* (quoting *Sony Corp. of America v. Universal City Studios, Inc.*, 464 U.S. 417, 429 (1984)).

45. *Id.* (quoting *Sony Corp.*, 464 U.S. at 477 (Blackmun, J., dissenting)).

ation."<sup>46</sup> When enforcement of copyrights would not advance the constitutional goals behind the law, a fair use defense will be successful.<sup>47</sup>

In *Folsom*, Justice Story implicitly relied on classical economic principles when denying the defendant in that case the right to copy.<sup>48</sup> The purpose of Story's analysis was to determine if the secondary use could become a substitute for the original work. He stated that "if [the alleged infringer] thus cites the most important parts of the work, with a view . . . to supersede the use of the original work, and substitute [the secondary use] for [the original use], such a use will be deemed in law a piracy [or unfair use]."<sup>49</sup> The Supreme Court continues to recognize that if secondary copies are allowed to substitute for original works, a disincentive for individual creativity would result. This disincentive is precisely what the enactment of the first U.S. copyright statute was intended to prevent.

### III. PREDICTING THE OUTCOME OF FAIR USE CASES: A RECOGNITION OF ECONOMIC MARKET SUBSTITUTION<sup>50</sup>

In analyzing each of the four Copyright Act factors, the focus should remain on the historical purpose of preventing a substitution of the original work by the secondary work.<sup>51</sup> The historical

46. 464 U.S. at 429 (emphasis added) (quoting *United States v. Paramount Pictures, Inc.*, 334 U.S. 131, 158 (1948)).

47. See Anderson & Brown, *Economics and Fair Use*, *supra* note 4, at 163-64.

48. *Folsom*, 9 F. Cas. at 347.

49. *Id.* at 344-45.

50. We have scrutinized federal fair use case law after 1976 and have found no holdings that refute our theory of market substitution.

Our view of the case law does not purport to explain a line of copyright cases known as "Parody or Disparagement," where defendants often claim fair use. See, e.g., *Acuff-Rose Music v. Campbell*, 972 F.2d 1429 (6th Cir. 1992) (infringement for rap artist who parodied music from another entertainer); *Dallas Cowboys Cheerleaders, Inc. v. Scoreboard Posters, Inc.*, 600 F.2d 1184 (5th Cir. 1979) (infringement liability for defendants who produced a poster that was similar to the plaintiff's poster but with topless cheerleaders); *Walt Disney Production v. Air Pirates*, 581 F.2d 751 (9th Cir. 1978) (infringement liability for defendant's comic books that parodied plaintiff's cartoon characters); *Berlin v. E.C. Publications, Inc.*, 329 F.2d 541 (2d Cir. 1964) (infringement liability for defendant's magazine that parodied plaintiffs' songs); *Eveready Battery Co. v. Adolf Coors Co.*, 765 F. Supp. 440 (N.D. Ill. 1991) (no infringement liability for defendant whose television commercial spoofed the plaintiff's Eveready "Bunny"); *Rogers v. Koons*, 751 F. Supp. 474 (S.D.N.Y. 1990) (infringement liability for defendants whose sculpture duplicated and parodied the plaintiff's "Puppies" photograph); *Columbia Pictures Corp. v. National Broadcasting Co.*, 137 F. Supp. 348 (S.D. Cal. 1955) (no infringement liability for defendants television skit that parodied plaintiff's movie).

51. See Anderson & Brown, *Economics and Fair Use*, *supra* note 4, at 166-169.

background explains why the four factors should not be understood to be a litany of requirements that must be met or balanced. Rather, the statutory factors of the 1976 Act may best be understood as providing four different perspectives on one central test: *Does the defendant's use act as a market substitute for the original work?* If it does, then the copier is infringing. If not, the copier is entitled to the fair use defense.

### A. Purpose and Character of the Secondary Use

In analyzing the first factor of section 107 of the Copyright Act<sup>52</sup>, the key inquiry is whether the "purpose and character" of the secondary use is so similar in nature to that of the primary use that the one can serve as a substitute for the other. For example, if the purpose and character of both the primary and secondary use is educational, then the likelihood of a substitution occurring is increased. However, if the purpose and character of the primary use is political commentary, for example, and the secondary use is entertainment, then a fair use is likely to be found. Some of those who have studied the fair use problem have erroneously concluded that the courts should determine the purpose and character of the secondary use and then check it against a list of uses favored as good public policy.<sup>53</sup> These commentators may be relying too much on what courts are saying rather than what courts are actually doing.<sup>54</sup>

For example, section 107 cites a "nonprofit educational purpose" as a characteristic that will not interfere with the ordinary "commercial nature" of copyrighted work.<sup>55</sup> However, a "nonprofit educational purpose" may not always indicate a fair use. In *Marcus v. Rowley*, for instance, the defendant's employee, a public high school teacher, copied eleven out of thirty-five pages from the plaintiff's cake decorating book.<sup>56</sup> Although the purpose and character of both the primary and secondary works was educational, and the purpose and character of the defendant's use was unquestionably nonprofit,<sup>57</sup> the Ninth Circuit held that the defendant in-

52. 17 U.S.C. § 107(1) (1992).

53. *Basic Books Inc., v. Kinkos Copies Corp.*, 758 F. Supp. 1522, 1533 (S.D.N.Y. 1991).

54. Of course, courts often make a correct decision, even if they have difficulty articulating the reasoning. When attempting to predict the outcome of actual cases, it is advisable to look at what courts actually do, rather than what they say.

55. *See* 17 U.S.C. § 107(1) (1992).

56. 695 F.2d 1171, 1173 (9th Cir. 1983).

57. The defendant's employee distributed the book to students at no charge. *See id.* at 1175.

fringed by copying the plaintiff's book.<sup>58</sup> The court held that a secondary use that is created for the same intrinsic purpose as the original work provides "strong indicia of no fair use."<sup>59</sup> Thus, under *Marcus*, copying for educational and nonprofit purposes does not necessarily shield the defendant from infringement liability. In fact, if the secondary use overlaps with the purpose and character of the primary use, the secondary use is not likely to be considered fair use.

*Marcus* is not the only case that seems confusing without the substitution analysis. In *Harper & Row*,<sup>60</sup> the defendant copied the plaintiff's manuscript for a news magazine article. Although section 107 of the Copyright Act lists criticism, comment, and news reporting as ordinarily fair uses,<sup>61</sup> the Supreme Court held that the defendant's use was not a fair use.<sup>62</sup> Since the purpose and character of both the plaintiff's and defendant's works was the same,<sup>63</sup> (i.e., both uses related to news reporting), the secondary use could effectively substitute for the original work. The defendant's secondary use was such a successful substitute that the market for the plaintiff's original copyrighted work was totally destroyed.<sup>64</sup> Thus, the Court noted that "[w]ith certain special exceptions . . . a use that supplants any part of the normal market for a copyrighted work would ordinarily be considered an infringement."<sup>65</sup>

The court in *Hustler Magazine, Inc. v. Moral Majority, Inc.*<sup>66</sup> reiterated the idea that a defendant's profit should not be determinative. In *Hustler*, a caricature of the defendant, Jerry Falwell, was featured as a cartoon in *Hustler Magazine*. Falwell photocopied a page from the plaintiff's magazine and used the copy for the purpose of raising money for the Moral Majority.<sup>67</sup> As a result of the fundraising, the defendant received over \$700,000.<sup>68</sup> Because the defendant used the photocopied cartoon for a profit-making pur-

58. *Id.* at 1178.

59. *Id.* at 1175.

60. 471 U.S. at 543 (1985).

61. See 17 U.S.C. § 107 (1976).

62. *Harper & Row*, 471 U.S. at 569.

63. *Id.*

64. *Id.*

65. *Harper & Row*, 471 U.S. at 568 (citation omitted). The Court also mentioned that "the fact that a publication was commercial . . . tends to weigh against a finding of fair use." *Id.* at 562. However, the Court's dicta can be a trap for the unwary. The profit factor cannot explain why, when almost all newspapers operate for a profit, the general rule is that profit-making newspapers have a broad privilege with respect to fair use.

66. 796 F.2d 1148 (9th Cir. 1986).

67. *Id.* at 1150.

68. *Id.*

pose, the orthodox fair use reasoning would hold that the use was presumptively unfair. However, the *Hustler* court held that while the purpose and character of Falwell's use was certainly profit-making or even purely commercial,<sup>69</sup> it was so different from the magazine's use, that the defendant was entitled to the fair use exception.<sup>70</sup> Thus, in *Hustler* the decisive factor was whether the purpose and character of the secondary work was sufficiently similar to the purpose and character of the plaintiff's original that the secondary work could serve as a market substitute for the primary work.

Furthermore, in *Basic Books, Inc. v. Kinko's Graphics Corp.*,<sup>71</sup> the purpose and character of the primary and the secondary uses was educational.<sup>72</sup> In *Basic Books*, a neighborhood college copyshop, Kinko's Graphics, made photocopies of the plaintiff's textbook material for use in college classrooms.<sup>73</sup> The court denied fair use, finding Kinko's to be an infringer.<sup>74</sup> The purpose and character of both the college textbooks and the photocopied course packets created by the copyshop was educational. Because they covered the same subject area as the textbooks, the course packets could become a total substitute for the copied textbooks. Had the course packets not contained excerpts from textbooks, but rather excerpts from a law review not marketed for sale to students, for example, a fair use might have been allowed. Regardless of its profit-making status, or the educational values involved, Kinko's created an economic substitute for the original work. As in *Marcus, Harper & Row*, and *Hustler*, the question of whether Kinko's use is best characterized as commercial or nonprofit and educational is misleading and unnecessary.

The best understanding of the first prong of the section 107 fair use test is that the focus should not be on the absolute purpose and character of the copyrighted work. Only the purpose and character of the original work relative to the secondary use is relevant. Fair use is allowed when the purpose and character of the two works is different enough that an economic substitution cannot occur.

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69. *Id.* at 1156.

70. *Id.*

71. 758 F. Supp. 1522 (S.D.N.Y. 1991).

72. *Id.* at 1531.

73. *Id.* at 1526.

74. *Id.* at 1547.

### B. Nature of the Copyrighted Work

Mainline fair use commentators have suggested that when the purpose of the work is factual in nature, the original work is entitled to less copyright protection.<sup>75</sup> Although the creative versus factual distinction may seem consistent with the general rule that facts and ideas are not protected by copyrights, the distinction simply does not explain the case law, unless one compares the primary use to the secondary use. The second factor provides another perspective on the question of fair use. Courts use the second factor to examine whether a secondary use can serve as an economic substitute for the original work.

Fair use will be allowed by the law when the "nature" of the two works does not overlap.<sup>76</sup> In *Hustler v. Moral Majority*,<sup>77</sup> the Ninth Circuit allowed the secondary user to photocopy a creative cartoon of Jerry Falwell. The court noted that the original work was "more creative than informational,"<sup>78</sup> and in dicta stated that the creative nature of the work weighed against a finding of fair use.<sup>79</sup> Such reasoning seems to follow the orthodox view of fair use. However, despite the creative nature of the plaintiff's work, the *Hustler* court permitted the secondary use because the defendant did not use the secondary work for its creative value.<sup>80</sup> Thus, even though the nature of the plaintiff's work was creative, the defendant was entitled to a fair use privilege because he used the creative work in an informational way.<sup>81</sup>

Comparison of the nature of the primary and secondary uses occurred again in *Iowa State University Research Foundation, Inc. v. American Broadcasting Companies, Inc.*<sup>82</sup> In *Iowa State*, the defendant network broadcast portions of the plaintiff's short biographical film of a college wrestler without permission.<sup>83</sup> Again, the orthodox approach to fair use would hold that since both works were factual and informative, the second factor should weigh in favor of fair use.<sup>84</sup> However, the court held against a finding of fair

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75. See Leval, *supra* note 34, at 1117.

76. 17 U.S.C. § 107(2) (1992).

77. 796 F.2d 1148 (9th Cir. 1986).

78. *Id.* at 1154.

79. *Id.*

80. *Id.* at 1156.

81. *Id.* at 1154.

82. 621 F.2d 57 (2d Cir. 1980).

83. *Id.* at 58-59.

84. See Leval, *supra* note 34, at 1117.

use.<sup>85</sup> The court in *Iowa State* stated the concept well: "Where the two works in issue fulfill the same function," fair use is unlikely to be found.<sup>86</sup> This is another way of stating that for a finding of fair use, the "nature" of the primary and secondary uses should not overlap.

Although the dicta in some opinions has suggested that to assess the second factor the court must consider whether the copyrighted work was in print or out-of-print,<sup>87</sup> these distinctions can be viewed as further evidence of whether the copyrighted work will suffer an economic substitution by the secondary work. For example, courts have considered the unpublished nature of the original work an important reason for denying fair use.<sup>88</sup> This denial reflects an implicit recognition that an unpublished work is especially susceptible to substitution by a secondary user. In *Salinger v. Random House, Inc.*,<sup>89</sup> the plaintiff, J.D. Salinger, sought to enjoin the publication of an unauthorized biography that contained quotes from his unpublished letters.<sup>90</sup> The Second Circuit denied the defendant publisher a fair use claim, stating that "[unpublished] works normally enjoy complete protection against copying any protected expression."<sup>91</sup> As shown in *Salinger*, when a work is unpublished, a secondary user can deny a copyright holder the benefits of first publication. After the secondary user has published, the copyright owner cannot profitably publish because the copy has garnered all the demand for the original.

To predict case outcomes, one should understand this second section 107 factor as follows: The absolute nature of the copyrighted work should not be the focus; only its nature relative to the secondary use is relevant. Fair use is allowed when the nature of the two works is so dissimilar that they do not overlap and result in a market substitution.

85. *Iowa State*, 621 F.2d at 62.

86. *Id.* at 61 (quoting 3 NIMMER ON COPYRIGHT § 13.05(B) at 13-58 (1979)).

87. *Basic Books*, 758 F. Supp. at 1533 (1991). See also *Harper & Row, Publishers, Inc. v. Nation Enters.*, 471 U.S. 539, 553-64 (1985).

88. See *Harper & Row*, 471 U.S. at 564. "The fact that a work is unpublished is a critical element of its 'nature.'" *Id.*

89. 811 F.2d 90 (2d Cir. 1987), cert. denied, 484 U.S. 890 (1987).

90. *Id.* at 92.

91. *Id.* at 97.

### C. Amount and Substantiality Used

The third statutory factor of section 107<sup>92</sup> provides another method for comparing the secondary use to the original use to determine if a market substitution is likely. In passing the third factor, Congress emphasized the comparison between the original and secondary work.<sup>93</sup> The orthodox analysis of the third factor considers the volume and significance of the copied work. The larger the volume or the greater the significance of the portion copied, the more likely that the secondary use will be found to infringe.<sup>94</sup>

In *Marcus*,<sup>95</sup> for example, the defendant copied approximately half (15 of 35 pages) of the plaintiff's cookbook.<sup>96</sup> Thus, the defendant's packet served as an effective substitute for the plaintiff's original work.<sup>97</sup> Thus, *Marcus* fits under the orthodox reasoning that extensive copying can defeat a claim of fair use.

However, the orthodox gloss is not always reliable. To predict case outcomes accurately, the analysis must focus on the likelihood of substitution when evaluating the amount copied. By focusing merely on the amount copied, the usual understanding of the third factor fails to account adequately for many of the case holdings. In *Iowa State*,<sup>98</sup> for instance, the defendant telecast only two and one-half minutes of the plaintiff's twenty-eight minute film.<sup>99</sup> The defendant claimed that the amount copied was quantitatively "insignificant."<sup>100</sup> The court's implicit reasoning, however, was that since the defendant's secondary use could substitute for the sale of the plaintiff's film, the secondary use infringed.<sup>101</sup>

The Supreme Court has applied an analysis similar to the *Iowa State* analysis of the third factor. For example, in *Harper & Row*,<sup>102</sup> the Court denied the defendant's fair use claim although the amount copied was quantitatively insignificant. Quoting a mere 300 words from the plaintiff's large book, the defendant published

92. 17 U.S.C. § 107(3) (1992).

93. The statute provides, in pertinent part, that a factor to be considered in determining whether a work is a fair use is "the amount and substantiality of the portion used in relation to the copyrighted work as a whole . . ." *Id.*

94. See Leval, *supra* note 34, at 1122.

95. 695 F.2d 1171 (9th Cir. 1983).

96. *Id.* at 1173.

97. *Id.* at 1177. One student who enrolled in the plaintiff's cooking class used the defendant's packet and actually refused to purchase the original cookbook. *Id.*

98. 621 F.2d 57 (2d Cir. 1980).

99. *Id.* at 59.

100. *Id.* at 61.

101. *Id.* at 61-62.

102. 471 U.S. 539 (1985).

its own version of President Gerald Ford's memoirs.<sup>103</sup> Despite the minimal copying, the Supreme Court held against the defendant.<sup>104</sup> Stating that the qualitative importance of the material taken must also be considered, the Court noted that the defendant copied what was essentially the "heart" of the original work.<sup>105</sup>

However, the Court's dicta, which implies a qualitative analysis, may be misleading. In *Hustler*,<sup>106</sup> defendant Jerry Falwell photocopied 100 percent of the plaintiff's original work. Nonetheless, the Ninth Circuit allowed Falwell a fair use, because the secondary use, a Moral Majority newsletter, was unlikely to siphon off demand for *Hustler Magazine*.<sup>107</sup> The court in *Hustler* focused on the likelihood that the secondary use would substitute for the original work.

Thus, the case law seems consistent only if the third factor is viewed as follows: the absolute amount copied by a secondary user is not important; rather, fair use is allowed when the amount copied from the original work is such that a substitution may not occur.

#### D. Effect of the Use on the Markets for the Copyrighted Work

The fourth factor, "the effect of the [secondary] use on the potential market for the copyrighted work,"<sup>108</sup> is the most obvious way to understand the principle of market substitution for an original work. The fourth factor best captures the genius of Justice Story's *Folsom* analysis.<sup>109</sup> The Supreme Court has recognized that this fourth factor is "undoubtedly the single most important element of fair use."<sup>110</sup> This recognition may reflect the Court's implicit understanding of the market substitution theory underlying fair use law. The fourth factor is most highly correlated with the substitution effect.<sup>111</sup>

103. *Id.* at 544-45.

104. *Id.* at 550. The Court implicitly recognized the substitution analysis when it stated that "the fair use doctrine has always precluded a use that 'supersede[s] the use of the original.'" *Id.* (citations omitted). "With certain special exceptions . . . a use that supplants any part of the normal market for a copyrighted work would ordinarily be considered an infringement." *Id.* at 568 (citation omitted).

105. *Id.* at 564-65.

106. 796 F.2d 1148, 1154-55 (9th Cir. 1986).

107. *Id.* at 1154.

108. 17 U.S.C. § 107(4) (1992).

109. See *supra* notes 20-29 and accompanying text.

110. See Harper & Row, 471 U.S. at 566.

111. *Id.* See also Anderson & Brown, *Economics and Fair Use*, *supra* note 4, at 232.

However, not every type of market impairment opposes fair use. The key to predicting the fair use cases is determining whether the substitution effect was the cause of the market impairment. For example, a criticism in a book review may impair a book's market and still be a fair use.<sup>112</sup> In *New Era Publications Int'l v. Carol Publishing Group*,<sup>113</sup> the defendant published an unflattering biography of L. Ron Hubbard that included quotations from Hubbard's copyrighted works. Although the biography undoubtedly had a marginally negative effect on the sale of Hubbard's own works, the defendant was granted a fair use because any market damage was not the result of a substitution in the market place for the original work.<sup>114</sup> In *Hustler*, even though the defendant admittedly sought to impair the market for the plaintiff's adult magazines, the secondary use did not substitute for the original work; therefore, the fair use privilege applied.<sup>115</sup>

When the secondary use substitutes for the original work, the secondary use infringes and fair use will be denied. In *Stewart v. Abend*,<sup>116</sup> the defendants, Alfred Hitchcock and Jimmy Stewart, created the successful movie *Rear Window*, based on the plaintiff's popular story, without permission.<sup>117</sup> In finding the defendants' movie an unfair use of the plaintiff's original work, the Supreme Court stated "that re-release of the film impinged on the ability to market new versions of the story."<sup>118</sup> In other words, if the plaintiff were to decide to make a movie based on his story, the defendants' movie would be a substitute in the market for the plaintiff's potential movie.

This same reasoning is reflected in *Iowa State*.<sup>119</sup> If the defendant in *Iowa State* had been allowed to broadcast portions of the plaintiff's film as a fair use, there would have been little, if any, market demand for the plaintiff's original film.<sup>120</sup> The opportunity to own and market copyrighted films and television programs provides incentives to continue to create such works. If the defendant in either *Stewart* or *Iowa State* had been allowed to substitute his secondary use for the plaintiff's original work, the incentive for

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112. *Harper & Row*, 471 U.S. at 566.

113. 904 F.2d 152 (2d Cir. 1990), cert. denied, 111 S. Ct. 297 (1990).

114. *Id.* at 160-61.

115. *Hustler*, 796 F.2d at 1156 (9th Cir. 1986).

116. 495 U.S. 207 (1990).

117. *Id.* at 211-12.

118. *Id.* at 238.

119. 621 F.2d 57 (2d Cir. 1980).

120. *Id.* at 62.

“authors” to create such works would have decreased.

Thus, the fourth factor provides another perspective through which to view the question of market substitution in fair use cases. Accordingly, the focus should not be on the absolute amount of market harm caused by a secondary user, only on market harm that is caused by economic substitution matters.

#### IV. PRACTICAL IMPLICATIONS

The orthodox view has consistently held that fair use is unprincipled and unpredictable; that it is a concession to conflicting interests; and that any case that falls outside the orthodox theory has been wrongly decided. However, the history, statute, and case law on the fair use doctrine recognize the principle of market substitution.

Practitioners can take some comfort in knowing that the fair use case law is more predictable than those who hold the orthodox view have argued. This Article has shown that an underlying rationality can be found in the fair use case law. This rationality recognizes the principle of economic substitution as a guiding force. Courts presented with fair use questions find fair use only when the secondary use does not act as a market substitute for the original work. When a secondary use siphons off demand for the original by acting as a substitute, however, the secondary use is found to infringe, and fair use is denied.

The statutory factors of the Copyright Act should be seen as a way to reach this determination. Assessing secondary uses in light of the market substitution analysis, as we have presented, accurately accounts for all the significant fair use cases handed down since 1976.<sup>121</sup> The fair use case law provides an inner consistency more likely to predict case results than the confused orthodox analysis. To predict fair use case outcomes more successfully, practitioners must look to the facts and holdings of the cases, concentrating on what the courts are doing, rather than the broad language they employ.

Finally, since the cases reveal an understanding of economic substitution as the proper guiding force for fair use analysis, in litigation, practitioners may wish to employ the services of an expert economist to construct market models addressing the issue of market substitution.<sup>122</sup> Economists may be able to build models that

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121. *But cf. supra* note 50 and accompanying text.

122. One familiar market representation is the cross-price elasticity model. *See Anderson & Brown, Economics and Fair Use, supra* note 4, at 174 (discussing the cross-price

may persuasively assist the trier of fact in a manner similar to the use of market surveys in trademark infringement cases.<sup>123</sup>

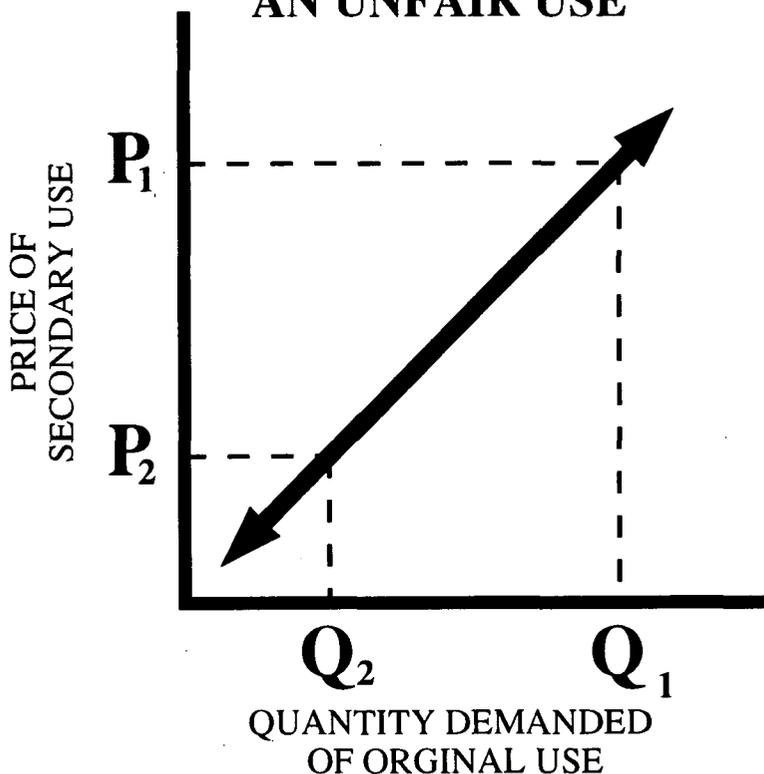
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elasticity model as applied to copyright fair use); Michael G. Anderson and Paul F. Brown, *Cross-Price Elasticity and Fair Use: Predicting Copyright Infringement*, presentation at Northwestern University School of Law (February 3, 1992); at the Marriott School of Management at Brigham Young University (October 22, 1992) (on file with authors) (explaining how the cross-price elasticity model can serve as a quantitative definition of market substitution, and therefore as evidence denying the fair use defense).

123. See *Anheuser-Busch Inc. v. Stroh Brewery Co.*, 750 F.2d 631 (8th Cir. 1984) (discussing the validity of market survey data in a trademark infringement case). The loss of market share in a fair use case may be analogous to the loss of market share in a trademark case. See *Scotch Whiskey Ass'n v. Consolidated Distilled Products, Inc.*, 210 U.S.P.Q. 639 (1981) (loss of market share indicative of trademark infringement).

## APPENDIX

## CROSS-PRICE ELASTICITY OF AN UNFAIR USE



Fair use should be denied when the secondary use is a substitute for the original use. Substitution may be defined by the cross-price elasticity of the two uses. Note that when the price of the secondary use is lowered from  $P_1$  to  $P_2$  the quantity demanded of the original use drops from  $Q_1$  to  $Q_2$ . This drop is indicative of market substitution and thus represents instances where the fair use defense to copyright infringement should be denied.

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