Occupy Copyright: A Law & Economic Analysis of U.S. Author Termination Rights

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INTRODUCTION

In 1933, two high school teenagers came up with the idea for a comic book hero with superhuman powers. They labored over the design, refined the character's story, and then decided to get their work published. After multiple rejections, they finally found a publisher who was willing to purchase the exclusive rights to their superhero for $130.[1] The first comic featuring Superman was published in 1938. Over the following years, D.C. Comics[2] made millions of dollars on the character contrived by these two young men, both of whom were reported to be nearly penniless in 1975.[3]

In 1976, the United States Congress revised the Copyright Act, extending the duration of terms for copyrighted works. Additionally, the new law introduced a

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1. *See* Siegel v. Warner Bros. Entm't, Inc., 542 F. Supp. 2d 1098, 1105-07 (C.D. Cal. 2008); *see also* Timothy K. Armstrong, *Shrinking the Commons: Termination of Copyright Licenses and Transfers for the Benefit of the Public*, 47 HARV. J. ON LEGIS. 359, 399 (2010).

2. The 1938 successor of the original publisher, Detective Comics, Inc. *See* Siegel v. Nat'l Periodical Publ'ns, Inc., 508 F.2d 909, 911 (2d Cir. 1974).

3. *See* Michael Dean, *An Extraordinarily Marketable Man: The Ongoing Struggle for Ownership of Superman and Superboy*, THE COMICS J., Oct.-Nov. 2004, at 13, 16. When the story of the poor, bought-out creators started making the rounds in the 1970s, Warner Bros. Entertainment (having acquired D.C. Comics and, with it, the rights to Superman in 1969), fearing for its reputation, proceeded to offer both authors a lifetime pension and healthcare benefits. *See Siegel*, 542 F. Supp. 2d at 1112-13.

termination right for authors[4] and their statutory successors. Thinking of cases like the above,[5] which are widely perceived as unfair to the original creators, Congress was interested in "safeguarding authors against unremunerative transfers"[6] by allowing them to opt out of their contractual agreements after a period of thirty-five years.[7] The original Superman creators (or in this case, their statutory successors) were thus presented the opportunity to renegotiate their payment, or completely withdraw the copyright they had assigned to D.C. Comics, now owned by massive media conglomerate Warner Bros. Entertainment, Inc., effective 2013. Consequently, both authors' estates filed termination notices with the U.S Copyright office.[8] Legal uproar ensued among the companies with financial stakes in Superman, as a first district court judgment in 2008 held that the notice was valid.[9] Today, it remains unresolved what these terminations mean for the licenses that D.C. Comics has granted to Time Warner covering TV and movie rights, causing confusion among investors and fans alike.[10]

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4. For the purposes of this Article, "author" pertains to any creator of a copyrightable work.

5. STAFF OF H.R. COMM. ON THE JUDICIARY, 87TH CONG., REP. OF THE REGISTER OF COPYRIGHTS ON THE GENERAL REVISION OF THE U.S. COPYRIGHT LAW 93 (Comm. Print 1961) ("The situation in which authors are most likely to receive less than a fair share of the economic value of their works is that of an outright transfer for a lump sum.").

6. H.R. REP. NO. 94-1476, at 124 (1976).

7. Or fifty-six years, for grants prior to 1978. See *infra* Part I for details.

8. Siegel v. Warner Bros. Entm't, Inc., 542 F. Supp. 2d 1098, 1114 & n.3 (C.D. Cal. 2008). Due to the changes made by the 1976 Copyright Act and later the 1998 Sonny Bono Copyright Term Extension Act the original copyright term of 56 possible total years was extended first by nineteen years and then by an additional twenty, making it possible for the right successors of the Superman creators to retain their rights until this day. *See* 17 U.S.C. § 302(a) (2006); *see also infra* note 33.

9. *Siegel*, 542 F. Supp. 2d at 1145 (concerning notice served by the right successors of author Jerry Siegel).

10. *See* D.C. Comics v. Pac. Pictures Corp., No. CV 10-3633 ODW (RZx), 2012 WL 4936588 (C.D. Cal. Oct. 17, 2012); Simon Brew, *Warner Bros Wins Latest Round of Superman Rights Battle*, DEN OF GEEK (Mar. 22, 2013), *available at* http://bit.ly/11nHr8v.

The case is not a lone exception. Taking advantage of the changes made in the 1976 Copyright Act and the copyright extensions instated by Congress over the past few decades,[11] authors of copyrighted works can begin terminating their copyright assignments as of 2013. Courts will have multiple issues to clarify in the legal battles that are about to ensue. Despite (or because of) the detailed complexity of the laws introduced in 1976,[12] they remain obscure to many industry participants and have left some looming open questions. Courts have yet to decide on issues such as which categories of works are subject to termination rights, and how strictly to interpret their "inalienability."[13] For this reason, much of the discussion surrounding the introduction of author termination rights is only now becoming relevant, as the period approaches in which courts will begin to establish the boundaries of the rules.

Prior literature has drawn attention to the fact that there are already discrepancies in how courts are attempting to resolve open issues.[14] So far, however, the evaluation of the judicial decisions, their outcomes, and how to best proceed moving forward, as well as of author termination rights generally, is largely focused on establishing and interpreting

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11. Through both the 1976 Copyright Act and the 1998 Sonny Bono Copyright Term Extension Act. *See infra* note 33.

12. The district court in *Siegel* remarks on the confusing complexity of the laws, saying "[t]he termination provisions contained in the Copyright Act of 1976 have aptly been characterized as formalistic and complex, such that authors, or their heirs, successfully terminating the grant to the copyright in their original work of authorship is a feat accomplished 'against all odds.'" 542 F. Supp. 2d at 1101-02 (citing WILLIAM F. PATRY, 2 PATRY ON COPYRIGHT § 7:52 (2007) [hereinafter PATRY, COPYRIGHT]).

13. The Supreme Court has characterized the wording "notwithstanding any agreement to the contrary" to mean inalienability. *See infra* note 64 & Part I.E.

14. Such as whether there is any room for the parties to contract around termination rights, *See* Lydia Pallas Loren, *Renegotiating the Copyright Deal in the Shadow of the "Inalienable" Right to Terminate*, 62 FLA. L. REV. 1329 (2010) [hereinafter Loren, *Renegotiating*]; Peter S. Menell & David Nimmer, *Pooh-Poohing Copyright Law's "Inalienable" Termination Rights*, 57 J. COPYRIGHT SOC'Y U.S. 799 (2010) [hereinafter, Menell & Nimmer, *Pooh-Poohing*]; Allison M. Scott, *Oh Bother:* Milne*,* Steinbeck*, and an Emerging Circuit Split over the Alienability of Copyright Termination Rights*, 14 J. INTELL. PROP. L. 357 (2006).

legislative intent.[15] This Article contributes to the ongoing debates by highlighting the economic issues that could influence the outcome of the law in real-world markets. It predicts that introducing a termination right will effect price changes and risk allocation, essentially creating a lottery that rewards a small subset of authors, but reducing individual gains for the majority. First of all, this casts considerable doubt on the distributive-oriented justification for the law, but this Article also discusses why this price and risk allocation may not necessarily have a positive effect within the general incentive theory underlying copyright law. Furthermore, uncertainty, the length of copyright terms, and the long time period between right assignments and the termination possibility may mitigate the potential for positive effects on creation incentives. Finally, this Article demonstrates that adverse effects on publisher[16] incentives may hinder socially desirable investments. It concludes that author termination rights as they are currently structured in the United States are likely not desirable within a utilitarian theory of copyright law.[17]

Part I provides a more detailed legal explanation of the author termination rights in the U.S. Copyright Act of 1976. Part II follows with an economic analysis of termination rights and their effects. Implications are discussed in Part III.

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15. *See* Loren, *Renegotiating*, *supra* note 14, at 1345; Peter S. Menell & David Nimmer, *Judicial Resistance to Copyright Law's Inalienable Right to Terminate Transfers*, 33 COLUM. J.L. & ARTS 227 (2010) [hereinafter Menell & Nimmer, *Judicial Resistance*]; Menell & Nimmer, *Pooh-poohing*, *supra* note 14, at 811-14. Only a few commentators and scholars have raised economic concerns. *See* Guy A. Rub, *Stronger than Kryptonite? Inalienable Profit-Sharing Schemes in Copyright Law*, 27 HARV. J.L. & TECH 49 (2013).

16. For the purposes of this Article, "publisher" pertains to any entity that acquires rights from the author for the purpose of disseminating and benefitting from the copyrighted work.

17. For more on why it makes sense to analyze copyright law from this perspective, and also for a discussion of whether there is reason for those who argue instead for a wealth-distributive purpose of copyright law to find author termination rights undesirable, see *infra* Part III.

I. LEGAL SITUATION

The U.S. Copyright Act of 1976 instated a termination right for all authors who enter into a copyright assignment or licensing agreement. Although this right officially became law on January 1, 1978, its main effects will begin to materialize only now, more than three decades later, as terms begin to end and the windows in which authors are free to make use of their termination rights start to occur. The statutory details are as follows.

A. *History*

The Copyright Act of 1909 gave authors two consecutive twenty-eight-year terms of copyright, subject to a renewal by the author.[18] Any rights the author granted to others during the first term were at the author's disposal again at the beginning of the second term.[19]

In 1912, the famous song "When Irish Eyes Are Smiling," co-written by George Graff, Jr., was registered for copyright by music publisher M. Witmark & Sons. Given the first term of twenty-eight years, the copyright renewal by the author was not going to be possible until around the year 1940. In 1917, however, Witmark made another agreement with the songwriter Graff to secure "all copyrights and renewals of copyrights and the right to secure all copyrights and renewals of copyrights," including "any and all rights therein that I [Graff] or my heirs, executors, administrators or next of kin may at any time be entitled to."[20] When the first term was up, however, both publisher Witmark and songwriter Graff filed for copyright renewal. Subsequently, Graff assigned his copyright for the renewal term to publisher Fred Fisher Music Co., which began selling its own copies of "When Irish Eyes Are Smiling." In the resulting legal case,

18. *See* Copyright Act of 1909, 17 U.S.C. § 24 (1970). This dual term of copyright can be traced back as far as the Statute of Anne from 1709. *See* Copyright Act of 1909, Pub. L. No. 60-349, 35 Stat. 1075, 1080-81 (codified as amended at 17 U.S.C. § 24 (1970)); 8 Anne, c. 19.

19. *See* H.R. REP. NO. 60-2222, at 14 (1909) (explaining the reasoning behind this).

20. Fred Fisher Music Co. v. M. Witmark & Sons, 318 U.S. 643, 645 (1943).

Fisher and Graff contended that the original 1917 assignment of the copyright renewal right to Witmark was void because it went against the intent of the law.[21]

In 1943, the Supreme Court ruled in *Fisher v. Witmark* that an assignment to assign his renewal, made by an author in advance of the twenty-eighth year of the original term of copyright, is valid and enforceable.[22] It argued: "If an author cannot make an effective assignment of his renewal, it may be worthless to him when he is most in need. Nobody would pay an author for something he cannot sell."[23] This precedent established alienability of the copyright renewal rights before they had vested.[24] It thus became common for publishers to have authors sign over their renewal rights along with the original copyright assignment.[25] Many argued that this decision essentially undermined the original intent of the law, which was to give authors a second chance to capitalize on their works later in time.[26]

In 1976, the Copyright Act (effective date 1978)[27] abolished the dual copyright term, granting instead a single, longer copyright for a total of the author's life plus fifty years.[28] The statute also newly introduced a termination

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21. *See id.* at 647; *see also* H.R. REP. NO. 60-2222, at 14 (1909) ("It not infrequently happens that the author sells his copyright outright to a publisher for a comparatively small sum. If the work proves to be a great success and lives beyond the term of twenty-eight years, your committee felt that it should be the exclusive right of the author to take the renewal term, and the law should be framed as is the existing law, so that he could not be deprived of that right.").

22. *Fred Fisher Music Co.*, 318 U.S. at 657-59.

23. *Id.* at 657.

24. Melville B. Nimmer, *Termination of Transfers under the Copyright Act of 1976*, 125 U. PA. L. REV. 947, 951 (1977).

25. STAFF OF H.R. COMM. ON THE JUDICIARY, 87TH CONG., REP. OF THE REGISTER OF COPYRIGHTS ON THE GENERAL REVISION OF THE U.S. COPYRIGHT LAW 93 (Comm. Print 1961) ("It has become a common practice for publishers and others to take advance assignments of future renewal rights.")

26. *See id.* at 53 ("[T]he reversionary purpose of the renewal provision has been thwarted to a considerable extent"); *see also* Nimmer, *supra* note 24, at 951.

27. Pub. L. No. 94-553, 90 Stat. 2541, 2541-2602 (codified as amended at 17 U.S.C. §§ 101-810 (1976)).

28. *Id.* at 2572 (codified as amended at 17 U.S.C. § 302(a) (1976)).

right for authors.[29] The House Committee Report explains the legislative concept of "safeguarding authors against unremunerative transfers."[30] The 1961 Report of the Register of Copyrights contains the following paragraph:

> It has been argued that most authors do not need or want to be treated as incompetent to handle their business affairs. Many of them have banded together in organizations which negotiate standard contracts providing for continuing royalties. Their assignments can be and often are given for limited periods of time.
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> It is still true, however, that most authors are not represented by protective organizations and are in a relatively poor bargaining position. Moreover, the revenue to be derived from the exploitation of a work is usually unpredictable, and assignments for a lump sum are still common. There are no doubt many assignments that give the author less than his fair share of the revenue actually derived from his work. Some provision to permit authors to renegotiate their disadvantageous assignments seems desirable.[31]

It seems that the Copyright Register was thus indeed concerned with the type of case as illustrated in the introduction, where authors of copyrighted works are bought out by a small lump fee.

There are two provisions governing termination rights, one for copyright grants made prior to the effective date of the 1976 Copyright Act (1978), and one for copyright grants made after the law came into effect. These two provisions and their differences are described in more detail in the following.

B. *Copyright Grants Made Prior to 1978*

In 1976 and in 1998, the United States Congress enacted two copyright term extensions.[32] Termination rights were thus extended to include the additional term of protection.

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29. *Id.* at 2569, 2574 (codified as amended at 17 U.S.C. §§ 203, 304(c)).

30. H.R. REP. NO. 94-1476, at 124 (1976).

31. STAFF OF H.R. COMM. ON THE JUDICIARY, 87TH CONG., REP. OF THE REGISTER OF COPYRIGHTS ON THE GENERAL REVISION OF THE U.S. COPYRIGHT LAW 54 (Comm. Print 1961).

32. Copyright Act of 1976, Pub. L. No. 94-553, 90 Stat. 2541, 2572 (codified as amended at 17 U.S.C. § 302(a) (2006)); Sonny Bono Copyright Term Extension

Section 304 of the Copyright Act provides that licenses or transfers of copyright that were entered into before January 1, 1978, are subject to termination "during a period of five years beginning at the end of fifty-six years from the date copyright was originally secured, or beginning on January 1, 1978, whichever is later."[33] Because copyright was extended, section 304 permits authors and their statutory successors to claim part of the value inherent to the extension of the copyright term.

The termination right is limited in terms of eligible parties and timeframe.[34] Only authors themselves or, should the author be deceased, the author's statutory successors can terminate the copyright grant.[35] Terminations are not automatic. In order for a termination to be effective, action is required on the part of the terminating party.[36] Notice of termination must be given a maximum of ten and a minimum of two years before the termination date.[37] The effective date of termination must be "during a period of five years beginning at the end of fifty-six years from the date copyright was originally secured."[38] If no termination is made within the given time frame, the grantee can continue to exploit the work according to the original contract for the remainder of the copyright term.[39]

Act, Pub. L. No. 105-298, sec. 102(b), 112 Stat. 2827, 2827 (1998) (codified at 17 U.S.C. § 302(a) (2006)).

33. 17 U.S.C. § 304(c)(3) (2006).

34. *See* other regulations issued by the Copyright Office at 37 C.F.R. § 201.10 (2009).

35. 17 U.S.C. § 304(c)(1). Section 304(c)(1) establishes that a termination can be executed by at least one-half of successors that own and are entitled to the right as per section 304(c)(2). 17 U.S.C. § 304(c)(1). For more details on the statutory successors, see *infra* Part II.D.

36. 17 U.S.C. § 304(c)(4).

37. 17 U.S.C. § 304(c)(4)(A).

38. 17 U.S.C. § 304(c)(3).

39. 17 U.S.C. § 304(c)(6)(F). Or for however long was originally agreed to by the parties. It is the norm in most publishing industries to assign copyright for the entire possible (or even conceivably possible) extent and duration. *See, e.g.*, Alan H. Kress, *in* 8 ENTERTAINMENT INDUSTRY CONTRACTS: NEGOTIATING AND DRAFTING GUIDE 159-84 (Donald C. Farber & Peter A. Cross eds., 2008), form 159-

Unlike terminations under section 203 of the Copyright Act, which, as discussed below, are limited to grants made by the author, the section 304 termination right applies to pre-1978 transfers made by both authors and authors' statutory successors.[40] Termination rights apply to outright transfers, as well as any type of license (exclusive or non-exclusive).[41] They do not, however, apply to works made for hire.[42]

C. *Copyright Grants Made After 1978*

Because the 1976 Copyright Act eliminated the copyright term renewal period[43] and created a single, longer term for copyright (life of the author plus fifty years,[44] then later seventy years[45]), section 203 of the Copyright Act provides a way for authors or their statutory successors to terminate a grant after thirty-five years.[46] This essentially replaces the function of the author's previous renewal opportunity, in order to "safeguard[ ] authors against unremunerative transfers."[47] Section 203 allows for termination "during a period of five years beginning at the end of thirty-five years

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1; Dionne Searcey & James R. Hagerty, *Lawyerese Goes Galactic as Contracts Try to Master the Universe*, WALL ST. J., Oct. 29, 2009, at A1, A18.

40. 17 U.S.C. § 304(c)-(d). For reasoning, see STAFF OF H.R. COMM. ON THE JUDICIARY, 87TH CONG., REP. OF THE REGISTER OF COPYRIGHTS ON THE GENERAL REVISION OF THE U.S. COPYRIGHT LAW 53-54 (Comm. Print 1961); Loren, *Renegotiating*, *supra* note 14, at 1335-37.

41. 17 U.S.C. § 304(c).

42. 17 U.S.C. § 304(c)-(d). Or to transfers made through a will. *Id.* This makes sense in that the copyright is seen to originate with the party that receives the copyright through will or work made for hire. *See* Loren, *Renegotiating*, *supra* note 14, at 1137-39, 1147-48. On the other end, however, since these "transferees" are not the original creator, they do not get to benefit from termination rights themselves. *See id.*

43. *See supra* Part I.A.

44. 17 U.S.C. § 302(a) (1976).

45. 17 U.S.C. § 302(a) (2006), as per the Sonny Bono Copyright Term Extension Act, Pub. L. No. 105-298, 112 Stat. 2827 (1998).

46. *See* 17 U.S.C. § 203(a) (2012).

47. H.R. REP. NO. 94-1476, at 124 (1976).

from the date of execution of the grant."[48]

Unlike terminations under section 304, the termination under section 203 is limited to grants made by the original author only.[49] Further transfers of copyright are not subject to termination through the transferer.[50] Just like terminations under section 304, the right to terminate is limited to the author or statutory successors[51] and must be exercised during the time frame of a maximum of ten and a minimum of two years before the termination date.[52] It applies to all types of transfers and licenses,[53] but not to works-made-for-hire.[54] What this means in practice is described in the following.

D. *Implications*

To illustrate the mechanics of both types of author termination rights, take the case of the Superman creators. The original authors Jerome Siegel and Joe Shuster granted publisher Detective Comics the copyright to Superman in 1938.[55] Because this was a grant made prior to 1978, their termination right is governed by section 304(c), which states that "[t]ermination of the grant may be effected at any time during a period of five years beginning at the end of fifty-six years from the date copyright was originally secured."[56] For pre-1978 grants, "'secured' means the actual date the work

48. 17 U.S.C. § 203(a)(3) (2012). "[O]r, if the grant covers the right of publication of the work, the period begins at the end of thirty-five years from the date of publication of the work under the grant or at the end of forty years from the date of execution of the grant, whichever term ends earlier." *Id.*

49. *Compare* 17 U.S.C. § 203(a), *with* 17 U.S.C. § 304(c)(1).

50. *See* 17 U.S.C. § 203(a).

51. 17 U.S.C. §§ 203 (a)(1)-(2), 304(c)(1)-(2). As with section 304 terminations, successors must have a majority interest in order to terminate. 17 U.S.C. §§ 203(a)(1), 304(c)(1).

52. 17 U.S.C. § 203 (a)(4)(A).

53. 17 U.S.C. § 203(a).

54. 17 U.S.C. § 203(a). Or transfers made through a will. *See id.*

55. *See* Siegel v. Warner Bros. Entm't Inc., 542 F. Supp. 2d 1098, 1102-03, 1107 (C.D. Cal. 2008).

56. 17 U.S.C. § 304(c)(3).

was first published with notice" or is registered.[57] In this case the effective termination period is therefore from 1994 to 1999. Furthermore, termination notice must be given "not less than two or more than ten years before" the effective date of termination.[58] When Jerome Siegel passed away in 1996, his termination right automatically moved to his statutory successors in accordance with section 304(c)(2), in this case his widow and daughter.[59] They both served notice of termination in 1997, with an effective date two years later, in 1999.[60]

Had the original Superman grant been executed in 1978, rather than 1938, the situation would have been as follows: section 203(a)(3) sets the effective termination date "at any time during a period of five years beginning at the end of thirty-five years from the date of execution of the grant;"[61] which in this case would begin in 2013.[62] Jerome Siegel's widow and daughter would be able to regain copyright ownership any time between 2013 and 2018. What this means is that for grants made post-1978, the authors (or their statutory successors) are starting to be able to effectively terminate their grants under section 203 as of the time of this Article. In the few termination cases that have already arisen, it is becoming clear that the letter of the law

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57. *See* PATRY, COPYRIGHT, *supra* note 12, § 7:43; *see also* 1 MELVILLE NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 11.05[B][1] (Matthew Bender, rev. ed. 2009).

58. 17 U.S.C. § 304 (c)(4)(A).

59. *See Siegel*, 542 F. Supp. 2d at 1113-14.

60. *Id.* at 1114. Although there was much discussion in the resulting case as to the exact dates of termination and whether notice was valid, these complications are left out of this version, which only serves as an example for the mechanics of termination rights. *See id.* at 1116-24.

61. 17 U.S.C. § 203(a)(3). "[O]r, if the grant covers the right of publication of the work, the period begins at the end of thirty-five years from the date of publication of the work under the grant or at the end of forty years from the date of execution of the grant, whichever term ends earlier." *Id.*

62. *See* 17 U.S.C. § 203(a)(3). As with terminations under section 304, the authors or their successors must serve notice "not less than two or more than ten years before [the effective termination] date." *See* 17 U.S.C. §§ 203(a)(4)(A), 304(a)(4)(A).

leaves unresolved questions. Some of the most relevant issues are described in the following.

E. *Open Questions*

The 1976 law establishes that the termination rights under sections 203 and 304 are restricted to the original author and their statutory successors[63] and do not apply to works made for hire.[64] Sections 203 and 304 also state that the termination rights are valid "notwithstanding any agreement to the contrary."[65] In 1990, the Supreme Court characterized this description to mean inalienability of the right.[66] While the letter of the law may seem fairly simple and straightforward, these formalities are subject to a considerable range of interpretation by courts in practice.

For one thing, it has not been entirely clear whether the rights to some types of works fall under the work-made-for-hire doctrine.[67] A problematic example of this has been sound recordings. Subject to considerable debate, the decision about whether or not sound recordings should be categorized as works made for hire and thus subject to author termination rights has hinged on courts' interpretation and has massive implications for the recording industry in having to deal with the effects of the 1976 Copyright Act.[68] In coming years, many

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63. *See* 17 U.S.C. §§ 203(a)(1)-(2), 304 (c)(1)-(2).

64. 17 U.S.C. §§ 203(a)-(b), 304(c).

65. 17 U.S.C. §§ 203(a)(5), 304(c)(5).

66. *See* Stewart v. Abend, 495 U.S. 207, 230 (1990).

67. The 1976 Copyright act introduced a new definition of works for hire. According to 17 U.S.C. § 101 (2012), a "work made for hire" is either: "(1) a work prepared by an employee within the scope of his or her employment; or (2) a work specially ordered or commissioned for use as a contribution to a collective work, as a part of a motion picture or other audiovisual work, as a translation, as a supplementary work, as a compilation, as an instructional text, as a test, as answer material for a test, or as an atlas, if the parties expressly agree in a written instrument signed by them that the work shall be considered a work made for hire." Copyright Act of 1976, Pub. L. No. 94-553, 90 Stat. 2541, 9544 (codified as amended at 17 U.S.C. § 101 (2012)).

68. *See* Corey Field, *Their Master's Voice? Recording Artists, Bright Lines, and Bowie Bonds: The Debate Over Sound Recordings as Works Made for Hire*, 48 J. COPYRIGHT SOC'Y U.S.A. 145 (2000); Randy S. Frisch & Matthew J. Fortnow, *Termination of Copyrights in Sound Recordings: Is There a Leak in the Record*

established musicians or their statutory successors will be able to attempt termination of right transfers to financially valuable works.[69] Whether they can do so depends largely on the validity of the record companies' work-made-for-hire argument.[70] To complicate matters, the definition and interpretation of a work-made-for-hire may differ depending on whether the work was made prior to 1978 (and thus governed by the 1909 Copyright Act), or whether it was made later, falling under the stricter definition of the 1976 Act.[71] Patrick Murray looks at the relationship between the work-made-for-hire doctrine and author termination rights, confirming that much of the outcome is subject to court interpretation.[72] He argues that the question of whether a work is "made-for-hire" is central to termination right issues,[73] and that courts can and should be guided by economic considerations that affect the system as a whole.[74]

The question of inalienability is also not as clear-cut as the statute makes it seem. For example, courts are currently divided on whether and when agreements between the same

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Company Vaults?, 17 COLUM.-VLA J.L. & ARTS 212 (1993); Abbott Marie Jones, *Get Ready 'Cause Here They Come: A Look at Problems on the Horizon for Authorship and Termination Rights in Sound Recordings*, 31 HASTINGS COMM. & ENT. L.J. 127 (2009) [hereinafter Jones, *Get Ready*]; Mary LaFrance, *Authorship and Termination Rights in Sound Recordings*, 75 S. CAL. L. REV. 375 (2002); Ryan A. Rafoth, *Limitations of the 1999 Work-For-Hire Amendment: Courts Should Not Consider Sound Recordings to Be Works-For-Hire When Artists' Termination Rights Begin Vesting in Year 2013*, 53 VAND. L. REV. 1021 (2000); Kathryn Starshak, Comment, *It's the End of the World as Musicians Know It, or Is It? Artists Battle the Record Industry and Congress to Restore Their Termination Rights in Sound Recordings*, 51 DEPAUL L. REV. 71 (2001).

69. *See* Rub, *supra* note 15, at 129. Including, for example, Bruce Springsteen and Billy Joel, among others. *See id.*

70. *See id.* at 62-63.

71. *See* NIMMER & NIMMER, *supra* note 57, § 5.03[B]; *see also* Playboy Enters., Inc. v. Dumas, 53 F.3d 549, 553 (2d Cir. 1995).

72. Patrick Murray, *Heroes-For-Hire: The Kryptonite to Termination Rights Under the Copyright Act of 1976*, 23 SETON HALL J. SPORTS & ENT. L. 411 (2013).

73. *See, e.g.*, Mills Music, Inc. v. Snyder, 469 U.S. 153 (1985); *see generally* John Molinaro, *Who Owns Captain America? Contested Authorship, Work-For-Hire, and Termination Rights Under the Copyright Act of 1976*, 21 GA. ST. U. L. REV. 565 (2004); *see also* Rub, *supra* note 15, at 62.

74. *See* Murray, *supra* note 72, at 424-29.

parties are "agreements to the contrary."[75] There have already been a few notable cases in which the parties, possibly in an attempt to circumvent the inalienability restriction, have tried to terminate the original agreement and re-enter into a "new" contract in order to effectively restart the term. While some courts have cracked down on these attempts, declaring them invalid,[76] a couple of recent cases in the Ninth and Second Circuit have come to more lenient conclusions.[77] This ambiguity has sparked discussion over what "agreement to the contrary" means, and whether alienability of termination rights should be allowed under certain circumstances.[78] Some claim that these cases go against the law, effectively "enabling a grantee to renegotiate the terms of the grant so as to frustrate recapture by the author's family."[79] It appears to be in the power of the courts to interpret the inalienability requirement strictly or not. Only very few commentators have looked at the question in light of the theory and purpose of U.S. copyright law, in particular with regard to economic incentives.[80] So far the debate over the desirable interpretation of these formalities has mainly focused on the reasoning behind the introduction of the termination right.[81]

Further questions include what types of grants author termination rights apply to, in particular whether authors

75. Armstrong, *supra* note 1, at 403 n.255.

76. *See, e.g.*, Classic Media, Inc. v. Mewborn, 532 F.3d 978, 979-80 (9th Cir. 2008).

77. *See* Penguin Group (USA) Inc. v. Steinbeck, 537 F.3d 193, 196 (2d Cir. 2008); Milne v. Stephen Slesinger, Inc., 430 F.3d 1036, 1037-38 (9th Cir. 2005).

78. *See, e.g.*, Menell & Nimmer, *Pooh-Poohing*, *supra* note 14, at 827; *see also* Loren, *Renegotiating*, *supra* note 14, at 1344.

79. *See* Menell & Nimmer, *Pooh-Poohing*, *supra* note 14, at 802.

80. *See, e.g.*, Rub, *supra* note 15 (exploring the justification of U.S. author termination rights from an economic perspective); *see also infra* Part II.

81. *See* STAFF OF H.R. COMM. ON THE JUDICIARY, 87TH CONG., REP. OF THE REGISTER OF COPYRIGHTS ON THE GENERAL REVISION OF THE U.S. COPYRIGHT LAW 93 (Comm. Print 1961); Loren, *Renegotiating*, *supra* note 14; Menell & Nimmer, *Pooh-Poohing*, *supra* note 14; *see also* H.R. REP. NO. 94-1476, at 124 (1976).

can revoke copyright assignments made under Creative Commons or other open-source licenses.[82]

These open questions are relevant because their judicial interpretation will establish the boundaries of termination rights. Near-future decisions in this area will set legal precedence for times to come. In ruling over author termination right cases, courts have space to influence the costs and benefits of the law. For example, courts can be swayed by anecdotes of bought-out artists[83] and interpret the inalienability of termination rights strictly, declaring rescissions and copyright re-grants invalid in all cases,[84] or applying the work made for hire doctrine narrowly.[85] Or, courts can factor economic awareness and concerns into their interpretations, taking the below-addressed issues into consideration. The above-discussed open questions are all examples of areas where there is considerable judicial leeway. More generally, when discussing not only judicative, but also which legislative directions to take moving forward, having some idea of the potential economic effects of these laws is a useful insight.[86] Rather than draw on the discussion of legislative intent like most of the prior literature,[87] the following Part therefore looks at the author termination right system from an economic perspective.

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82. *See* Armstrong, *supra* note 1, at 411; Lydia Pallas Loren, *Building a Reliable Semicommons of Creative Works: Enforcement of Creative Commons Licenses and Limited Abandonment of Copyright*, 14 GEO. MASON L. REV. 271, 275 (2007).

83. *See, e.g.*, Sean McGilvray, *Judicial Kryptonite?: Superman and the Consideration of Moral Rights in American Copyright*, 32 HASTINGS COMM. & ENT. L.J. 319, 333-35 (2010).

84. *See* Rub, *supra* note 15, at 66-67.

85. *See* Murray, *supra* note 72, at 437 (citing Marvel Worldwide, Inc. v. Kirby, 777 F. Supp. 2d 720, 725 (S.D.N.Y. 2011) as a counter-example).

86. Although this Article uses judicial interpretation as an example for the timely relevance of this research and how it can be useful in practice, see *infra* note 268, the economic analysis is more generally applicable.

87. This Article comes back to legislative intent in the discussion of implications. *See infra* Part III.

II. ECONOMIC ANALYSIS

This Part looks at how existing law & economic theory applies to author termination rights, in particular in the context of contracting and the parties' investment incentives. By instating author termination rights in the 1976 U.C. Copyright Act, the United States Congress is essentially intervening in the parties' freedom of contract. Termination rights effectively allow one of the parties to a contract to terminate at a specific time, regardless of what was originally agreed to. Furthermore, this right belongs to only one of the parties. The intervention has the explicit purpose of giving one party to the contract a renegotiation opportunity.[88]

Economic theory on contracts and investment incentives predicts a number of standard effects that only a few scholars have considered in the discussion surrounding author termination rights.[89] Guy Rub delivers a rare economic analysis, arguing that termination rights are costly and unnecessary. Like in the following Part,[90] he warns against a misallocation of risk between authors and publishers.[91] While he suggests that termination rights could increase incentives to create if their term were shorter, he argues that a tragedy of the anticommons problem[92] and the cost of risk-shifting outweigh the benefits in the all-over tradeoff. This analysis concurs with the risk allocation effect. It explores both this aspect and the problem of hold-up in more depth. Based on economic factors like uncertainty and intertemporality in decision-making, it also questions a noticeable effect of termination rights on creation incentives.[93] This Article also

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88. *See supra* Part I.A.

89. *See, e.g.*, Kal Raustiala & Christopher Sprigman, *The Music Industry Copyright Battle: When is Owning More Like Renting?*, FREAKONOMICS (Aug. 31, 2011), http://www.freakonomics.com/2011/08/31/the-music-industry-copyright-battle-when-is-owning-more-like-renting.

90. *See infra* Part II.A.

91. *See* Raustiala & Sprigman, *supra* note 89.

92. *See* Rub, *supra* note 15, at 75, 118.

93. This inquiry is a relevant consideration within the utilitarian function of copyright law. The idea of incentivizing creative work is central to U.S. copyright theory. *See* PAUL GOLDSTEIN, *Economic Foundations of Copyright*, *in* GOLDSTEIN ON COPYRIGHT § 1.14 (3d ed. 2008); NIMMER & NIMMER, *supra* note 57, §1.03[A];

explores additional behavioral effects and the role they could play in the termination right setting. Aside from the standard economic concerns of price changes and risk-shifting, bounded rationality may have an influence on actor incentives and behavior.

Examining author termination rights from the perspective of law & economics can be a helpful tool. While there are limitations to economic theory, in particular because there may be other factors than efficiency worth considering in practice,[94] it can be useful to step back and look at this type of contracting situation through an economic lens. Economic theory can point to relevant effects that may not be intuitively obvious to lawmakers.

The following Parts elaborate on the economic theory behind the above-mentioned issues and illustrate how they apply in the specific context of author termination rights.

A. *Price Changes and Risk Allocation*

Publishing industries, in other words markets for copyright grants, commonly comprise a large number of sellers (authors), and a far smaller number of buyers (publishers).[95] The buyers not only have access to the distribution channels necessary to disseminate and market the work, but also, importantly, they are in a better position to diversify risk. Markets for creative works are

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see also Justin Hughes, *Fair Use Across Time*, 50 UCLA L. REV. 775, 797 (2003); Joseph P. Liu, *Copyright and Time: A Proposal*, 101 MICH. L. REV. 409, 428 (2002). The U.S. Constitution enables copyright laws that grant "[a]uthors . . . the exclusive Right to their . . . Writings" in order "[t]o promote the progress of Science and useful Arts." U.S. CONST. art. I, § 8, cl. 8. For further discussion of the incentives that promote creative works, see *infra* Part III.

94. *See, e.g.*, *infra* Part III (discussing distribution effects).

95. *See* Alan B. Albarran, *Media Economics*, *in* THE SAGE HANDBOOK OF MEDIA STUDIES 291, 296 (John D.H. Downing et al. eds., 2004); Mike Jones, *Market Research*, *in* 1 CONTINUUM ENCYCLOPEDIA OF POPULAR MUSIC OF THE WORLD: MEDIA, INDUSTRY AND SOCIETY 554, 555 (John Shepherd et al. eds., 2003) [hereinafter Jones, *Market Research*]; Allen J. Scott, *A New Map of Hollywood: The Production and Distribution of American Motion Pictures*, 36 REGIONAL STUD. 957 (2002) (providing examples of publisher concentration); Michael Szenberg & Eric Youngkoo Lee, *The Structure of the American Book Publishing Industry*, 18 J. CULTURAL ECON. 313 (1994).

characterized by high uncertainty of future successes and failures.[96] With only a small portion of creations becoming popular and a great many not, making investments in a creative work carries significant risk. Publishers, by taking on a large number of projects, mitigate the all-over risk by distributing it over their entire pool of investments. Because authors, for the most part, are in no position to do the same,[97] they have an interest in signing the risk of success or failure over to publishers. Furthermore, as discussed in the preceding paper in this doctoral thesis, authors are often dependent on a source of immediate income, whereas the buyers generally are not.[98] Sellers are therefore interested in exchanging the copyrights to their work for an upfront sum of money.

All of the above is reflected in the fact that pure royalty-rate contracts are relatively scarce in practice.[99] Publishers have an interest in purchasing the full transfer of copyright for an upfront fee. Royalties will often enter into contracts with an author once he or she has become established and successful, although even then, profit participation usually

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96. *See* RICHARD E. CAVES, CREATIVE INDUSTRIES: CONTRACTS BETWEEN ART AND COMMERCE 2-3, 61 (2000); ALBERT N. GRECO, THE BOOK PUBLISHING INDUSTRY 5-6 (2d ed. 2005); Jones, *Market Research*, *supra* note 68, at 555-56; Sarah J. Skinner, *Estimating the Real Growth Effects of Blockbuster Art Exhibits: A Time Series Approach*, 30 J. CULTURAL ECON. 109 (2006).

97. While it is conceivable that some authors may self-publish a large number of works, publishers commonly work with amounts that by far exceed that of an individual.

98. *See* Fred Fisher Music Co. v. M. Witmark & Sons, 318 U.S. 643, 657 (1943); *see also* Kate Darling, *Contracting About the Future: Copyright and New Media*, 10 NW. J. TECH. & INTELL. PROP. 485, 507-08 (2012).

99. At least for not yet established artists. *See, e.g.*, ARTHUR DE VANY, HOLLYWOOD ECONOMICS: HOW EXTREME UNCERTAINTY SHAPES THE FILM INDUSTRY 245 (2004); DONALD S. PASSMAN, ALL YOU NEED TO KNOW ABOUT THE MUSIC BUSINESS 68-88 (7th ed. 2011); Darlene C. Chisholm, *Profit-Sharing Versus Fixed-Payment Contracts: Evidence From the Motion Pictures Industry*, 13 J.L. ECON. & ORG. 169, 176-77 (1997) [hereinafter Chisholm, *Profit-Sharing*]; Menell & Nimmer, *Pooh-Poohing*, *supra* note 14, at 802 (on record labels and the music industry).

only makes up part of the remuneration.[100] While this circumstance could be attributed to bargaining disadvantages on the side of authors, it makes economic sense to have buy-out contracts for creative works. If buyers are willing and able to bear the (high) risks of success and failure, while sellers prefer to exchange this risk for immediate payment, royalty-rate contracts are not in either party's interest.[101] While for established authors the uncertainty of the work's success is reduced on both sides, new or less famous authors are a particularly high-risk investment.[102] For example, a 2007 study by Martin Kretschmer and Philip Hardwick looks at earnings of authors from copyright, finding that royalty-based income is an extremely uncertain source.[103] A small subset of authors will profit from royalty contracts, while the large part of authors will not.[104]

In this setting, basic economic theory predicts that introducing a termination right for authors will have two relevant effects. First, it makes the initial assignment of a copyright less valuable to publishers, decreasing the price they are willing to pay to authors upfront. Second, this

100. *See* DE VANY, *supra* note 99, at 254; PASSMAN, *supra* note 99, at 66-68; Chisholm, *Profit-Sharing*, *supra* note 99, at 176-77; Menell & Nimmer, *Pooh-Poohing*, *supra* note 14, at 802.

101. *See* Christoph Engel & Michael J. Kurschilgen, *Fairness Ex Ante and Ex Post: Experimentally Testing Ex Post Judicial Intervention into Blockbuster Deals*, 8 J. EMPIRICAL LEGAL STUD. 682, 683 (2011).

102. *See* sources cited *supra* notes 96, 99.

103. Martin Kretschmer & Philip Hardwick, *Authors' Earnings from Copyright and Non-Copyright Sources: A Survey of 25,000 British and German Writers* (Centre for Intellectual Property Policy & Management, Bournemouth Univ.), Dec. 2007, at 26.

104. *See* Richard Watt, *Licensing and Royalty Contracts for Copyright*, *in* 3 REV. ECON. RES. ON COPYRIGHT ISSUES 1, 15 (2006). One way to look at royalty contracts is through the lens of a principal-agent relationship. *See* Ruth Towse, *Copyright and Economic Incentives: An Application to Performers' Rights in the Music Industry*, 52 KYKLOS 369, 372-78 (1999); *see also* Peter DiCola, *Money from Music: Survey Evidence on Musicians' Revenue and Lessons About Copyright Incentives*, 55 ARIZ. L. REV. 301 (on musician revenue generally and the distribution of royalty-based versus other income).

reallocates some of the risk of future success or failure back to the author.

Because publishers know that authors and their statutory successors can terminate, the contract for successful works is necessarily limited to thirty-five years. Reducing the term from the entire duration of the copyright (life of the author plus seventy years)[105] to a potential maximum of thirty-five years reduces the expected value of the copyright assignment that publishers are purchasing. In particular, publishers have to take into account that the works that turn out to be most profitable are the transfers that are most likely to be terminated. There is apparent imbalance in this contract situation: unlike the author, the publisher has no termination right, and therefore no opportunity to correct for a disproportionately high fee paid up front. The economically predicted reaction on the part of the publisher is to either reduce the price paid for the initial assignment,[106] or enter into fewer exploitation contracts with authors.[107]

Of course, even if they receive less payment upfront, introducing a termination right gives authors the possibility of receiving more money at a future point in time. However, this will only offset the initial loss in price for a small subset of highly successful authors. Kal Raustialia and Christopher Sprigman have likened this to a regressive tax, because the net effect is to transfer wealth from the unsuccessful to the successful artists.[108] Furthermore, should publishers decide

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105. *See* 17 U.S.C. § 302(a).

106. *See* Rub, *supra* note 15, at 95-98.

107. Although this is theoretically empirically measurable, since the law came into effect in 1976 and publishers may have changed their behavior after knowledge of the change, the intricacies of legal reality may prevent measurable strong results for the time period between introduction of the law and now. The exact mechanics of the rules were (and are) quite obscure and difficult to understand in detail, let alone interpret. Some publishers may have optimistically assumed that their business comprised works made for hire (e.g. sound recordings), or that right-holders would not be able to navigate (or be able to afford to navigate) this complex legal terrain. They also may have relied on coming up with workarounds, such as pre-termination agreements etc., the validity of which have yet to be decided by courts.

108. *See* Raustiala & Sprigman, *supra* note 89.

to reduce the number of contracts they invest in, fewer authors will receive any payment at all. Additionally, the work of those who lose out on initial contracts will not be distributed,[109] resulting in less visibility for the respective artists and fewer total artistic works in the market. Finally, this additional payment for the lucky few will not occur until at least thirty-five years after the transfer or license of copyright. As mentioned above, authors are generally the party in need of a more or less immediate source of income, and are also far less able to diversify risk. The introduction of a termination right, in that it rewards only the most successful artists down the line, effectively reallocates some of the risk from the publisher back to the author.[110]

Given that the reasoning behind termination rights appears to be to help authors as the disadvantaged party,[111] this effect is unlikely what Congress originally envisioned.[112] Discussion of legislative intent aside, however, there could be economic justification for the law. In theory, it could be that the "regressive tax" outcome is desirable, for instance under the assumption that this high-risk lottery system will generate a "superstar effect," inducing creators to strive for uncertain—but very high—payment.[113] This would incentivize the creation of artistic works by many, even though only a few individuals are rewarded.[114] While this is

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109. At least not through the traditional channels that the publishers utilize in their function as gatekeepers.

110. *See, e.g.*, William M. Landes & Richard A. Posner, *An Economic Analysis of Copyright Law*, 18 J. LEGAL STUD. 325, 327 (1989).

111. *See* H.R. REP. NO. 94-1476, at 140 (1976); *see also supra* Part I.A.

112. *See supra* Part I.A.; *see also infra* Part III.B.

113. *See* Sherwin Rosen, *The Economics of Superstars*, 71 AM. ECON. REV. 845 (1981); Diane L. Zimmerman, *Copyrights as Incentives: Did We Just Imagine That?*, 12 THEORETICAL INQUIRIES L. 29, 41-42 (2011). For more on the "superstar effect" in creative industries, see CAVES, *supra* note 96, at 73-76.

114. Some have also argued that risk allocation could incentivize the authors who are most likely to be successful, while weeding out those with lesser potential. *See* Henry Hansmann & Marina Santilli, *Royalties for Artists Versus Royalties for Authors and Composers*, 25 J. CULTURAL ECON. 259, 265 (2001). This argument is weaker to the extent that the success and failure of works is unpredictable. *See* CAVES, *supra* note 96, at 61; GRECO, *supra* note 96, at 5-6; Jones, *supra* note 68, at 140.

not the given reason for introducing author termination rights,[115] these author incentives deserve examination in light of the general incentive theory behind U.S. copyright law.[116] Part II.D explores the effect of author termination rights on creation motivation in more detail.

First, however, the following Section addresses another concern regarding the introduction of author termination rights, namely that risk-reallocation back to the author may have a negative effect on publisher incentives. Any positive effects on author incentives *ex ante* would have to be weighed against the costs of an (*ex post*) effect on investment.[117] Economically, a royalty-rate contract (which is comparable here in terms of introducing profit participation between author and publisher) will necessarily lessen a publisher's incentives to invest in the success of the work.[118] Author termination rights not only decrease these incentives (similar to the case of royalty contracts)—they also raise further questions of rent-seeking behavior and hold-up situations. This is explored in the following.

B. *Hold-Up and Publisher Investment Incentives*

Apart from risk-reallocation, economic theory predicts that the author termination right may affect the publisher's investment incentives. While copyrighted works may be the brainchild of the original creator, much of a work's value to society can come from later investments in quality,

115. *See supra* Part I.A; *infra* Part III.

116. *See* sources cited *supra* note 93.

117. While this tradeoff cannot, of course, be conclusively measured with data, this Article indicates that a positive incentive effect is likely to be smaller than the costs of termination right introduction. *See infra* Parts II.2, II.4, III; *see also* DiCola, *supra* note 104, at 303 n.8 (explaining that some indication is valuable in the context of copyright policy, which currently lacks sufficient data to conclusively measure tradeoffs).

118. *See* CAVES, *supra* note 96, at 56-57 ("[T]he author's royalty based on sales leaves the publisher with an underinducement to promote the [work] (the author, correspondingly, wants more promotion than would maximize author's and publisher's joint profits). The author's advance [payment], though, strengthens greatly the publisher's marginal incentive to promote—he gets roughly the full resulting gross profit— . . . which increases the efficiency of the contract.").

marketability, and of course from access to the work through its subsequent distribution.[119] The reason that copyrights are so commonly transferred or licensed to another party is often because the original author is not in the best position to make his or her work widely accessible to the public.[120] In fact, the United States copyright system is based on the assumption that authors will enter into distribution contracts over their works,[121] and recognizes publishers as both necessary and desirable. Intermediary incentives are therefore a relevant concern for copyright policy.[122] Publishers function as intermediaries that disseminate works to the public and generate value by assessing markets, making necessary alterations to the work, and attempting to ensure the maximum profitable distribution thereof.[123] Their entire business model is basically to purchase copyrights and make them remunerative by investing in marketing, finding the right distribution channels, and exploring new media and exploitation methods.[124] In the process, they will often make contributions to the quality of the work itself (think, for example, of record labels that professionally record and master songs, book publishers that are involved in everything from editing to design, etc.). Given the role of publisher investments in the quality and distribution of creative works, as well as the development of new, improved exploitation methods, it seems important to consider the effects of author termination rights on these investment incentives.

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119. *See* Shyamkrishna Balganesh, *Foreseeabilty and Copyright Incentives*, 122 HARV. L. REV. 1569, 1621-23 (2009).

120. *See id.*; *see also* Mark A. Lemley, *Ex Ante Versus Ex Post Justifications for Intellectual Property*, 71 U. CHI. L. REV. 129, 132-36 (2004).

121. *See* Jessica Litman, *Real Copyright Reform*, 96 IOWA L. REV. 1, 10-12 (2010).

122. *See, e.g.*, Fox Film Corp. v. Doyal, 286 U.S. 123, 127 (1932) ("The sole interest of the United States and the primary object in conferring the [copyright] monopoly lie in the general benefits derived by the public from the labor of authors."); *see also* DiCola, *supra* note 104, at 305-07.

123. *See also* DiCola, *supra* note 104, at 306-07.

124. *See, e.g.*, Darling, *supra* note 98, at 526-27.

Allowing for a termination right, and thus a later renegotiation of contracts for (successful) works is comparable to a revenue-sharing contract *ex ante*. As mentioned above, this will reduce publishers' investment incentives in any case, because they lose part of the value they will be investing in creating.[125] Furthermore, however, both economic theory and intuition suggest a potential hold-up problem when authors have the right to withdraw their grant and force publishers into contract renegotiation.

Contract theory predicts that relationship-specific investments can give rise to undesirable opportunistic behavior.[126] "Relationship-specific" refers to any investment that is unique to a contractual agreement and has no (or lower) value outside of the particular relationship between the parties.[127] Once one of the parties has sunk costs in relationship-specific investments, these costs cannot be recouped when the relationship ends.[128]

For copyright contracts, the investment problem arises because most of the above-mentioned investments that publishers make in improving, promoting, distributing, and sustaining the popularity and value of an artistic work are relationship-specific, meaning they are tied to a contract over a specific creation with a specific author. The publisher invests in the work because he or she is the holder and beneficiary of the copyright, and thus has an interest in increasing its value as much as possible. If the original

125. *See* CAVES, *supra* note 96, at 56-57; Landes & Posner, *supra* note 110, at 327; Rub, *supra* note 15, at 111.

126. *See* Darlene C. Chisholm, *Asset Specificity and Long-Term Contracts: The Case of the Motion Pictures Industry*, 19 E. ECON. J. 143, 144 (1993) [hereinafter Chisholm, *Asset Specificity*].

127. Salanié defines relationship-specific investment as "an investment that increases the productivity of the relationship under study, has a lower value outside of this relationship, [or] is costly for the party that makes it." BERNARD SALANIÉ, THE ECONOMICS OF CONTRACTS: A PRIMER 180 (MIT Press 1997) (1994); *see also* PATRICK BOLTON & MATHIAS DEWATRIPONT, CONTRACT THEORY 461-62 (2005); Vincent P. Crawford, *Relationship-Specific Investment*, 105 Q. J. ECON. 561 (1990); Oliver Hart & John Moore, *Incomplete Contracts and Renegotiation*, 56 ECONOMETRICA 755 (1988); Benjamin Klein et al., *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J. L. & ECON. 297, 322-24 (1978).

128. *See* Chisholm, *Asset Specificity*, *supra* note 126, at 144.

author (or the original author's statutory successors), however, can threaten to terminate the contract and initiate renegotiation of terms, the publisher risks losing the value from his or her investment. Assuming that the original author (or statutory successor), has full knowledge of the commercial success of his or her work, this will allow them to drive the price up and capture the entire bargaining surplus. Because the investment costs are sunk and all future profit is dependent on continuing the contractual relationship with the author, the publisher can be "held up"—theoretically to the point at which nothing is gained from having made the investment in the first place.

Because publishers can foresee this situation, it may dissuade them from making investments when they could or should from a social welfare perspective: economic theory predicts that such hold-up situations will cause socially undesirable underinvestment.[129] Because the termination right can only be exercised during a specific point in time, it is also plausible that publishers will strategically manipulate their investments, such as by waiting to make large investments until the danger of being held up has passed. They may even attempt to sabotage the commercial success of a work during the time leading up to the window in which authors can consider to renegotiate.

Returning to the story of the rights to "Superman," it is intuitively clear that Time Warner and any other involved publishers with stakes in the exploitation rights to the character have halted any major investments in new projects, and will continue to do so, at the very least until the current legal battle has been resolved.[130] In fact, the district court appears to have recognized this incentive problem in a follow-up decision, going so far as to essentially impose a duty on Time Warner to begin production of its movie sequel to the

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129. *See* SALANIÉ, *supra* note 127, at 175-83.

130. *See* Michael Cieply, *Ruling Gives Heirs a Share of Superman Copyright*, N.Y. TIMES, Mar. 29, 2008, at C1; Ethan Smith, *Warner Bros. Wins Court Fight Over Superman*, WALL ST. J., Jan. 10, 2013, http://www.online.wsj.com/news/articles/SB10001424127887324442304578233962555228832.

2006 success "Superman Returns."[131] It seems that the worry is indeed loss of value to the work due to underinvestment on the part of Time Warner.[132] In absence of this judicial pressure, fans would be kept waiting or entirely deprived of the sequel, and will perhaps turn their interest (and money) towards substitutes. Another example of distorted investment incentives is the speculation that Time Warner, facing this mandate, chose the director for the Superman movie based on how fast the movie could be released rather than on artistic merit.[133]

In terms of superheroes, the situation for many other popular characters is equally grim. Superman is far from being an exceptional case. For example, in the midst of a $4 billion dollar acquisition, statutory successors of Marvel superhero creator Jack Kirby have served forty-five termination notices on figures from the "X-Men" and "Fantastic Four," effective 2014.[134] All of these characters now risk being tied up in litigation and withheld from the public for an unpredictable amount of time.[135] Again, the historical success of these characters and their value today cannot be attributed to their authors alone, as the publishers have been responsible not only for character development, but also for all of the advertising and merchandising related to the work.[136]

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131. *See* Siegel v. Warner Bros. Entm't, Inc., No. CV 04-8400-SGL, 2009 WL 2014164, at *21, 24 (C.D. Cal. Jul. 9, 2009).

132. *See id.* at *25-27.

133. *See* Rub, *supra* note 15, at 112 n.246 (citing Chris Schrader, *Legal Wars Could Divide 'Superman' Franchise in Two*, SCREENRANT, http://screenrant.com/superman-movie-legal-battle-siegel-shuster-schrad-117539 (last updated March 9, 2013)).

134. *See* Marvel Worldwide, Inc. v. Kirby, 777 F. Supp. 2d 720, 724 (S.D.N.Y. 2011); Michael Cieply & Brooks Barnes, *Disney Faces Rights Issues Over Marvel*, N.Y. TIMES, Sept. 21, 2009, at B1.

135. The case, *Marvel Worldwide, Inc. v. Kirby*, is ongoing, as it is facing appeal at the Second Circuit Court of Appeals. *See* Murray, *supra* note 72, at 413-14; *see also, e.g.*, Molinaro, *supra* note 73 (on *Marvel Characters, Inc. v. Simon*, 310 F.3d 280 (2d Cir. 2002), over the rights to Captain America).

136. For which most authors do not have the resources. *See* Murray, *supra* note 72, at 436.

This situation is not limited to comic book characters, stretching across all creative industries subject to copyright transfer terminations through authors and their statutory successors. Rub, for example, highlights investment decisions in the recording industry and how record companies can strategically underinvest in a work during the time period before the termination rights can be exercised, or release works like best-hits records right before termination rather than at the time most beneficial to the author and the public.[137]

Again, the transfer of copyright to a publisher has the purpose of facilitating investments and securing distribution of popular works. This corresponds to the interests of all involved parties, including authors and the general public. A termination right will cut into this investment incentive, because the author (or the author's statutory successors) can step in at a later time and capture value that the publisher has invested in. This can influence to what extent or how a publisher invests in a work *ex ante*.

There may also be hindrances to publisher investment *post* renegotiation of the contract. Even if publishers come to agreements with authors and statutory successors at the point of termination, ensuring that they can continue to exploit the copyrights, it is possible that the new agreement will be in the form of a revenue-sharing contract, for example involving royalty-rates.[138] This is because the value of the work is more certain, making it potentially in the seller's interest to share future revenue, rather than be bought out. Buy-outs are more attractive to the seller when risk is involved. As mentioned above, profit participation contracts are in neither party's interest *ex ante*. *Ex-ante*, authors of a new work with uncertain success will prefer to burden the publisher with the risk of success or failure in return for an immediate paycheck.[139] *Ex post* (i.e. at the time of

137. *See* Rub, *supra* note 15, at 112.

138. For discussions of royalty-rate contracts, see CAVES, *supra* note 96, at 56-57; PASSMAN, *supra* note 99, at 74-82; Chisholm, *Profit-Sharing*, *supra* note 99; Menell & Nimmer, *Pooh-Poohing*, *supra* note 14, at 802.

139. For famous authors, or in instances where there is a higher probability of a work being successful on the market, profit participation contracts make more

termination), however, the value of the work is more certain. Publishers can no longer make the offer to bear the risk of success or failure in exchange for a smaller buy-out price. Again, publishers will prefer to buy out the copyright so that they can fully reap the gains of their own investments in the work's success.[140] In the case of termination rights, however, only owners of successful works will initiate renegotiation. Because they already know that the work is profitable, they no longer have the same valuation and risk-allocation problem that they had when agreeing to the initial arrangement. Now able to use the work's value and the publisher's sunk investments as bargaining leverage, authors and their statutory successors may demand profit participation in uses of the work. Where this occurs, it will lessen the return on *ex post* publisher investments, potentially setting sub-optimal incentives.[141]

Rub additionally explores the potential for a tragedy of the anticommons in a system with author termination rights.[142] The tragedy of the anticommons applies when a work is controlled by a multitude of right-owners, making it difficult to contract individually[143] and, in the termination right context, raising the risk that assembled or collaborative works will be vetoed at some point in the future by one or more of the right-holders.[144] While this is a legitimate concern in other legal systems,[145] the structure of author termination rights in United States copyright law is more likely to

sense (and are more common, *see* DE VANY, *supra* note 99, at 245-46; PASSMAN, *supra* note 99, at 68-82). In this instance, however, there is no need to introduce a termination right, since the author is more likely to have negotiated an appropriate remuneration up front. Furthermore, again, the deal is one-sided: in cases where works are not successful, the publisher has no option of getting money back.

140. Whether this is *ex ante* or *ex post* does not matter to the publisher. *See* CAVES, *supra* note 96, at 56-57.

141. *See id.*

142. *See* Rub, *supra* note 15, at 118-26.

143. *See* Michael A. Heller, *The Tragedy of the Anticommons: Property in the Transition from Marx to Markets*, 111 HARV. L. REV. 621, 668, 670 (1998).

144. *See* Rub, *supra* note 15, at 77, 130.

145. *See* Darling, *supra* note 98, at 519-25.

mitigate this problem. The work made for hire doctrine is designed (and used in practice) to cover most of the works with a multitude of creators, a major example being films.[146] Nevertheless, the risk of right termination through one of the authors could deter investment in collective projects that bring previously individual copyrighted works together, for example using new media formats.[147] This would exacerbate the hold-up problem illustrated above.

In general, all of the above may hamper socially desirable investments in quality and distribution of creative content. This cost also affects the authors, who generally have a strong interest in seeing their works brought to success, marketed, and widely shared. While it may still be the case that there are also benefits to allowing authors a contract renegotiation opportunity (for example, allowing authors to renegotiate payment for successful works at a later point in time could theoretically foster creation incentives through the prospect of being able to reap high future earnings),[148] this must be weighed against the costs of underinvestment due to hold-up.[149] Part II.D will explore the author incentive side of the cost-benefit analysis in more detail. First, however, the following Section addresses one of the main criticisms that hold-up theory may face in this context: reputational concerns in scenarios with repeated interaction.

C. *Repeated Games*

One argument frequently made against strong hold-up effects in real-world contract situations is that parties are often interested in (or dependent on) maintaining a good

146. *See* 17 U.S.C. § 101 (covering works "specially ordered or commissioned for use as a contribution to a collective work" and explicitly mentioning films). The music and software industries are also contractually structured to avoid collaborative copyright ownership between a large multitude of parties, e.g. sound mixers are unlikely to have authorship claims in recordings. Rub acknowledges this. *See* Rub, *supra* note 15, at 116 n.264, 118-19 n.272.

147. *See generally* Darling, *supra* note 98.

148. *But see infra* Part II.D.

149. For further discussion, see *infra* Part III.

relationship with each other.[150] In the case of authors and publishers, it initially seems plausible that the author would have other contractual relations with the same publishing partner, or could want to retain the possibility of future interactions. While a one-shot game induces authors to make demands that capture the bargaining surplus, introducing a repeated game situation mitigates the hold-up problem, because authors will be unlikely to extort sums from their publishers that would endanger their relationship.

Publishers, on the other hand, may also be concerned about their reputation. While they are not in a position to hold up the author *ex post*, the general situation of the perceived disparity between initial copyright price and work value may entice favorable settlement gestures towards authors, particularly when public scrutiny is involved. As mentioned above,[151] Time Warner offered the Superman creators lifetime pensions and healthcare benefits when the story of their financial condition got attention in the press.[152]

Theoretically, while the desire to maintain a good relationship with a publisher might lessen any hold-up concerns, it would also mean that authors would not gain as much leverage through termination rights as legislative intent assumes. From this perspective, one would need to question what purpose granting author termination rights serves at all. It seems that, in either case, it could be preferable to resort to alternative ways of reaching these policy goals, whether they are utilitarian or distributive.[153] Even more realistically, however, it is questionable whether this repeated game scenario applies to most cases of author termination rights in practice at all. The shortest period of time that passes before an author is faced with the possibility of termination is thirty-five years. While some authors may still be dependent on continuing contractual relationships

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150. *See, e.g.*, Joseph Farrell & Eric Maskin, *Renegotiation in Repeated Games*, 1 GAMES & ECON. BEHAV. 327, 327-28 (1989) (on the idea of sustainable subgame-perfect equilibria in repeated games).

151. *See* sources cited *supra* note 3.

152. *See* Siegel v. Warner Bros. Entm't Inc., 542 F. Supp. 2d 1098, 1112-13 (C.D. Cal. 2008). This was prior to having any legal obligation, e.g. through author termination right negotiations.

153. *See infra* Part III.

with a specific publisher at such a late point in time, many will not. For the most part, thirty-five years down the road, the situation is likely to be different. Furthermore, many rights will have changed hands and gone to the authors' statutory successors. Unless the right successors are themselves authors and in a relationship with the same publisher, it seems unlikely that a repeated game scenario would occur, or lessen the statutory successors' ability to extract financial gains from the publisher through author termination rights.

One question left unaddressed by static hold-up theory is whether the renegotiation possibility could have a positive effect on *ex ante* author incentives, in other words on the investments made to create the work in the first place. This is explored in the following Part.

D. *Uncertainty, Intertemporal Choice, and Author Incentives*

One potential argument in favor of author termination rights resides within the utilitarian theory of U.S. copyright law.[154] If authors can expect to reap high future earnings from the success of their works, they may have additional incentive to create, or to become authors in the first place. This would encourage the production of artistic work in general, furthering the "progress of art," which is the constitutionally defined aim of the U.S. copyright system.[155]

As mentioned above,[156] introducing author termination rights creates a lottery-like effect, reducing prices for initial copyright assignments, but giving authors a high-risk, high-gain chance at earning profits much later on. This lottery, also called a "superstar effect," could entice more artistic creation *ex ante* through the prospect of potentially large

154. *See* sources cited *supra* note 93. For more discussion on the aims of the copyright system, see *infra* Part III.

155. *See* U.S. CONST. art. I, § 8, cl. 8 ("To 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."); *see also* sources cited *supra* note 93 and discussion *infra* Part III.

156. *See supra* Part II.A.

reward.[157] The "superstar effect" in creative industries has faced some criticism with regard to efficiency.[158] Rather than rehash the discussion over whether or not high-risk, high-reward systems function as efficient incentive mechanisms in creative markets in general,[159] this Section highlights some effects that apply specifically to the context of author termination rights and make the former discussion largely irrelevant. If the "superstar effect" is to be generally functional as an author incentive mechanism, this relies on authors basing their decision-making on the future chance of high reward. Not only must authors factor in the future remuneration possibility at the point in time during which they are deciding whether to invest in creating the work, but this prospect must outweigh whatever losses they suffer through a termination right introduction.[160]

The positive effect on creation incentives operates under the assumptions that [1] authors prefer the uncertain probability of high payment to the more certain probability of lower payment; [2] the uncertain payment possibility has sufficient value to the author despite occurring in the far future. These assumptions are examined in the following.

1. *Uncertainty and Risk Aversion*. With regard to work creation incentives, the author's situation involves a decision based on uncertain information. Copyright is granted (automatically) once the work has been fixed in a tangible medium of expression.[161] Its market success, however,

157. *See* Rosen, *supra* note 113, at 845; *see also* Zimmerman, *supra* note 113, at 41-42.

158. *See, e.g.*, ROBERT H. FRANK & PHILIP J. COOK, THE WINNER-TAKE-ALL SOCIETY: HOW MORE AND MORE AMERICANS COMPETE FOR EVER FEWER AND BIGGER PRIZES, ENCOURAGING ECONOMIC WASTE, INCOME INEQUALITY, AND AN IMPOVERISHED CULTURAL LIFE 110 (1995); DiCola, *supra* note 104, at 307.

159. For more on this question, see FRANK & COOK, *supra* note 158, at 110; *see generally* DiCola, *supra* note 104 (finding that musicians are motivated by copyright through the guarantee of significant future rewards if, in accordance with the superstar model, they improbably gain large popularity).

160. *See supra* Part II.A.

161. 17 U.S.C. § 102(a) (2011).

remains highly speculative.[162] In absence of author termination rights, the author has the near-future possibility of monetizing his or her copyright by selling it to a publisher, and no far-future possibility to correct for undervaluing the work in the initial assignment. With the introduction of author termination rights, the author gains a far-future possibility of correction at the price of a lower compensation upfront.[163] Compared to the near-future compensation, however, this far-future correction opportunity is highly uncertain.

Standard economic theory applies the concept of expected utility to decision-making under uncertain conditions. Actors will choose among different prospects, which are essentially collections of all of the possible outcomes of an action multiplied by their respective probabilities of occurring.[164] Expected utility theory states that the value of a "prospect" is the expected value of all of its outcomes.

To assess the expected value of the uncertain payment coming from exercising a termination right, the author will operate with the weighted average of potential values times the probabilities that they will occur. While this sounds highly complex and mathematical, it may not be so unrealistic in effect: with regard to the question of complete information, economic theory recognizes that real-world actors' cognitive abilities are limited.[165] Predictive uncertainty, i.e. the inability to recognize or take into account all possible outcomes deriving from an action, is part of the

162. *See* CAVES, *supra* note 96, at 2-3, 61; GRECO, *supra* note 96, at 5-6; Jones, *Market Research*, *supra* note 95, at 555-56.

163. *See supra* Part II.A.

164. *See* Philippe Mongin, *Expected Utility Theory*, *in* THE HANDBOOK OF ECONOMIC METHODOLOGY 171, 171-79 (John B. Davis et al. eds., 1998).

165. *See* Oliver E. Williamson, *The New Institutional Economics: Taking Stock, Looking Ahead*, 38 J. ECON. LITERATURE 595, 600 (2000) ("There is close to unanimity . . . on the idea of limited cognitive competence—often referred to as bounded rationality."). But see *infra* Part II.E for more on a different definition of "bounded rationality" as understood by behavioral economics.

rational actor model.[166] Most real-world situations that require decision-making involve some degree of uncertainty, meaning the actors do not have complete information to base their decisions on. Whenever the cost of acquiring the necessary information is too high,[167] actors will use their limited information to make choices.[168] Choices are then based on probabilities and anticipated likelihoods, and reflect this limitation of uncertainty. Even if authors have very limited information about their success chances, they will likely operate with some sort of probability value.

According to the substitution axiom, if all prospects have the same expected values, an actor will be indifferent in choosing between them.[169] Within this framework, if the (expected) value of the later payment is generally higher than the price authors expect to get for their work upfront pre-introduction, then the introduction of author termination rights would incentivize more creation. If it is not, for example, if the choice is between $120 or a 1% chance of getting $11,000, termination rights will not incentivize more creation. There are, however, further factors to consider. In particular, risk-averse actors will value the choices differently.

An actor is risk averse if he or she prefers a certain prospect to a risky prospect, despite them having the same expected value. Risk aversion is generally assumed for expected utility models, which is explained by the concept of decreasing marginal utility. This holds that more of something within a certain time frame will diminish the

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166. *See, e.g.*, Oliver Hart & John Moore, *Foundations of Incomplete Contracts*, 66 REV. ECON. STUD. 115 (1999); Eric Maskin & Jean Tirole, *Unforeseen Contingencies and Incomplete Contracts*, 66 REV. ECON. STUD. 83 (1999).

167. For instance because it is difficult to predict future chances. *See* RICHARD R. NELSON & SIDNEY G. WINTER, AN EVOLUTIONARY THEORY OF ECONOMIC CHANGE 88 (1982).

168. *See, e.g.*, OLIVER E. WILLIAMSON, ANTITRUST ECONOMICS: MERGERS, CONTRACTING, AND STRATEGIC BEHAVIOR 74-78 (1987); OLIVER E. WILLIAMSON, MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS 21–26 (1975).

169. *See* Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, 47 ECONOMETRICA 263, 266 (1979).

utility of additional units.[170] In other words, money earned when times are tough will have more value than the same amount of money earned when times are good and general income is high.[171]

Applied to termination rights, a risk-averse author will value the certain payment more than the uncertain payment, even if the two expected values are equal. In general, individuals are assumed to be risk-averse, especially with regard to their basic income.[172] Furthermore, early in their careers, authors may be particularly likely to be risk averse regarding their work and to prefer the immediate certain payment.[173] From this perspective, the prospects of a high-risk lottery may not necessarily have a positive effect on creation incentives. Authors may not value uncertain future payment highly enough to outweigh the loss they suffer in their more immediate payment. This effect, despite theoretical indication, cannot be measured conclusively.[174] But even if a positive value remains within this framework, there are additional factors to consider. One such factor is the question of intertemporal decision-making, since the prospect of financial reward occurs so far in the future. This is explored in the following.

2. *Discounting*. Another issue is what value the potential future payment has for the author at the time of creation, especially given that it is in exchange for a present cost. The intuitively plausible notion that most authors might prefer

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170. *See* Milton Friedman & L.J. Savage, *The Utility Analysis of Choices Involving Risk*, 56 J. POL. ECON. 279, 279-80 (1948).

171. *See* PAUL KRUGMAN & ROBIN WELLS, ECONOMICS 545-49 (2009).

172. *See* Friedmand & Savage, *supra* note 170, at 279-80; *see also* KRUGMAN & WELLS, *supra* note 171, at 545-49.

173. *See* Hansmann & Santilli, *supra* note 114, at 262; *see also* Rub, *supra* note 15, at 99.

174. Some have also argued that high-risk, high-reward intellectual property systems, similar to state-run lottery systems, could be based on individuals recognizing the respective size of gains versus losses, but systematically overestimating their personal chances of success. *See* Dennis D. Crouch, *The Patent Lottery: Exploiting Behavioral Economics for the Common Good*, 16 GEO. MASON L. REV. 141 (2008). *But see infra* Part II.D.2 (discussing intertemporal effects).

immediate rather than later payment[175] has a solid basis in economic theory. One important aspect of far-future payment that could influence decision-making preferences (and in the author termination right context therefore creation incentives) is discounting.

Discounting pertains to the phenomenon of placing higher value on something received immediately than one does on the same thing received at a later point in time. While part of this is a simple reflection of the fact that goods or capital regularly lose value in the future because the general supply thereof increases, it is also recognized that people exhibit a strong personal preference for immediate payment.[176] The economic concept of discounting is based on early recognition of psychological factors involved in intertemporal decision-making.[177] In the 1930s, economists began to use a single parameter for these factors, called the discount rate.[178]

Discounting is relevant in the context of author termination rights, because if the initial payment for the author's copyright is reduced through the introduction of a termination possibility, a high discount rate could actually reduce author investment incentives rather than raise them.[179] How much more an individual values the same thing now versus later is reflected in his or her personal time preferences. The higher the time preference rate, the more highly the individual will discount future values. While the

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175. *See* Rub, *supra* note 15, at 86-87.

176. *See* ANDREU MAS-COLELL ET AL., MICROECONOMIC THEORY (1995) (rejecting the critical view that this assumption is but a technical convenience); ARTHUR C. PIGOU, THE ECONOMICS OF WELFARE 24-25 (1920).

177. *See e.g.*, EUGEN BÖHM-BAWERK, CAPITAL AND INTEREST (1889); JOHN RAE, THE SOCIOLOGICAL THEORY OF CAPITAL (1834).

178. The discounted utility model was introduced by Paul A. Samuelson. *See* Paul A. Samuelson, *A Note on Measurement of Utility*, 4 REV. ECON. STUD. 155 (1937); *see also* Shane Frederick et al., *Time Discounting and Time Preference: A Critical Review*, 40 J. ECON. LIT. 351 (2002).

179. Similar to, and in fact in addition to, the effect of risk aversion and uncertainty discussed above. *See supra* Part II.D.1.

extent of this is partly subjective, individuals are assumed to systematically discount future value.[180]

Additionally, there is evidence that uncertain payoffs will further influence the extent of discounting. People tend to have much higher discount rates when rewards are certain.[181] Given that, in the termination right context, the first reward is far more certain than the second uncertain payout, it is plausible that authors may discount the future value even more highly.

In summary, because the author may not value far-future gains as much as immediate ones, this could influence his or her decision to create the work. Given that there is no exact knowledge of the reward values in relation to each other, nor the discount rates of individual authors,[182] it is not possible to determine that the effect of termination rights on

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180. Time preferences are recognized to be heterogeneous. *See infra* note 188. For evidence of heterogeneous time preference rates leading to distribution effects, see, for example, Lutz Hendricks, *How Important is Discount Rate Heterogeneity for Wealth Inequality?*, 31 J. ECON. DYNAMICS & CONTROL 3042 (2007).

181. See, for example, a seminal study by Gideon Keren & Peter Roelofsma, *Immediacy and Certainty in Intertemporal Choice*, 63 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 287 (1995).

182. In this context, another potentially relevant theory of interest is the behavioral economic concept of time inconsistency. In particular, empirical studies have shown that—contrary to traditional assumption—individuals' discount rates do not necessarily remain constant for all future time periods, but instead appear to grow smaller over time. *See* Richard Thaler, *Some Empirical Evidence on Dynamic Inconsistency*, 8 ECON. LETT. 201, 201-07 (1981); *see also* HAL R. VARIAN, INTERMEDIATE MICROECONOMICS: A MODERN APPROACH 556-57 (7th ed. 2006). This observation, called hyperbolic discounting, *see* Ariel Rubenstein, *"Economics and Psychology"? The Case of Hyperbolic Discounting*, 44 INT. ECON. REV. 1207 (2003), would weaken the result in so far that authors would not discount as much as initially assumed, since the expected profit is in the far, rather than immediate, future. However, while hyperbolic discounting has been manifestly demonstrated in cases with given (certain) time-frames and payoffs, the results of studies introducing uncertainty have been highly ambiguous. *See* Martin Ahlbrecht & Martin Weber, *The Resolution of Uncertainty: An Experimental Study*, 152 J. INST. & THEORETICAL ECON. 593 (1996) (finding that introducing uncertainty dramatically affects estimated discount rates); Keren & Roelofsma, *supra* note 181, at 287-97 (finding the same). Because the question of future value of copyrighted works involves such considerable uncertainty, the concept of hyperbolic discounting cannot (yet) serve as a solid theoretical basis to evaluate the problem at hand.

author incentives is necessarily a negative one. What theory indicates, however, is that the positive effect may be smaller than assumed. Again, even if authors are positively motivated to create more work, this effect must be evaluated within a tradeoff. Any positive incentives must be weighed against the costs explored above, in particular the effects on publisher incentives and costs to the system as a whole.[183]

It may be that authors anticipate (at least part of) the possibility of far-future gains with the introduction of author termination rights. Even so, there are a few additional considerations as to their relevancy for work creation. These are highlighted in the following.

3. *Further Considerations*. There are two further factors that could play a role in authors' intertemporal decision-making process, thereby impacting their creation incentives. These have to do with the length of the time period before termination rights can be exercised, and with the statutory succession of the rights.

First of all, because thirty-five years must elapse before the termination right can take effect, some authors will no longer be alive at this point. While copyright incentives may include the author's desire to accumulate wealth for his or her family and/or successors, the prospect of payment *post mortem* may have a different value to some compared to wealth they can enjoy while they are alive.[184]

The law specifies that author termination rights pass on to the right successors when the author is deceased.[185] Interestingly, the law assigns this interest to the statutorily designated successors, rather than permitting the author to determine whom he or she wishes to pass the right to. Ownership of termination rights follows the rules laid out in the Copyright Act, and therefore belongs first and foremost to the author's widow or widower, then to his or her children,

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183. Although neither side of the tradeoff can be exactly measured due to lack of numbers, we can try to get an idea of their respective weights in relation to each other.

184. *See, e.g.*, RAE, *supra* note 177 (on the uncertainty of human life as a factor that reduces the motivation to defer gratification).

185. 17 U.S.C. §§ 203(a)(2), 304(c)(2).

and finally to the grandchildren.[186] Only if none of these statutorily designated successors are alive can the ownership be transferred according to the will of the author, or be owned by the author's executor, administrator, personal representative, or trustee.[187] This succession happens regardless and independent of what the author actually wants.[188]

Therefore, when talking about creation incentives, it can be useful to remember that the author will in many cases not personally and directly profit from this far-future possibility of renegotiation. Additionally, the transfer of this option to the parties that will later profit may not even be in the author's interest.

Incentivizing the creation of a work is only the first step. As seen above, another incentive purpose is to facilitate the subsequent distribution of the work.[189] This relates to the contracting situation between author and publisher. While far-future gains may not impact the author's incentive to create, they could influence the slightly later transaction between the parties. In the contracting situation, both the authors' decisions and motivations as well as the publishers' decisions and motivations are relevant. For example, in the transaction, publishers could equally discount future gains or losses when deciding whether to purchase a copyright.[190] The

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186. 17 U.S.C. §§ 203(a)(2)(A)-(C), 304(c)(2)(A)-(C).

187. 17 U.S.C. §§ 203(a)(2)(D), 304(c)(2)(D). Although if the author serves notice of termination before his or her death, the termination right will have vested in the author and become part of the estate. In this case, the author can determine through will to whom the right passes. *See* 17 U.S.C. §§ 203(b)(2), 304(c)(6)(B), 304(d)(1).

188. Some have criticized this. *See* Lee-ford Tritt, *Liberating Estates Law From the Constraints of Copyright*, 38 RUTGERS L.J. 109, 167-82 (2006). Desai criticizes the transfer of copyrights to heirs generally, pointing out undesirable rent-seeking behavior. *See* Deven R. Desai, *The Life and Death of Copyright*, 2011 WIS. L. REV. 219 (2011).

189. *See* Balganesh, *supra* note 119, at 1621; *see also supra* Part II.B.

190. To the extent that publishers discount the future, this influences to what extent the prices for initial copyright assignments drop when author termination rights are introduced. For heavy discount rates, the price difference pre- and post-termination right introduction will be smaller. However, much of the literature assumes time preferences to be heterogeneous. *See* Robert B. Barsky et al.,

parties' behavior in the contracting situation influences the price of the copyright assignment and the distribution of the work, both *ex ante* and *ex post* termination rights.

While so far this Article has indicated that the economic costs of risk-shifting and hold-up outweigh the potential benefits of incentivizing creation through author termination rights,[191] the next Section looks at some additional effects that are worth considering in the general tradeoff. There are some behavioral economic concepts that could potentially play a role in the context of author termination right contracts *ex ante* and *ex post*, in particular fairness preferences and opt-in effects.

E. *Behavioral Economics*

So far, the above-predicted economic outcomes operate under the classic assumption of individuals as rational actors. While this simplification of reality is useful and sometimes necessary, some research over the last few decades has shown that people may be subject to systematic biases that can—and should—be considered in models of

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Preference Parameters and Behavioral Heterogeneity: An Experimental Approach in the Health and Retirement Study, 112 Q. J. ECON. 537 (1997); Kerwin Kofi Charles & Erik Hurst, *The Correlation of Wealth across Generations*, 111 J. POLIT. ECON. 1155 (2003); Erik Hurst, Ming Ching Luoh & Frank P. Stafford, *The Wealth Dynamics of American Families: 1984-1994*, 29 BROOKINGS PAPERS ON ECON. ACTIVITY 267 (1998); Per Krusell & Anthony A. Smith, Jr., *Income and Wealth Heterogeneity in the Macroeconomy*, 106 J. POL. ECON. 867 (1998); Emily C. Lawrance, *Poverty and the Rate of Time Preference: Evidence From Panel Data*, 99 J. POL. ECON. 54 (1991); Andrew A. Samwick, *Discount Rate Heterogeneity and Social Security Reform*, 57 J. DEV. ECON. 117 (1998). The economic assumption that firms have lower discount rates than individuals is based on two factors. First, firms are likely less subject to the "impatience" of individuals, who may discount because they underestimate future needs due to shortsightedness or carelessness. *See* BÖHM-BAWERK, *supra* note 177, at 269; ARTHUR C. PIGOU, 1 THE ECONOMICS OF WELFARE 24-25 (2005) (speaking of a cognitive illusion); *see also* Frederick et al., *supra* note 178, at 354. Second, discounting is attributed to an internal risk premium that arises because the future enjoyment of capital is contingent on uncertain circumstances that are more prevalent in individuals (such as, for example, the probability of not dying beforehand). *See* GEORGE REISMAN, CAPITALISM: A TREATISE ON ECONOMICS 55-56 (1998).

191. Which this Part has indicated may be small to non-existent.

economic behavior.[192] These extensions to classic models are still far from perfectly mirroring the real world, but incorporating established human biases that more accurately reflect the behavior of individuals can change relevant outcomes and improve the power of classic economic theory as a predictive tool. Law and economics look at the implications of legal rules through an economic approach to human behavior. According to Gary Becker, this behavior assumes that actors "[1] maximize their utility [2] from a stable set of preferences and [3] accumulate an optimal amount of information and other inputs in a variety of markets."[193] However, so long as people are deviating from the rational actor model in a systematic way, considering behavioral biases is consistent with economic modeling.[194]

One bias that may more accurately reflect the choices humans make in some situations is the concept of bounded rationality.[195] Bounded rationality, in this context, means that actors deviate from Becker's approach[196] and display non-optimizing behavior, but in a systematic, measurable way.[197] Behavioral economic studies have demonstrated a few effects that go beyond the classic recognition of limited cognitive capabilities,[198] some of which may be relevant in the context of author termination rights. The following Parts

192. *See* Kenneth J. Arrow, *Rationality of Self and Others in an Economic System*, *in* RATIONAL CHOICE: THE CONTRAST BETWEEN ECONOMICS AND PSYCHOLOGY 201, 202 (Robin M. Hogarth & Melvin W. Reder eds., 1986); Christine Jolls et al., *A Behavioral Approach to Law & Economics*, 50 STAN. L. REV. 1471, 1478 (1998); Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, 185 SCI. 1124 (1974).

193. GARY S. BECKER, THE ECONOMIC APPROACH TO HUMAN BEHAVIOR 14 (1976).

194. *See* Arrow, *supra* note 192, at 202 ("[T]here is no general principle that prevents the creation of an economic theory based on other hypotheses than that of rationality. . . . [A]ny coherent theory of reactions to the stimuli appropriate in an economic contex . . . could in principle lead to a theory of the economy."); *see also* COLIN F. CAMERER, GEORGE LOEWENSTEIN, & MATTHEW RABIN, ADVANCES IN BEHAVIORAL ECONOMICS 3 (2011); Jolls et al., *supra* note 192, at 1478.

195. *See* Herbert A. Simon, *A Behavioral Model of Rational Choice*, 69 Q.J. ECON. 99 (1955).

196. *See* BECKER, *supra* note 193, at 14.

197. Herbert A. Simon, *Theories of Bounded Rationality*, *in* DECISION AND ORGANIZATION 161, 163-64 (C.B. McGuire & Roy Radner eds., 1971).

198. Unlike discussed above in Part II.D on uncertainty.

explore the behavioral economic concepts of fairness preferences and opt-in effects, and their potential implications for author termination rights. Fairness preferences may play a role for authors' *ex ante* creation incentives, as well as the terms and desirability of the initial assignment of copyright to a publisher. Opt-in effects could potentially lessen the *ex post* costs of hold-up and the negative effect on publisher investment incentives.

1. *Fairness Preferences*. As mentioned above, the prices of copyright assignments and the subsequent distribution of works depend on how the parties contract with each other. A potential effect of interest in this context is that of the parties' fairness preferences, because it may influence their contracting behavior. Fairness preferences may also play a role for creation incentives, especially if termination rights make the creator environment a more attractive one to be in from a fairness preference perspective.

Fairness preferences can be described as follows: the standard economic model assumes that all actions are motivated by self-interest.[199] Behavioral economic studies have shown, however, that people sometimes do not behave in accordance with the classic rational actor model when values are attached to their perception of "fairness."[200] There is evidence that people will systematically display behavior some would describe as "altruistic," or "spiteful," even when these actions involve a cost to themselves.[201] While such behavior can theoretically also be categorized as "self-interested" because it fits into a more general model of utility,

199. *See* George J. Stigler, *Economics or Ethics?*, *in* The TANNER LECTURES ON HUMAN VALUES 190 (Sterling McMurin ed., 1981) ("[W]here self-interest and ethical values with wide verbal allegiance are in conflict[,] [m]uch of the time[,] most of the time in fact, self-interest theory . . . will win.").

200. *See* Ernst Fehr & Simon Gächter, *Fairness and Retaliation: The Economics of Reciprocity*, 14 J. ECON. PERSP., Aug. 2000, at 159; Elizabeth Hoffman et al., *Behavioral Foundations of Reciprocity: Experimental Economics and Evolutionary Psychology*, 36 ECON. INQ. 335 (1998); Daniel Kahneman et al., *Fairness and the Assumptions of Economics*, 59 J. BUS. 285 (1986); James Konow, *Fair Shares: Accountability and Cognitive Dissonance in Allocation Decisions*, 90 AM. ECON. REV. 1072 (2000).

201. *See* NICK WILKINSON, AN INTRODUCTION TO BEHAVIORAL ECONOMICS 328 (2008).

behavioral economics expands on the rational actor model to explicitly include costly actions that benefit others without *material* gain for oneself,[202] and costly actions that impose a cost on others with no corresponding *material* gain.

While fairness preferences are intuitively evident in real-world observations that do not fully align with the standard rational actor model,[203] their existence and consistency are also based on a body of empirical evidence. Behavioral economic studies have explored fairness preferences in ultimatum bargaining games,[204] dictator games,[205] trust games,[206] and public goods games,[207] finding that people systematically deviate from what the rational actor model predicts. Behavioral economists have since developed models that incorporate fairness preferences. For example, inequity aversion models.[208] People display inequity aversion when

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202. But rather a psychological benefit from which the actor derives utility.

203. For example, tipping in the service industry, voter participation, lost-and-found offices, punishing people who free ride on others' investments—even when it is costly to do so—, and so on.

204. Werner Güth et al., *An Experimental Analysis of Ultimatum Bargaining*, 3 J. ECON. BEHAV. & ORG. 367, 380 (1982); Elizabeth Hoffman et al., *On Expectations and Monetary Stakes in Ultimatum Games*, 25 INT. J. GAME THEORY 289, 292, 297 (1996) [hereinafter Hoffman, *On Expectations*]; John List & Todd Cherry, *Learning to Accept in Ultimatum Games: Evidence from an Experimental Design that Generates Low Offers*, 3 J. EXP. ECON., June 2000, at 11.

205. *See* Robert Forsythe et al., *Fairness in Simple Bargaining Experiments*, 6 GAMES & ECON. BEHAV. 347 (1994); Hoffman et al., *On Expectations*, *supra* note 204.

206. Joyce Berg et al., *Trust, Reciprocity, and Social History*, 10 GAMES & ECON. BEHAV. 122, 131-38 (1995).

207. John O. Ledyard, *Public Goods: A Survey of Experimental Research*, *in* HANDBOOK OF EXPERIMENTAL ECONOMICS 111 (John H. Kagel & Alvin E. Roth eds., 1995); *see also* David Sally, *Conversation and Cooperation in Social Dilemmas: A Meta-Analysis of Experiments from 1958 to 1992*, 7 RATIONALITY & SOC'Y 58 (1995).

208. *See, e.g.*, Ernst Fehr & Klaus M. Schmidt, *A Theory of Fairness, Competition, and Cooperation*, 114 Q.J. ECON. 817 (1999); *see also* Gary E. Bolton & Axel Ockenfels, *ERC: A Theory of Equity, Reciprocity, and Competition*, 90 AM. ECON. REV. 166 (2000). Further models deal more with reciprocity. *See* Armin Falk & Urs Fischbacher, *A Theory of Reciprocity*, 54 GAMES & ECON. BEHAV. 293 (2006); Matthew Rabin, *Incorporating Fairness into Game Theory and Economics*, 83 AM. ECON. REV. 1281 (1993).

they care about the size of their payoffs in relation to other people's payoffs.[209]

Fairness preferences and inequity aversion could play a role in the context of author termination rights. For example, an experimental study by Christoph Engel and Michael Kurshilgen indicates that allowing for *ex-post* adjustment of copyright exploitation contracts could have positive effects because people tend to deviate from the rational actor model in this context.[210] In the study, participants bargain over the sale of a commodity, assuming that its future value is highly uncertain. In one version, there is no possibility to correct the bargained-for price after the deal is struck.[211] In the other version, the parties have the opportunity to renegotiate the payment, and if that fails, a third party is asked to determine an "appropriate purchase price."[212] Engel and Kurschilgen look at the changes in market prices, amount of agreements, and the differences in perceived fairness of the deals.[213] They find that with the introduction of a renegotiation possibility, lower prices are indeed paid for authors' copyrights *ex ante*.[214] The experiment also finds, however, that more deals are struck, which benefits both parties and affects an improvement in social welfare because more trade takes place.[215] The reason for this is assumed to be the parties'

209. *See* Bolton & Ockenfela, *supra* note 208; Fehr & Schmidt, *supra* note 208.

210. Engel & Kurschilgen, *supra* note 101, at 682, 699-700.

211. *Id.* at 684-86.

212. *Id.* at 687-89. The experiment is based on the "Bestseller Paragraph" in German copyright law, which gives authors the right to a reasonable cut of profits in right transfers to works that turn out to be "bestsellers," i.e. if the profits and advantages from the use of the work are clearly disproportionate to what the author originally was paid. *See* Gesetz über Urheberrecht und verwandte Schutzrechte (Urheberrechtsgesetz) (Copyright Act), Sept. 9, 1965, BUNDESGESETZBLATT [BGBL.] I, at 1273, § 32(a) (Ger.) ("[D]ie vereinbarte Gegenleistung . . . in einem auffälligen Missverhältnis zu den Erträgen und Vorteilen aus der Nutzung des Werkes steht"). While this law is slightly different from United States author termination rights, the experiment itself (as seen above) is simplified enough for the setting to be comparable and equally applicable.

213. Engel & Kurschilgen, *supra* note 101, at 682.

214. As suggested above, *supra* Part II.A.

215. Engel & Kurschilgen, *supra* note 101, at 693-99.

fairness preferences. Offers to purchase are rejected *ex ante* without the future possibility to correct for value. When questioned, the participants reported less perceived *ex post* unfairness with the adjustment possibility.[216] This indicates that fairness preferences might create barriers to trade that can be mitigated by introducing the possibility of *ex post* contract adjustment.

The overall implication of these findings is that the introduction of author termination rights may overcome existing barriers to trade resulting from the parties' fairness preferences, thus leading to more agreements. Even though the initial prices that copyrights trade for are lower, the finding that more deals are struck deviates from the outcome predicted by standard economic theory. The results of the experiment indicate that sellers (authors) and buyers (publishers) do indeed have and act on fairness preferences.

The implications of fairness preferences would affect the cost-benefit tradeoff of author termination rights. As discussed above, standard economic theory assumes the introduction of a termination right to have negative *ex ante* economic implications.[217] The existence of fairness preferences could lessen the negative impact and be worth considering in the general tradeoff.

2. *Opt-In Effects.* Behavioral effects could also come into play at the point in time when the termination rights are exercisable. The termination right allows the author to threaten the publisher with copyright withdrawal, thereby initiating a renegotiation over the terms of the grant. Assuming rational actors, this threat will be made whenever the value of the granted rights is—or has become—larger than what was agreed to in the original contract. The parties will then always renegotiate and come to new terms reflecting the change in value. However, assuming boundedly rational actors may lead to a different outcome. One possible bias could be opt-in effects. Opt-in effects refer to the stickiness of default rules. Studies have shown that systems requiring individuals to take a specific, even non-costly,

216. Although interestingly their results show this for the buyers, i.e. the publishers, and not necessarily for the sellers, i.e. the authors. *See id.* at 684.

217. For example, lower initial prices, a shift of risk from the publisher to the author, and ambiguous effects on creation incentives.

action in order to achieve an outcome that corresponds to their preferences can lead to a far lower amount of individuals opting for this outcome than would in absence of the need to take action.

This goes further than simply being a matter of transaction costs.[218] For example, Johnson and Goldstein look at peoples' choices as to whether or not to donate their organs.[219] They compare countries with an opt-out default, meaning that in these countries people's consent to donating their organs is presumed unless they register otherwise, to countries with an opt-in default, meaning that people must explicitly consent to donating their organs. Standard economic theory would predict that, in this situation, peoples' willingness to donate or not donate will correspond to their (pre-held) preference, since it is not overly costly to express. In fact, however, countries with an opt-out default are shown to have a far higher donation rate, even when controlled for social and other factors.[220] Furthermore, countries with low donation rates were found to have similarly high approval rates of organ donation in the population when surveyed for sentiment, despite the fact that the numbers of people who had actually signed a donor card were far lower.[221]

Similarly, studies have revealed that changing defaults for employee 401(k) (or other) saving plans from opt-in to opt-out considerably increases enrollment.[222] Here too, even though only few employees had previously chosen the

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218. For example, the costs of the action outweighing the potential gains from taking it.

219. Eric J. Johnson & Daniel G. Goldstein, *Do Defaults Save Lives?*, 302 SCI. 1338, 1338-39 (2003).

220. *Id.* at 1338.

221. *Id.* (citing THE GALLUP ORGANIZATION, THE AMERICAN PUBLIC'S ATTITUDE TOWARD ORGAN DONATION AND TRANSPLANTATION 14-15 (1993) (discussing a 1993 poll that shows that while 85% of Americans approve of organ donation, only 28% had opted to do so)).

222. James J. Choi et al., *Defined Contribution Pensions: Plan Rules, Participant Decisions, and the Path of Least Resistance*, *in* 16 TAX POLICY AND THE ECONOMY 67 (James M. Poterba ed., 2002); Brigitte C. Madrian & Dennis Shea, *The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior*, 116 Q.J. ECON. 1149 (2001).

contribution rate that later became the default, most chose to stay with the default once it was in place.[223]

There are various hypotheses as to why these default rules are sticky. If preferences are constructed,[224] in other words, not already formulated like standard economic theory assumes, actors may decide based on thinking that the default is a recommendation from the entity that set it,[225] or they may be avoiding making an active decision because it requires psychological (or other) effort,[226] or they may be reluctant to change the status quo due to loss aversion.[227] Regardless of whether due to framing effects, starting points, or other factors, most opt-in and opt-out regimes tend to display dramatic differences.[228]

Although some of the above hypotheses might not necessarily apply in the context of termination rights, the fact that action is required on the part of authors to make use of their rights could nevertheless be an issue. If actors are indeed generally hindered by more than just transaction costs in taking specific actions that would otherwise be in their interest, then authors may make less use of termination rights than intended. Furthermore, the execution of termination rights is considerably complicated.[229] According to the observations of the district court in *Siegel v. Warner Bros. Entertainment*, "[t]he termination provisions contained

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223. Madrian & Shea, *supra* note 222, at 1150.

224. John W. Payne et al., *Behavioral Decision Research: A Constructive Processing Perspective*, 43 ANN. REV. PSYCHOL. 87 (1992); Paul Slovic, *The Construction of Preference*, *in* CHOICES, VALUES, AND FRAMES 489-502 (Daniel Kahneman & Amos Tversky eds., 2000).

225. *See, e.g.*, Madrian & Shea, *supra* note 222, at 1150.

226. *See* Johnson & Goldstein, *supra* note 219, at 1338.

227. For more on loss aversion, see Amos Tversky & Daniel Kahneman, *Loss Aversion in Riskless Choice: A Reference-Dependent Model*, 106 Q.J. ECON. 1039 (1991).

228. *See* Cass R. Sunstein & Richard H. Thaler, *Libertarian Paternalism is Not an Oxymoron*, 70 U. CHI. L. REV. 1159, 1159-60 (2003).

229. *See* 17 U.S.C. §§ 304 (c), 203(b); 37 C.F.R. § 210.10 (2009) (further regulations issued by the Copyright Office); *see also* Loren, *Renegotiating*, *supra* note 14, at 1335; William Patry, *Choice of Law and International Copyright*, 48 AM. J. COMP. L. 383, 447 (2000) [hereinafter Patry, *Choice of Law*].

in the Copyright Act of 1976 have aptly been characterized as formalistic and complex, such that authors, or their heirs, successfully terminating the grant to the copyright in their original work of authorship is a feat accomplished 'against all odds.'"[230] The court further notes: "[I]t is difficult to overstate the intricacies of these provisions, the result of which is that they are barely used, no doubt the result desired by lobbyists for assignees."[231] It is further the author's responsibility to keep track of the exact dates and initiate the termination. The publisher has no notification or information duties. In practice, this is likely to result in a certain percentage of authors—or their statutory successors—forgetting, not being aware of, not going through the trouble for, or otherwise relinquishing their termination possibilities.

This effect would mitigate at least part of the negative effects described above. It can be noted, however, that instating a complicated legal rule to benefit authors who neglect to make use of it for behavioral reasons, would be both strange and unnecessary. It would be more efficient in the interest of policy makers and all involved parties to find a better-suited solution.

The next and final Part of this Article will recap the discussed costs and benefits and explore their relevance for copyright policy.

III. IMPLICATIONS

This Article has looked at the economics surrounding the introduction of author termination rights. This Part will explore the implications of the discussed effects. The first Section will do so within the standard incentive theory framework.[232] The second Section will look at author

230. Siegel v. Warner Bros. Entm't Inc., 542 F. Supp. 2d 1098, 1101-02 (C.D. Cal. 2008) (citing PATRY, COPYRIGHT, *supra* note 12, § 7:52).

231. *Siegel*, 542 F. Supp. 2d at 1117 (quoting Patry, *Choice of Law*, *supra* note 229, at 447); *see also* Burroughs v. Metro-Goldwyn-Mayer, Inc., 683 F.2d 610, 621 (2d Cir. 1982) (commenting that the steps necessary to make a termination effective oftentimes create "difficult, technical questions").

232. This is not the only conceivable framework: literature on the theories and philosophies of intellectual property often brings up the concept of copyright as a moral right inherent to the author. *See* Barbara Friedman*, From Deontology to*

termination rights from the perspective of the officially given policy goals. The reasoning behind author termination rights is largely distributive and has been central to the discourse surrounding the U.S. Copyright Act of 1976. It should therefore not go unaddressed.

A. *Utilitarian Goals*

Given the utilitarian function of copyright law in aiming to incentivize the creation of artistic works,[233] the theory behind author termination rights could be that the opportunity to renegotiate rights later on and additionally profit from the success of the work leads to more creation *ex ante*. The anticipation of future profits will entice more authors to create in the first place, thus furthering the progress of the arts, as is the proclaimed goal of the system.[234] While this is not the given rationale for introducing termination rights,[235] it makes sense to first evaluate them within this framework.

Because authors are given a chance to reap some of the benefits later on if what they create is successful, this could motivate their work. From the economic perspective of our policy in practice thus far, which is based on a very simple concept, this adds up. Copyright theory, as it is commonly

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Dialogue: The Cultural Consequences of Copyright, 13 CARDOZO ARTS & ENT. L.J. 157 (1994); Justin Hughes, *The Philosophy of Intellectual Property*, 77 GEO. L.J. 287, 350-51 (1988). This theory is the historical basis for copyright law in some countries. *See, e.g.*, Darling, *supra* note 98, at 497-505; Jane C. Ginsburg, *A Tale of Two Copyrights: Literary Property in Revolutionary France and America*, 64 TUL. L. REV. 991 (1990); Neil Netanel, *Alienability Restrictions and the Enhancement of Author Autonomy in United States and Continental Copyright Law*, 12 CARDOZO ARTS & ENT. L.J. 1 (1994). However, moral rights theory has never been given a strong stance in United States copyright policy, where copyright is regarded (and generally treated) as an incentive mechanism. Authors are granted exclusionary rights in order "[t]o promote the Progress of . . . [the] Arts." U.S. CONST. art. I, § 8, cl. 8. As such, this Article has chosen this framework for its central analysis. *See supra* Part II.

233. *See* sources cited *supra* note 93.

234. U.S. CONST. art. I, § 8, cl. 8 ("To 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.").

235. *See supra* Part I; *see also infra* Part III.B.

understood in practice, assumes linearity of author incentives.[236] The more future gains an author is promised, the more artistic creation this will incentivize.

However, it can be questioned as to what happens to authors' incentives when a highly uncertain, far-future remuneration possibility is introduced at the cost of what authors can sell their rights for up front. It could be that the increased risk of the introduced lottery simply amplifies the "superstar effect,"[237] with a positive effect on creation incentives. As discussed above, this positive effect necessarily assumes that authors value the chance probability of later payment more than what they lose in certain immediate payment, since introducing termination rights will lead to lower prices and/or less initial contracts.

The payment possibility through termination rights is highly uncertain, and more than thirty-five years[238] in the future. Exploring the concepts of decision-making under risk, and discounting future value, this Article has questioned whether the far-future payment has sufficient value to authors *ex ante* to be preferable to a higher buy-out price, and thus have a positive influence on their work. It is plausible that authors will discount this uncertain, far-future payment chance at the point in time of work creation, placing higher value on more immediate, certain payment.[239] Additionally, since many authors will never see any of the money personally, even if their work is successful,[240] it could also be

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236. *See* Jessica Litman, *War Stories*, 20 CARDOZO ARTS & ENT. L.J. 337, 344 (2002); Sara K. Stadler, *Incentive and Expectation in Copyright*, 58 HASTINGS L.J. 433, 435 (2007).

237. *See supra* Part II.A; *see also* sources cited *supra* note 113 and accompanying text.

238. The chance of later profiting from future financial success of their works must be factored into their decision-making process before the work exists, in other words, well over thirty-five years in advance. The term for termination rights does not begin until the rights are transferred to another party, which is after the decision-making process to create the work occurs, and usually after the work itself has been created.

239. *See supra* Part II.D.

240. This is because, over thirty-five years down the road, it could just be an author's rights-successors who profit. While some authors may value this equally, some may not, particularly since the statutory rights-successors are not

that the introduction of author termination rights reduces, rather than increases, *ex ante* incentives.

This is not the first criticism of the policy assumption in copyright that author incentives are linear. For example, drawing on economic theories of predictive uncertainty, Shyamkrishna Balganesh argues that there are natural limits to what behavior the law can expect to incentivize through copyrights.[241] Laws that attempt to correct for unanticipated value *ex post* assume that this value was foreseeable, and thus would be factored in by a rational actor and taken into account when deciding whether to invest in creating a work.[242] But this foreseeablity could be limited.[243]

Based on the incentive purpose of copyright law, it has also frequently been argued that unanticipated windfalls[244] should not be allocated to the author because they are unlikely to have influenced the decision to create the work.[245] Because of limited cognitive capability, or the above-discussed factors, some gains are unlikely to be factored into authors' decision-making, and it is questionable that these should automatically go to creators.[246] The argument is that copyright law, like other areas of the law,[247] should reflect

necessarily to whom the author would prefer to bequeath his or her wealth. *See supra* Part II.D.

241. *See* Balganesh, *supra* note 119.

242. *See id.*

243. *See id.* at 1592.

244. A windfall is an unanticipated financial gain that comes about independent of work, planning, or any other socially desirable activity on the creator's part. *See* Eric Kades, *Windfalls*, 108 YALE L.J. 1489, 1491 (1999).

245. *See e.g.*, Rey v. Lafferty, 990 F.2d 1379, 1388 (1st Cir. 1993); Cohen v. Paramount Pictures Corp., 845 F.2d 851, 854 (9th Cir. 1988); ABKCO Music, Inc. v. Westminster Music, Ltd., 838 F. Supp. 153, 156 (S.D.N.Y. 1993); Platinum Record Co. v. Lucasfilm, Ltd., 566 F. Supp. 226, 227-28 (D.N.J. 1983); Kirke La Shelle Co. v. Paul Armstrong Co., 188 N.E. 163, 165-66 (N.Y. 1933).

246. *See, e.g.*, Balganesh, *supra* note 119, at 1590 (discussing windfalls) ("In practical terms, copyright windfalls allow creators to engage in monopolistic pricing in new markets that are unlikely to have formed a crucial part of their incentives in creating the work. In addition, in relation to new uses and later-developed technologies, these windfalls give creators control over markets that they clearly are not best positioned to develop.").

247. For example, tort law.

what actually influences decision-making, rather than simply assuming that more gains equals more creation. To the extent that far-future gains are not relevant to the creation of artistic work, copyright policy should reconsider whether they are properly allocated or even necessary.

While the argument is sometimes that the expectation is unlikely to influence an author's incentive to create a work because of its highly uncertain nature,[248] this Article recognizes that actors may factor in the probability of future gains, no matter their uncertainty. In other words, the uncertainty does not necessarily influence the assumption that the chance of high future earnings factors into a decision-making process at the outset of creation. Indeed, the theory of the "superstar effect" takes this into account. But because the introduction of termination rights increases risk at a price to the author, it becomes less effective when authors are risk-averse. Risk-averse actors will prefer certain to uncertain payment. This Article draws attention to the fact that actors in creative markets may be risk-averse, and may furthermore additionally discount values in the far future.[249] An incentive effect that is based on the predictive uncertainty of author termination rights thirty-five years down the road may be less strong than an incentive provided by anticipated immediate and more certain payment, even when such payment is smaller than the expected future remuneration.

Even if author termination rights have a slightly positive effect on incentives, this must be weighed against other factors. This Article also looks at the potential for hold-up situations and their effect on investment incentives.[250] Hold-up, which is plausible in the termination right context, can reduce quality and distribution of artistic works, as well as hinder the development of new exploitation methods and technologies. This would neither be in authors' nor in the

248. *See* Balganesh, *supra* note 119, at 1615 (discussing predictability) ("[A] creator's belief that her work will come to be used in association with some *wholly unforeseeable* medium, merely because such unforeseeable media emerged in the past, represents an expectation that is not necessarily grounded in anything other than a bald prediction that a historical contingency is likely to repeat itself.").

249. *See supra* Part II.D.

250. *See supra* Part II.B.

public's best interest. Again, the utilitarian goal of the copyright system is to trade off exclusive rights in return for not just creation incentives, but also distribution of, and access to, artistic works.[251]

While the law specifically intends to give authors the type of bargaining advantage seen in the hold-up scenario,[252] consideration of the effects on publisher investment seems to be lacking. The arguments of large publishing corporations in court are often not viewed particularly kindly by the general public, because it appears to be—and is likely—the case that they are trying everything they possibly can to protect their own financial interests. The argument of investment incentives, however, does line up with economic theory and should be weighted in policy decision-making.[253] This incentive structure essentially affects not just the financial gains of publishers, but also the interests of authors, and that of the general public. Intermediaries perform an essential role in both generating additional value of the work, and fostering public access. As mentioned above, the incentive system is primarily designed for this purpose, and not simply to remunerate authors.[254] Quality, distribution, and investment in new media formats are things that benefit both authors and public interest.[255] If copyright is intended to foster distribution and public access to artistic works, hold-up situations will be at odds with these

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251. *See supra* Part II.B; *see also* Ashok Chandra, *Crisis of Indefinite Consequence: How the Derivative Works Exception and the Lanham Act Undercut the Remunerative Value of Termination Transfers*, 16 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 241, 250 (2005) (citing United States v. Paramount Pictures, Inc., 334 U.S. 131, 158 (1948) ("[R]eward to the author or artist serves to induce release to the public of the products of his creative genius.")).

252. *See infra* Part III.B.

253. *See supra* Part II.B.

254. *See supra* Part II.D.2; *see also* Murray, *supra* note 72, at 415.

255. *See* DiCola, *supra* note 104, at 307. One cannot lose sight of the intermediaries' function within the system. *See id.* ("[T]o fully understand copyright incentives, one must measure the financial rewards the intermediaries receive, the services they offer in terms of developing and disseminating works to the public, and how changes in the financial rewards to intermediaries are affecting the public's access to creative works.").

goals. This cost must thus be weighed against whatever benefits that author termination rights confer.

Additionally, this Article looks at some behavioral economic factors that could come into play in the termination right context. One discussed effect that could impact distribution contracts is fairness preferences. If authors feel that a prospect of future compensation correction is more "fair" than a system without termination possibility, then more deals may be struck, even if these deals are at lower prices.[256] *Ex post*, the fact that making use of the right to terminate requires an action, not to mention some effort, on the part of the authors or right successors could mean that the barrier to exercising author termination rights is higher than assumed.[257] Both of these effects could mitigate some of the costs inherent to a termination rights system.

Again, it is useful to remember that copyright laws are a tradeoff. Exclusive rights, and the possibility to capitalize on artistic works, are granted in order to correct for a market failure.[258] This correction does not come without economic costs. Copyrights reduce the distribution and accessibility of works.[259] Author termination rights, just like the copyrights they apply to, create economic inefficiencies, induce rent-seeking behavior, and come with transaction costs.[260] Furthermore, this Article draws attention to the fact that termination rights induce price and risk-shifting that is not necessarily efficient and may add to this cost. It also

256. *See supra* Part II.E.1.

257. *See supra* Part II.E.2.

258. *See* GOLDSTEIN, *supra* note 93, § 1.14; NIMMER & NIMMER, *supra* note 57, §1.03[A]. Copyright enables creators of artistic works to recoup production costs by creating exclusive rights on content so they can monetize it. Without this mechanism, the theory goes, content will be too easily replicated, eroding the creator's profits and reducing the incentive to invest in creating content, resulting in market failure. *See* Landes & Posner, *supra* note 110, at 326.

259. *See* Landes & Posner, *supra* note 110, at 326; GOLDSTEIN, *supra* note 93, § 1.14.

260. Transaction costs are the costs incurred in performing market exchanges, frequently subcategorized as search and information costs, bargaining costs, and enforcement costs. *See* Carl J. Dahlman, *The Problem of Externality*, 22 J.L. & ECON. 141, 148 (1979) (expanding on the original theory in Ronald H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 15 (1960)).

demonstrates that hold-up situations could have negative effects on distribution and access to copyrighted works. While it is difficult to measure the costs and benefits conclusively,[261] this Article indicates that the relative weight of the costs is probably larger than the benefits. Author termination rights are likely to have a much smaller positive *ex ante* effect on creation incentives[262] than the negative effects they introduce.

However, investment incentives, while prevalent in U.S. copyright theory, are not everything. Another possible effect that copyright policy could be interested in fostering, even at the cost of some inefficiency, is wealth redistribution to authors. This is discussed in the following.

B. *Distributive Goals*

Another reason to grant author termination rights within copyright law serves distributive purposes. Policy makers may not care about incentives and instead be looking to achieve wealth redistribution.[263] In many countries outside of the United States, the copyright system's history and purpose is seen not as an incentive mechanism for the public benefit, but rather as a direct compensation mechanism for authors.[264] Because authors have created something, the compensation falls first to them, as the originators of the work. Introducing author termination rights could

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261. *See* David McGowan, *Copyright Nonconsequentialism*, 69 MO. L. REV. 1, 9 (2004) (on the fact that copyright discourse is (necessarily) based on indication rather than empirical data).

262. If any at all. *See supra* Part II.D.

263. *See, e.g.*, Molly Shaffer Van Houweling, *Distributive Values in Copyright*, 83 TEX. L. REV. 1535, 1540-41 (2005).

264. For example, Germany. *See, e.g.*, Schulbuch, Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court] July 7, 1971, 31 ENTSCHEIDUNGEN DES BUNDESVERFASSUNGSGERICHTS [BVERFGE] 229 (240) (Ger.); *see also* CATHARINA MARACKE, DIE ENTSTEHUNG DES URHEBERRECHTSGESETZES VON 1965 [THE FORMATION OF THE COPYRIGHT ACT OF 1965] 729 (2003) (Ger.); F. Willem Grosheide, *Paradigm's in Copyright Law*, *in* OF AUTHORS AND ORIGINS: ESSAYS ON COPYRIGHT LAW 205, 207 (Brad Sherman & Alan Strowel eds., 1994); Murray, *supra* note 72, at 416.

potentially serve such distributive purposes, rather than utilitarian purposes.

Indeed, looking at the documented debate and case law on the U.S. Copyright Act of 1976, there are two main reasons given for the introduction of author termination rights. One argument is that authors are at a bargaining disadvantage with dealing with publishers.[265] Allowing them a chance to terminate unremunerative agreements later on endeavors to reduce some of the publishers' bargaining leverage.[266] The other reason is the high uncertainty surrounding the success and failure of creative works.[267] Because neither party is sufficiently able to foresee the future value of the copyright at the time of the agreement, the termination right serves to correct any imbalance caused by inaccurate predictions.

Some prior literature, in answering the question of how the details of author termination rights are to be interpreted as the law comes into full effect over the next few years, bases its answer on either of these reasonings.[268] Both of them are essentially distributive, because they intend to reallocate wealth to authors as the deserving or disadvantaged party. Based on the analysis in this Article, however, it seems that both the valuation problem and the issue of bargaining leverage are unfittingly addressed by termination rights.

As seen above, the uncertain future value of artistic works makes it in the author's interest to allocate the risk of success or failure to the publisher. It is one of the reasons why publishers exist in the first place. Allowing authors a termination right will reallocate part of the risk back to the

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265. *See* Mills Music, Inc. v. Snyder, 469 U.S. 153, 172-73 (1985); Marvel Characters, Inc. v. Simon, 310 F.3d 280, 292 (2d Cir. 2002); H.R. REP. NO. 94-1476, at 124 (1976); STUDIES PREPARED FOR THE SUBCOMM. ON PATENTS, TRADEMARKS, AND COPYRIGHTS OF THE COMM. ON THE JUDICIARY, 86TH CONG., 31 RENEWAL OF COPYRIGHT 125 (Comm. Print 1961) (claiming "the author . . . is necessarily in a poor bargaining position"); *see also* Loren, *Renegotiating*, *supra* note 14, at 1345-46.

266. *See* STUDIES PREPARED FOR THE SUBCOMM. ON PATENTS, TRADEMARKS, AND COPYRIGHTS OF THE COMM. ON THE JUDICIARY, 86TH CONG., 31 RENEWAL OF COPYRIGHT 125 (Comm. Print 1961); Loren, *Renegotiating*, *supra* note 14, at 1345-46.

267. *See* Loren, *Renegotiating*, *supra* note 14, at 1346.

268. *See* Loren, *Renegotiating*, *supra* note 14; Menell & Nimmer, *Judicial Resistance*, *supra* note 15; Menell & Nimmer, *Pooh-Poohing*, *supra* note 14.

party least benefited by bearing it. Publishers will reduce what they are willing to pay for copyright grants, because the expected value is necessarily lower: they have no option to recoup money from the author when the work turns out to be unsuccessful, yet are subject to a shorter exploitation period when the value of the work turns out to be high. In the latter case, a small subset of highly successful authors (or their statutory successors) will get paid well the second time, but the majority will receive less *ex ante*. While this could theoretically fit into a utilitarian justification for termination rights, as discussed above, it is unlikely what Congress envisioned in their focus on the disadvantaged creator. Authors are essentially giving up part of their initial payment in return for a highly uncertain chance of reward thirty-five years down the road.[269] If the intent behind the law is to correct the "imbalance" that results from the difficulty of predicting a work's success, it is questionable whether this is actually achieved by giving only (successful) authors and statutory successors the possibility to negotiate for more money *ex post*.

This brings us to the other argument of bargaining leverage. It could be plausible that authors are generally at a bargaining disadvantage in dealing with publishers in practice.[270] For example, a limited number of publishers in a market will create imbalances in negotiating with a far larger number of authors.[271] Large numbers of actors in a market can band together to increase their leverage, and authors' guilds may be effectual in some industries. Yet the stories of bought-out authors are persistent[272] and it thinkable that allowing these particular authors a

269. And quite possibly not until after their death.

270. *See* Darling, *supra* note 98, at 506-15; *see also* sources cited *supra* note 265. *But see* Rub, *supra* note 15, at 78-85 (rejecting the notion of authors as the weaker party in some, but not all, creative industries).

271. Both bargaining theory and experimental evidence indicate that competition plays a role in price negotiation. *See, e.g.*, Brit Grosskopf, *Reinforcement and Directional Learning in the Ultimatum Game with Responder Competition*, 6 EXPERIMENTAL ECON. 141 (2003); *see also* sources cited *supra* note 95.

272. *See id.*

termination right will give them more leverage in a second negotiation.[273] The above-discussed effects indicate, however, that this will only benefit a small subset of highly successful authors and come at the expense of the rest. Authors who have been successful for such a long period of time will often not need additional bargaining power, because they are now Bob Dylan, for example. In many cases, this will not even be the original author, but rather the statutory successors. If it turns out that authors as a group lose bargaining power and part of their income in the initial copyright assignments,[274] the argument that termination rights generally give authors more leverage needs to be relativized.

In essence, no matter which of these two justifications one chooses, if the effect of this law is to reduce the initial prices that authors can sell their copyrights for, as well as shift the burden of risk back to them, then this outcome poses the question whether the rule is performing its distributive function as intended.

C. *Outlook*

This Article indicates that the introduction of author termination rights is neither in the interest of distributive-oriented nor utilitarian-oriented copyright policy. The normative implication of this result would be to eliminate author termination rights in United States copyright law and look for alternative ways to achieve the goals of the legislature, should such goals still be preferred. Because a legislative solution is difficult to bring about,[275] this Section turns to ways in which the negative effects of termination rights could be reduced within the given legislative framework. As seen above, termination rights will be subject to considerable judicial interpretation in the near future. There is some leeway with regard to the strictness of their

273. Particularly in the case of relationship-specific investments on the part of the publisher. *See supra* Part II.B.

274. For a general discussion on the effects of economic price changes and risk allocation, see *supra* Part II.A.

275. *See infra* note 276.

application, essentially allowing courts to influence some of the costs of author termination rights.

Returning to the open legal questions addressed in the first Part of this Article, courts will soon be asked to decide on issues like the boundaries of works made for hire and inalienability. Assuming we stay within the given framework of the law,[276] this Article indicates that a narrow interpretation of author termination rights may be in the interest of both utilitarian and distributive-based policies. Rather than deciding based on anecdotes of disadvantaged artists at the mercy of publishing conglomerates,[277] courts can take economic factors into account in their decision-making. This would mean interpreting the inalienability of termination rights narrowly, declaring rescissions and copyright re-grants valid in certain cases.[278] It would also mean not hesitating to apply the work made for hire doctrine where it makes economic sense to do so.[279] Judicial interpretation can establish the boundaries of the rights, setting legal precedence for times to come. In the context of author termination rights, courts thus have some space to influence the above-discussed costs and benefits of the law.

CONCLUSION

This Article contributes to the ongoing debate surrounding author termination rights by providing further economic insight. U.S. law grants authors a contract termination right thirty-five years after the license or transfer of their copyrights. This Article argues that, from an

276. Others have made suggestions to change the legislation, e.g. Rub argues for shortening the time period before termination of transfer can be exercised and restructuring the copyright post-termination as a liability versus a property rule. *See* Rub, *supra* note 15, at 123. The insights from this Article support these suggestions. However, its policy recommendations (to the extent that they are made) remain focused on the given framework and what immediate changes are possible and realistic (i.e. common-law judicial interpretation in the many cases on the immediate horizon that will set precedents).

277. *See* Murray, *supra* note 72, at 424 (discussing courts' observable tendency to be influenced by such concerns); *see also* McGilvray, *supra* note 83, at 333-36.

278. *See* Rub, *supra* note 15, at 113-14.

279. *See, e.g.*, Marvel Worldwide, Inc. v. Kirby, 777 F. Supp. 2d 720, 749-50 (S.D.N.Y. 2011).

economic perspective, author termination rights are likely not desirable for authors, publishers, or the general public. Price changes, risk-shifting, hold-up problems, and skewed incentive structures raise questions about the distributive policy argument of author termination rights, and put them at odds with the utilitarian purpose of U.S. copyright law.