

# COPYRIGHT AND CONTRACTS MEET AND CONFLICT: COPYRIGHT PREEMPTION OF CONTRACTS

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*Both copyright law and contract law can regulate certain actions with respect to certain information goods fixed in a tangible medium of expression. However, because contracts can regulate what copyright leaves unregulated and free to exploit, there is tension between the two.*

*The enforceability of such contracts is typically being discussed under the auspice of copyright preemption doctrine. Two main approaches emerged in the numerous decisions on this topic. The first approach suggests that contracts are never preempted. The competing approach holds that preemption should be found where a contract regulates an activity that is an exclusive right, such as reproduction or distribution. The Article suggests that while both approaches are supported by well-established narratives in copyright law discourse, they are both misguided.*

*The Article explores several features of copyrighted goods that might, when taken together, make some contracts undesirable from a copyright law policy perspective. The Article concludes that standard-form-agreements that make the copying of an idea or a minor expression illegal, should typically be preempted by the Copyright Act. Most other contracts, including negotiated contracts over ideas, which are quite common, should survive preemption.*

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INTRODUCTION

Copyright law is a system of legal norms that govern certain actions with respect to creative works fixed in a tangible medium of expression.<sup>1</sup> Contracts allow individuals to create legal norms with respect to creative (or non-creative) works that are fixed (or not fixed) in a tangible medium of expression. Thus, there is a certain overlap between the two areas of the law. This overlap can create tension.

This Article focuses on the legal relationship between the copyright owners and the consumers who buy copies of their works. Copyright law prohibits buyers from taking certain actions, such as mass commercial copying, in copyrighted items they purchase.<sup>2</sup> However, in many respects, these limitations are narrow. Copyright liability cannot be found with respect to information that is outside the subject matter of copyright, in particular ideas and facts.<sup>3</sup> It applies only to actions that are part of the exclusive rights, i.e., reproduction, distribution, public display, and public performance,<sup>4</sup> and not to any other actions that can be taken with copyrighted goods, such as mere usage. And, finally, even with respect to works that are within the subject matter of copyright and with respect to actions that are part of the exclusive rights, the user’s actions might be shielded by one of the many defenses to copyright liability.<sup>5</sup>

Contract law can regulate all that copyright law leaves free to the user, and the

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<sup>1</sup> 17 U.S.C. § 102(a) (2012).

<sup>2</sup> 17 U.S.C. § 106(1) (2012).

<sup>3</sup> 17 U.S.C. § 102(b) (2012); *Feist Publications, Inc., v. Rural Telephone Service Co.*, 499 U.S. 340 (1991).

<sup>4</sup> 17 U.S.C. § 106 (2012).

<sup>5</sup> 17 U.S.C. §§ 107-122 (2012).

caselaw includes examples of contracts the push against all these limitations: contracts over ideas,<sup>6</sup> contracts over facts,<sup>7</sup> contracts that restrict the user's ability to use a copyrighted product,<sup>8</sup> and contracts in which the user promises to refrain from actions that are shielded by a statutory defense.<sup>9</sup>

The enforceability, under contract law, of these contracts, is typically being discussed under the auspice of copyright preemption doctrine. It is frequently argued that because copyright law is part of the federal law and contract law is mostly a creation of the states, these contracts are preempted by the Copyright Act.

This copyright preemption argument was discussed in more than 200 reported decisions. Two main approaches emerged in the caselaw. The first approach originated in 1990<sup>10</sup> but it became recognized with and is commonly attributed to the 1996 decision of the Seventh Circuit in *ProCD v. Ziedenberg*.<sup>11</sup> Under this approach, which is referred to hereunder as no-contract-preemption approach, copyright law does not preempt contracts. Courts who adopted this view held that because contractual rights, unlike copyright, are in personam and because those rights, again – unlike copyright, are contingent on the defendant's consent, they are different from copyright and therefore not preempted.

The no-contract-preemption approach is inspired by the perception of copyright as property.<sup>12</sup> This narrative, which existed in copyright discourse for decades, focuses on the authors and their interests and suggests that copyright law incentivizes creation by creating property rights in information goods. Property rights are typically transferable and they are the basis of trade.<sup>13</sup> This narrative seems to be closely related to the libertarian narrative and the viewpoint of some law and economics scholars. Specifically, the Coase Theorem suggests that as long as transaction costs are low enough, the main goal of the legal system is to clearly define property rights and enforce contracts that trade in these rights.<sup>14</sup> Some of the proponents of the no-contract-preemption approach, including Judge Frank Easterbrook, who authored the Seventh Circuit decision in *ProCD*, uses the logic of the Coase Theorem to justify this approach.<sup>15</sup> The no-contract-preemption approach has become popular in recent years and it is arguably the current precedence in the

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<sup>6</sup> See, e.g., *Montz v. Pilgrim Films & Television, Inc.*, 649 F.3d 975 (9th Cir. 2011) (en banc); *Forest Park Pictures v. Universal Television Network, Inc.*, 683 F.3d 424 (2d Cir. 2012).

<sup>7</sup> See, e.g., *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996).

<sup>8</sup> See, e.g., *Natl. Car Rental System, Inc. v. Computer Associates Intern., Inc.*, 991 F.2d 426 (8th Cir. 1993); *Acorn Structures, Inc. v. Swantz*, 846 F.2d 923 (4th Cir. 1988).

<sup>9</sup> See, e.g., *Bowers v Baystate Technologies, Inc.*, 320 F.3d 1317, 1326 (Fed Cir 2003); *Davidson & Associates v Jung*, 422 F3d 630, 639 (8th Cir 2005).

<sup>10</sup> *Taquino v. Teledyne Monarch Rubber*, 893 F.2d 1488 (5th Cir. 1990).

<sup>11</sup> *ProCD*, *supra* note 7.

<sup>12</sup> See *supra* Section III.A.

<sup>13</sup> See *supra* note \_\_\_\_.

<sup>14</sup> R. H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 10 (1960).

<sup>15</sup> Frank H. Easterbrook, *Contract and Copyright*, 42 HOUS. L. REV. 953 (2005).

Fifth, Seventh, Ninth, Eleventh, and the Federal Circuit.<sup>16</sup>

A second approach suggests that contracts, as such, are not shielded from preemption. Under this approach, which is referred to hereby as partial-contract-preemption, consent in itself does not make contracts distinguishable enough from copyright claims.<sup>17</sup> Courts should instead examine the contractual promise when deciding if it is preempted or not. Specifically, preemption should be found when the contract regulates an activity that is an exclusive right, such as reproduction or distribution.<sup>18</sup> This approach is also supported by a well-established narrative in copyright law discourse — the delicate balance narrative.<sup>19</sup> This narrative suggests that copyright law creates a delicate balance between competing interests: those of authors, distributors, and users. This delicate balance should be protected against easy changes by contracts. This approach was popular in the 1980s and the early 1990s. It became less popular in recent years and it is currently the likely precedent in the Sixth and Eighth Circuits.<sup>20</sup> The Second Circuit still did not choose whether to adopt one of these approaches<sup>21</sup> and the Southern District of New York, which is within the Second Circuit’s jurisdiction, which issued more decisions than any other court on this topic, is notoriously inconsistent in choosing which approach to follow.<sup>22</sup>

This Article suggests that the two approaches are misguided. The main fallacy of the partial-contract-preemption approach is that it fails to come up with a test that separates contracts that should be enforced from those that should not.<sup>23</sup> Even if one strongly believes that copyright law is primarily a system that creates and preserves a delicate balance, it is unclear why this balance should lead to a refusal to enforce contracts that regulate activities that are exclusive rights. Indeed, it is shown that this test is not only difficult to administer and somewhat arbitrary, but in many common scenarios it can lead to absurd results.<sup>24</sup> It is sometimes too narrow and allows certain contracts that seem undesirable to escape preemption and it is sometimes too broad by preempting common and reasonable contracts, such as confidentiality agreements, as they control the distribution of factual information.

The competing approach, no-contract-preemption, is very easy to administer and it respects the principles of freedom of contracts. However, this approach seems to take the idea of freedom of contracts, the trust that the Coase Theorem

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<sup>16</sup> See *supra* notes 103 - 108 and the accompanying test.

<sup>17</sup> See, e.g., *Wrench LLC v. Taco Bell Corp.*, 256 F.3d 446 (6th Cir. 2001).

<sup>18</sup> *Id.*

<sup>19</sup> See *supra* Section III.B.

<sup>20</sup> See *supra* notes 115 - 116 and the accompanying test.

<sup>21</sup> See *Forest Park Pictures*, *supra* note 6.

<sup>22</sup> Compare *Am. Movie Classics Co. v. Turner Entm't Co.*, 922 F. Supp. 926, 931 (S.D.N.Y. 1996) (applying the partial-contract-preemption approach) with *Architectronics, Inc. v. Control Sys., Inc.*, 935 F. Supp. 425, 438 (S.D.N.Y. 1996) (applying the no-contract-preemption approach).

<sup>23</sup> See *supra* Section IV.A.

<sup>24</sup> *Id.*

places on the market, and the related metaphor of copyright as property, too far.<sup>25</sup> Copyright law is a property right, but it is one that is quite different from real and even personal property. The markets for copyrighted goods are minefields of market failures and they demand special analysis prior to the application of unrestricted contractual freedom. Transactions costs, in particular, are a significant problem in these markets and, as suggested by Ronald Coase himself,<sup>26</sup> they require hesitation before the market can be trusted to lead to desirable results.

This Article suggests that several features of copyrighted goods might, when taken together, make some contracts undesirable from a copyright law policy perspective. First, information goods are not just the product of the creative process, but also the input in it. Therefore, expanding the control of the copyright owner over the information goods she create, as facilitated by contracts, raises the cost of creation for future authors. Therefore, more control can typically increase both the benefits and costs of creation. It is thus possible that authors, as a group, will prefer less control over more control, and if that is the case, the law should enforce this social contract.

Second, the number of information goods that are used as input in the creative process is very high. A typical creative work can easily use hundreds of previously created information goods as input. The non-rivalrous nature of information makes such usage very easy and it might even foster subconscious use. This can lead to the emergence of a risky situation in which the use of a resource (in this case a new creative work) requires the consent of many right holders (in this case the copyright owners of the works that were used in the creation of a new work). In such a case, called a tragedy of the anticommons, holdouts are expected, and socially inefficient underuse is likely.<sup>27</sup> Luckily, there are doctrines in copyright law that address the situation. This Article explains that the idea-expression distinction,<sup>28</sup> together with the substantial similarity tests,<sup>29</sup> create a high threshold for using creative works as input in the creative process. Thanks to these doctrines, only a small fraction of the works used require a license and therefore the tragedy of the anticommons is significantly mitigated and usually avoided altogether.

Contracting around norms that tackle the tragedy of the anticommons can thus be socially undesirable. It is shown that as long as transaction costs are low enough, the parties can avoid this tragedy themselves. However, standard-form-agreements operate and facilitate contracting in a high transaction-cost environment. Therefore, a standard-form-agreement, which makes the copying of ideas or the copying of minor expression illegal, should typically be preempted by the Copyright Act. Most

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<sup>25</sup> See *supra* Section IV.B.

<sup>26</sup> Coase, *supra* note 14.

<sup>27</sup> See generally Michael A. Heller, *The Tragedy of the Anticommons: Property in the Transition from Marx to Markets*, 111 HARV. L. REV. 621 (1998).

<sup>28</sup> 17 U.S.C. § 102(b) (2012).

<sup>29</sup> *Arnstein v. Porter*, 154 F.2d 464, 472 (2d Cir. 1946).

other contracts, including negotiated contracts over ideas, which are quite common, should survive preemption.

This Article proceeds as follows. Part I shows how contracts can complete copyright policy but can also provide norms that seems to extend the scope of copyright protection. Part II explores the doctrine of copyright preemption and its application to the preemption of contracts. It introduces the two approaches that were developed in the caselaw with respect to copyright preemption of contracts. Part III identifies the doctrinal basis of these two approaches and the well-established narratives that support them. Part IV explains that the two approaches fail to come up with a socially desirable test to copyright preemption. The no-contract-preemption approach leads to the enforcement of contracts that conflict with copyright policy and the partial-contract-preemption approach is unable to come up with a test that will reasonably identify those contracts that should be preempted. Finally, Part V shows that by focusing on the market failures in the market for copyrighted goods, and especially on the problem of high transaction costs, categories of contracts that should or should not be preempted can be identified.

## PART I: CONTRACTS AND COPYRIGHT MEET AND CONFLICT

### A. *Copyright Meet Contracts*

Copyright law consists of legal norms that govern certain actions with respect to creative works fixed in a tangible medium of expression.<sup>30</sup> Contracts allow individuals to create legal norms with respect to creative (or non-creative) works that are fixed (or not fixed) in a tangible medium of expression. This Part explains how this potential overlap can create tension between the two legal regimes.

In many respects copyright and contracts complete one another. While in theory copyright law can operate without contracts — copyright is created at fixation and it protects the author's against reproduction — in practice copyright law cannot achieve its goals without trade, and trade cannot efficiently operate without contracts. As the main goal of copyright law, at least in the United States,<sup>31</sup> is to provide incentives to engage in creative activity, achieving this goal requires the creator to trade the products of his or her creative labor for compensation. Contracts are common at all stages of creations. They, for example, can form the legal relationship between joint authors or establish a work made for hire status, create the obligations and rights between authors and their publisher, dictate the arrangements between publishers, distributors, and retailers, and set certain rights

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<sup>30</sup> 17 USC § 102(a) (2012).

<sup>31</sup> Other legal systems, in particular civil law jurisdictions, justify copyright law on other grounds and, in particular, on the author's natural rights. *See generally* Jane C. Ginsburg, *A Tale of Two Copyrights: Literary Property in Revolutionary France and America*, 64 TUL. L. REV. 991 (1990) (exploring the different justifications for copyright law under French and United States law).

and duties of the consumer of copyrighted goods. This Article focuses on this last form of legal relationship: the rights and obligations of users with respect to certain information goods.

Copyright law itself implicitly acknowledges the importance of trade as it includes detailed rules that define the rights that a buyer and a licensee of copyrighted good has with respect to copies of copyrighted goods. Thus, when Charlie writes a book and sells a copy of it to Dan for \$50, copyright law dictates that Dan is able, *inter alia*, to read the book, resell it,<sup>32</sup> and discard the book but he cannot, subject to certain exceptions, create copies of the book,<sup>33</sup> read it out loud in public,<sup>34</sup> or write a sequel.<sup>35</sup> These latter actions, which cannot be taken without the permission of the copyright owner, are called exclusive rights. Copyright law itself does not force Dan to pay for the book but such an obligation can easily be enforced under contract law.<sup>36</sup>

This is the starting point of the journey. The difficult question that this Article addresses is to what extent the parties are allowed to deviate from these arrangements.

#### *B. How can Copyright and Contracts Conflict: Expending Rights in Information Goods*

The previous Section presents the basic bundle of rights that a buyer receives when purchasing copyright goods. This Section introduces the problems that arise when there are deviations from these arrangements

Some deviations seem unproblematic. The Copyright Act expressly states that the copyright owner is free to authorize a user or a licensee to take any action which is part of that owner's exclusive rights.<sup>37</sup> Thus a copyright owner can allow buyers or licensees (or anyone else) to make copies of the work, translate it into another

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<sup>32</sup> 17 U.S.C. § 109(a) (2012).

<sup>33</sup> 17 U.S.C. § 106(1) (2012).

<sup>34</sup> 17 U.S.C. § 106(4) (2012).

<sup>35</sup> 17 U.S.C. § 102(2) (2012).

<sup>36</sup> While a breach of a contractual obligation, such as a promise to pay, is not in itself an infringement of copyright, in some cases it can indirectly lead to liability under copyright law. For example, if a publisher-licensee breaches a condition in a publishing agreement and continues to distribute copies of the protected work, then the distribution is an infringement of copyright.

In the context of software and digital content the line between a breach of contract and copyright infringement is very fine, almost nonexistent. Software cannot be used without being copied to the computer's internal memory. Because copyright is an exclusive right, 17 U.S.C. § 106(1) (2012), every user of software must have a license that would permit her to create temporary copies as part of the standard usage. It follows that a breach of any condition in this license agreement is likely to result in copyright liability. *See MDY Indus., LLC v. Blizzard Entm't, Inc.*, 629 F.3d 928 (9th Cir. 2010).

<sup>37</sup> 17 U.S.C. § 106 (2012) (“... the owner of copyright ... has the exclusive rights to do and to authorize and of the following...”).

language, or display it in public.<sup>38</sup>

However, the other kind of deviation, in which the buyer or licensee promises to refrain from an activity that copyright law does not prohibit, is significantly more troubling and has been the source of significant controversy.

The typical situation where copyright policy and freedom of contracts conflict is simple to grasp. The plaintiff — the copyright owner — sells a copy of an information good to the defendant under a contract in which the defendant promises to refrain from an act that is not prohibited by copyright law (or to take an action that is not required by copyright law). After the promise is breached, the plaintiff brings a claim under contract law and the defendant argues that the enforcement of such a promise is inconsistent with copyright policy and is thus preempted.

There are more than 200 published decisions in cases that follow this fact pattern in the last 40 years. The next Part of this Article analyses the preemption argument and the two main approaches in the caselaw to address this challenge. In this Part a more basic question is addressed: where is the alleged conflict? It is shown that the conflict results from the fact that liability for copyright infringement is limited by three sets of doctrines — limitation on subject matter, limitation on infringing actions, and defenses — and contract law allows parties to set legal norms where copyright law does not reach.

The following chart graphically demonstrates this expansion. Copyright law extend only in the dark area, where the work falls within the subject matter of copyright, the defendant actions are part of the exclusive actions, and as long as they don't fall under one of the defenses with respect to copyright liability. The following discussion explains those limitations and the ways in which contract can allow the copyright owner to allegedly circumvent and extend their rights.

	Within copyright subject matter	Outside copyright subject matter
Actions that are exclusive rights	Def.	

<sup>38</sup> Cf., Michael E. Kenneally, *Commandeering Copyright*, 87 NOTRE DAME L. REV. 1179 (2012).



Actions that are not exclusive rights		
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### 1. Contracting around Copyright Subject Matters

Copyright law does not protect all kinds of information goods. A work must fall within the subject matter of copyright in order to be protected. In particular, copyright law does not protect ideas or factual information.

The Copyright Act expressly states that “in no case does copyright protection ... extend to any idea.”<sup>39</sup> This principle, which is as old as copyright law itself, forms the basis of the idea-expression distinction. Under this doctrine, copyright law extends to the expression of ideas but not to the ideas themselves. The Supreme Court held that this principle has a Constitutional aspect as it balances Congress’ power to enact copyright legislation and the principles of freedom of speech under the First Amendment.<sup>40</sup>

Contracts, by contrast, can and often do regulate rights in ideas. The most common fact pattern in which contractual promises with respect to ideas raise concerns from a copyright law perspective has to do with a Desny claim.<sup>41</sup> A Desny claim arises after the plaintiff has pitched an idea for some creative endeavor — a movie,<sup>42</sup> TV or radio show,<sup>43</sup> or commercial campaign<sup>44</sup> — to the defendant, who

<sup>39</sup> 17 U.S.C. § 102(b) (2012).

<sup>40</sup> *Eldred v. Ashcroft*, 537 U.S. 186 (2003); *Golan v. Holder*, 132 S.Ct. 873 (2012).

<sup>41</sup> These types of claims are called Desny because the legal theory on which they are based was established in a famous case called *Desny v. Wilder*, 46 Cal. 2d 715 (Sup. Ct. Cal. 1956). In that case the Supreme Court of California found that the renowned screenwriter Billy Wilder has made an implicit contractual promise to pay Victor Desny if Wilder would use an idea for a movie that Desny pitched. Wilder breach this implied-in-fact contract when it created the movie *Ace in the Hole* without paying Desny.

<sup>42</sup> See *Desny v. Wilder*, *supra* note 41 (an idea to produce the movie was used in the production of “*Ace in the Hole*,” copyright preemption was not discussed in this case); *Smith v. Weinstein*, 578 F. Supp. 1297 (S.D.N.Y. 1984) *aff’d*, 738 F.2d 419 (2d Cir. 1984) (an idea to the screenplay was allegedly used in the production of “*Stir Crazy*”)

<sup>43</sup> *Trenton v. Infinity Broad. Corp.*, 865 F. Supp. 1416 (C.D. Cal. 1994) (an idea to produce a new format of a radio show allegedly result in the popular show “*loveline*”); *Montz v. Pilgrim Films & Television, Inc.*, 649 F.3d 975 (9th Cir. 2011) (en banc) (an idea for a television show that would follow a team of paranormal investigators conducting field investigations was allegedly turned into the TV show *Ghost Hunters*); *Forest Park Pictures v. Universal Television Network, Inc.*, 683 F.3d 424, 428 (2d Cir. 2012) (an idea for a show revolving around a doctor that, after being expelled from the medical community for treating patients who could not pay, becomes a “conciierge” doctor to the rich and famous, was allegedly used in the production of the show “*Royal Pains*”).

<sup>44</sup> *Wrench LLC v. Taco Bell Corp.*, 256 F.3d 446 (6th Cir. 2001) (an idea to run a campaign for Taco Bell starring a Chihuahua was allegedly later used by Taco Bell); *Garrido v. Burger King Corp.*, 558 So. 2d 79 (Fla. 3d Dist. App. 1990) (an idea for a campaign for Burger King under the slogan

rejected the pitched idea but later used it. Contract law in many states holds that an implied-in-fact contract<sup>45</sup> exists in such a case and that this contract includes a promise by the defendant to pay to the plaintiff for the fair value of the pitched idea, if it is later used. In this way, contracts allegedly limit the distribution and the use of ideas, which copyright law explicitly excludes from protection.<sup>46</sup>

Factual information is also not within the scope of copyright protection. In *Feist v. Rural* the Supreme Court held that facts are not protected by the current Copyright Act, and because they lack creativity, Congress is not authorized by the Constitution to protect them by copyright in the future.<sup>47</sup>

In doing so, the Court rejected the doctrine of sweat-of-the-brow —recognized by most lower-courts at the time — which suggested that labor intensive collection of facts — e.g., in building a database – can be protected by copyright. However, while the reproduction or distribution of facts (and thus databases) is not copyright infringement,<sup>48</sup> it can constitute a breach of contract. In a famous case, *ProCD v. Zeidenberg*,<sup>49</sup> the plaintiff, ProCD, spent millions in assembling an electronic phone book, and sued the defendant for an alleged breach of a contractual promise to refrain from commercial use the not-copyrightable database. In another case the defendant was sued for breaching a contract that prohibited the reproduction of statistical information regarding jury decisions which was included in the plaintiff's

“It's my town, it's my Burger King” was allegedly used in creating the ad campaign under the slogan “Burger King Town.”)

<sup>45</sup> An implied-in-fact contract is “founded upon a meeting of minds, which, although not embodied in an express contract, is inferred, as a fact, from conduct of the parties showing, in the light of the surrounding circumstances, their tacit understanding.” *Baltimore & O.R. Co. v. United States*, 261 U.S. 592, 597 (1923). It is crucial to distinguish implied-in-fact claims, such as those discussed in a *Desny* claim, from implied-in-law claims (also called quasi contracts claims). The former create are based on a legal obligation that, like any other contractual claim, is based on the parties' consent, while the latter are not contracts at all as the legal obligation is not the result of consent but of unjust enrichment. See *Baltimore & O.R. Co., id.* (“[in] agreement ‘implied in law,’ more aptly termed a constructive or quasi contract ... by fiction of law, a promise is imputed to perform a legal duty, as to repay money obtained by fraud or duress”). The copyright preemption analysis for implied-in-law agreements, or unjust enrichment, which is beyond the scope of this Article, is dramatically different from the analysis of contractual, including implied-in-fact, contractual claims. *Cf., Worth v. Universal Pictures, Inc.*, 5 F. Supp. 2d 816, 821-22 (C.D. Cal. 1997) (holding that a *Desny* like claim is preempted by the Copyright Act because “a breach of an implied contract is a species of quasi contract,” *id.* At 822, thus clearly confusing implied-in-fact and implied-in-law agreements); *Fischer v. Viacom Int'l, Inc.*, 115 F. Supp. 2d 535, 541-42 (D. Md. 2000) (lumping together decisions that discuss implied-in-fact and implied-in-law contracts).

<sup>46</sup> *Cf., Yochai Benkler, Free As the Air to Common Use: First Amendment Constraints on Enclosure of the Public Domain*, 74 N.Y.U. L. REV. 354 (arguing that the distribution of ideas should be free for most legal restrictions).

<sup>47</sup> *Feist Publications, Inc., v. Rural Telephone Service Co.*, 499 U.S. 340 (1991).

<sup>48</sup> It should be noted that facts cannot be protected as such but the selection, coordination, and arrangement of facts is typically protected. 17 USC 103. Therefore, some collations of factual information is, to a degree, protected against reproduction and distribution.

<sup>49</sup> 86 F.3d 1447 (7th Cir. 1996).

publication.<sup>50</sup>

Thus, these contracts allegedly blur the line drawn by copyright law between protected and non-protected work. In the chart below such contracts represent expansion of the scope of protection along horizontal line.

	Within copyright subject matter	Outside copyright subject matter
Actions that are exclusive rights		
Actions that are not exclusive rights		

2. Contracting around the Exclusive Rights

Copyright law limits the rights of buyers of copyrighted goods. They are prohibited from taking certain actions with their purchased goods. However, these actions, called exclusive rights, are quite limited. Subject to the general defenses to copyright liability, which will be discussed in the next section, buyers are not allowed to reproduce the copyrighted good,<sup>51</sup> to create a derivative work of it,<sup>52</sup> distribute it,<sup>53</sup> and publicly display and perform it.<sup>54</sup> They are, however, allowed to take any other actions with respect to the copyrighted goods without the authorization of the copyright owner. Indeed, unlike the Patent Act,<sup>55</sup> the Copyright Act does not include an exclusive right to use the work and therefore any use that does not include reproduction, distribution and the like is not copyright infringement.

Contracts, however, might include promises that limit other actions that can be taken with respect to the work, and in particular, they can limit the ways in which the work is used. For example, in one famous case, the court was asked to enforce a

<sup>50</sup> Lipscher v LRP Publications, Inc, 266 F.3d 1305 (11th Cir 2001).

<sup>51</sup> 17 U.S.C. § 106(1) (2012).

<sup>52</sup> 17 U.S.C. § 106(2) (2012).

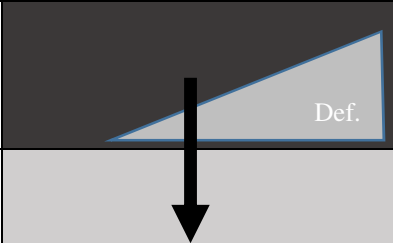
<sup>53</sup> 17 U.S.C. § 106(3) (2012). This right is significantly limited by the first sale doctrine. 17 U.S.C. § 109(a) (2012).

<sup>54</sup> 17 U.S.C. § 106(3)(4) (2012).

<sup>55</sup> 35 U.S.C. § 154.

promise not to use certain copyrighted architectural plans to build a building.<sup>56</sup> In another famous case, the plaintiff tried to enforce a promise to use software for the exclusive benefits of the promisor and not third parties.<sup>57</sup>

Some contracts, therefore, can be perceived as expanding the scope of copyright protection along the vertical axis to actions that are not part of the exclusive rights.

	Within copyright subject matter	Outside copyright subject matter
Actions that are exclusive rights		
Actions that are not exclusive rights		

### 3. Contracting around Defenses

While the conditions explored so far — that the work will be within the subject matter of copyright and that the defendant’s actions would be one of the exclusive rights — are required to find liability for copyright infringement, they are not sufficient. Another important condition is a negative one — the lack of a relevant defense. Indeed, many activities that include the copying or distributing of copyrighted protected materials are shielded by one of the dozens defenses that copyright law provide.<sup>58</sup> Contract liability, however, is not limited by the defenses to copyright liability and therefore a contract might include a promise to refrain from activities that are explicitly covered by a defense to copyright infringement.

The most important defense is fair use. Under copyright law,<sup>59</sup> certain usages, while involving any or several of the exclusive rights, are nevertheless fair and thus non-infringing. The fair use defense was described as “necessary to fulfill copyright's very purpose”<sup>60</sup> and as one of the few doctrines of copyright law with a

<sup>56</sup> *Acorn Structures, Inc. v. Swantz*, 846 F.2d 923 (4th Cir. 1988).

<sup>57</sup> *Natl. Car Rental*, *supra* note 8.

<sup>58</sup> Most of the defenses to copyright liability are found in section 107 through 122 of the Copyright Act. Section 106, which is the source for copyright liability, is explicitly made “[s]ubject to sections 107 through 122”

<sup>59</sup> Codified in 17 U.S.C. § 107 (2012).

<sup>60</sup> *Campbell v. Acuff-Rose Music, Inc.*, 510 U.S. 569, 575 (1994) (“[f]rom the infancy of copyright protection, some opportunity for fair use of copyrighted materials has been thought necessary to fulfill copyright's very purpose”).

Constitutional aspect.<sup>61</sup> Contractually, however, buyers and licensees can waive their rights to fairly use a copyrighted good and thus fair use might be weakened. Contracts that include a waiver of fair use have, on one hand, troubled commentators<sup>62</sup> but they have rarely been litigated<sup>63</sup> and might be uncommon. One important exception has to do with reverse engineering. The Ninth Circuit held that reverse engineering of software — the process of extracting certain design information from computer programs, typically for interoperability purposes — is usually fair use.<sup>64</sup> Thus, although reverse engineering typically includes the creation of temporary copies of copyright protected software, it is not an infringement of copyright. Software companies might include a contractual promise not to reverse engineer their product in their End User License Agreements (EULAs). These contractual provisions, which are common in software licenses,<sup>65</sup> were challenged as they limit the scope of fair use.<sup>66</sup>

Of course fair use is not the only defense under the Copyright Act and other defenses have also been contracted around. For example, the Copyright Act includes a specific provision that shields the making and distribution of a photograph of useful articles in connection with advertisements.<sup>67</sup> Therefore, if a publisher has a license to print a copyrighted work on the cover of a DVD, the publisher does not need a separate license to include pictures of the DVD cover in advertisements. However, the publisher might promise not to do so, and such a promise, if enforceable, might limit the scope of the defense under copyright law.<sup>68</sup>

Another important defense to copyright liability, the first sale doctrine, is a special case that deserves separate discussion.<sup>69</sup> The right to distribute copies of copyrighted works is one of the exclusive rights that a copyright owner has. However, this right is significantly limited by the first sale doctrine, which states that an owner of a lawfully made copy “is entitled ... to sell or otherwise dispose of the possession of that copy.”<sup>70</sup> A contractual promise that limits the transferability

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<sup>61</sup> Together the idea-expression distinction, *see supra* note 39, the doctrine creates a balance between Congress’ power to enact copyright legislation and the principles of freedom of speech under the First Amendment. Golan, *supra* note 39.

<sup>62</sup> [TBA]

<sup>63</sup> [TBA: statistics on the number of cases in which a waiver of fair use was litigated. In the appellate level there are probably only two such decision: *Bowers v Baystate Technologies* and *Davidson & Associates v Jung*]

<sup>64</sup> *Sega Enterprises Ltd. v. Accolade, Inc.*, 977 F.2d 1510 (9th Cir. 1992); *Sony Computer Entertainment, Inc. v. Connectix Corp.*, 203 F.3d 596 (9th Cir. 2000).

<sup>65</sup> [TBA]

<sup>66</sup> *Bowers v Baystate Technologies, Inc.*, 320 F.3d 1317, 1326 (Fed Cir 2003); *Davidson & Associates v Jung*, 422 F.3d 630, 639 (8th Cir 2005).

<sup>67</sup> 17 U.S.C. § 113(c) (2012).

<sup>68</sup> There are the facts of *Major v. Sony Music Ent., Inc.*, 1992 WL 210115 (S.D.N.Y. 1992),

<sup>69</sup> *See generally*, Guy A. Rub, *Rebalancing Copyright Exhaustion*, 63 EMORY L. J., section VI.E (forthcoming 2015).

<sup>70</sup> 17 U.S.C. § 109(a) (2012).

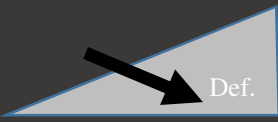
of copyrighted copies can thus restrict the scope of the first sale doctrine. However, in practice, such a conflict may not arise because the Copyright Act might offer an easier way to circumvent the first sale doctrine. The first sale doctrine is available to only owners of copyrighted goods and not to licensees. Under Ninth Circuit precedent the seller needs to only state in the contract that the transaction is a license and not a sale and then the rights of the buyer (now classified as a mere licensee) — and any future buyers (similarly now classified as licensees) to transfer copies are severely limited.<sup>71</sup> Therefore, in the Ninth Circuit there is no practical need to limit the first sale doctrine by a contractual cause of action but the contract can actually create a cause of action under copyright law against any possessor of the copyrighted good.

Under the Second Circuit approach, the result might be different. The Second Circuit decides whether a buyer is indeed a buyer or a mere licensee by examining the “economic realities” of the transaction. Therefore, if a transaction looks like a sale, the Second Circuit will treat it as such and thus apply the first sale doctrine.<sup>72</sup> In such a case, a seller might resort to contract law to enforce limitations on transferability. Such a case did not yet arise.

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<sup>71</sup> *Vernor v. Autodesk, Inc.*, 621 F.3d 1102 (9th Cir. 2010).

<sup>72</sup> *Krause v. Titleserv, Inc.*, 402 F.3d 119 (2d Cir. 2005).

	Within copyright subject matter	Outside copyright subject matter
Actions that are exclusive rights		
Actions that are not exclusive rights		

4. Redundancy and procedural limitations

There are cases in which defendants argue that a contractual promise is preempted by the Copyright Act even when it does not fall under one of the three categories described above. Many of those promises can be called redundant promises because they have to do with actions that are already prohibited by copyright law, typically the reproduction or distribution of copyrighted work. For example, in somewhat common fact pattern, the parties enter a contract that allows the defendant to create copies of the plaintiff’s work on the condition that no more than a certain number of copies will be created. The defendant creates additional copies or uses the work in a way that exceeds the condition.<sup>73</sup> In such a case, the defendant’s actions constitute copyright infringement and the contractual cause of action is somewhat redundant, partly because the remedies offered by copyright law are typically superior to those offered by contract law.<sup>74</sup> Thus, the decision on whether the contractual claim is preempted might not be of significance from a practical perspective.

In some unusual cases, a claim that might seem redundant can actually benefit the copyright owner because, for some reason, a copyright cause of action is barred. In these cases the contractual claim might possibly conflict with the copyright policy that barred the copyright claim. In one such unusual case, the short statute of

<sup>73</sup> See, e.g., *Wolff v. Inst. of Elec. and Electronics Engineers, Inc.*, 768 F. Supp. 66 (S.D.N.Y. 1991).

<sup>74</sup> The main remedy under contract law is expectation damages. Under the Copyright Act damages are set at “the copyright owner’s actual damages and any additional profits of the infringer, as provided by subsection,” 17 U.S.C. § 504(a)(1) (2012), which seems to, by definition, be higher than expectation damages. In addition the Copyright Act allows the plaintiff to collect statutory damages, 17 U.S.C. § 504(c) (2012), and is more generous in granting equitable remedies.

limitations period under the Copyright Act<sup>75</sup> ran out and so the copyright owner could arguably only bring a contractual cause of action claim.<sup>76</sup> In another case, the copyright claim was not available because the plaintiff did not comply with the required copyright formalities, and so it relied on a contractual cause of action.<sup>77</sup> Thus, in these cases, contracts do not expand the substantive rights of the copyright owner but they expand her ability to bring suit.

PART II: THE PARTIAL-PREEMPTION-APPROACH AND THE NO-PREEMPTION-APPROACH

A. *Copyright Preemption in General*

Courts address the conflict between contracts and copyright policy mainly through the doctrine of preemption.<sup>78</sup> The Supremacy Clause of the Constitution states that “the Laws of the United States shall be the supreme law of the land.”<sup>79</sup> From this Clause emerged the federal preemption doctrine under which “state laws that conflict with federal law are without effect.”<sup>80</sup> The Supreme Court held that Congress has the power to preempt state law and that this preemption power can be exercised through express prohibition (expressed preemption), through an explicit or implicit desire of Congress to “occupy the field” (field preemption) or when there is a conflict between the state and federal law (conflict preemption).<sup>81</sup> Preemption is found “where it is impossible for a private party to comply with both state and federal law ... and where under the circumstances of a particular case, the challenged state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.”<sup>82</sup>

The last time the Supreme Court addressed copyright preemption was in *Goldstein v. California*, which was decided prior to the enactment of the Copyright Act of 1976.<sup>83</sup> In this case the Court held that the Constitution does not preclude states from creating their own copyright-like mechanisms, and that Congress did not intend to “occupy the field” and therefore states are free to grant exclusive

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<sup>75</sup> 17 U.S.C. § 507(b) (2012) (“No civil action shall be maintained under the provisions of this title unless it is commenced within three years after the claim accrued”).

<sup>76</sup> *Ritchie v Williams*, 395 F.3d 283 (6th Cir. 2005).

<sup>77</sup> *Rachel v. Banana Republic, Inc.*, C-85-3786-MHP, 1985 WL 26030 (N.D. Cal. 1985) *aff'd in part, rev'd in part*, 831 F.2d 1503 (9th Cir. 1987). It should be noted that the formality that the plaintiff failed to comply with in this case — the notice requirement — was later abolished by the Berne Convention Implementation Act of 1988.

<sup>78</sup> This is of course not the only possible doctrinal venue to address the potential conflict although it is by far the most common one. Other doctrines might be found both in federal law, e.g., copyright misuse, and in state contract law, e.g., public policy and unconscionability.

<sup>79</sup> U.S. Const. art. VI, cl. 2.

<sup>80</sup> *Altria Grp., Inc. v. Good*, 555 U.S. 70, 76 (2008).

<sup>81</sup> *Crosby v. Nat'l Foreign Trade Council*, 530 U.S. 363, 372-73 (2000).

<sup>82</sup> *Id.*

<sup>83</sup> 412 U.S. 546 (1973).



rights to authors.<sup>84</sup> The Court therefore examined whether the specific state law in question in that case conflicted with the purpose and policy of the Copyright Act of 1909, and concluded that it does not.<sup>85</sup> Finally, the Court stated that Congress has the power to dictate national policy in the protection or the lack of protection of certain types of “writings.”<sup>86</sup> In 1976, when Congress revised the Copyright Act, it did just that.

*B. Expressed Preemption: Section 301(a)*

Congress used its power of expressed preemption when it enacted section 301(a) of the Copyright Act of 1976. This section reads:

*all legal or equitable rights that are equivalent to any of the exclusive rights within the general scope of copyright as specified by section 106 in works of authorship that are fixed in a tangible medium of expression and come within the subject matter of copyright as specified by sections 102 and 103 ... are governed exclusively by this title. Thereafter, no person is entitled to any such right or equivalent right in any such work under the common law or statutes of any State.*

Since the passage of the Copyright Act, copyright preemption of contracts is discussed almost exclusively in the context of Section 301(a).<sup>87</sup> The Supreme Court

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<sup>84</sup>*Id.*

<sup>85</sup> *Id.* In that case a 5-4 majority of the Court concluded that California may prohibit the copying of sound recordings that were not protected by the Copyright Act at the time because Congress “has left the area unattended, and no reason exists why the State should not be free to act.” *Id.*, at 570.

<sup>86</sup> *Id.*, at 559.

<sup>87</sup> There are some instances in which courts apply conflict preemption analysis to the Copyright Act, and ask whether a specific state law conflicts with the purpose or the policy behind the Copyright Act, without relying on section 301(a), but they are not common. In the context of preemption of contracts, the discussion is almost exclusively within the auspice of section 301(a). One exception is *Vault Corp. v. Quaid Software Ltd.*, 847 F.2d 255 (5th Cir. 1988). However, this decision actually did not discuss a preemption of a specific contract, but the preemption of the Louisiana Software License Enforcement Act, which permitted a software producer to impose certain terms upon purchasers, including prohibiting reverse engineering, provided that the terms are set forth in a license agreement. The Fifth Circuit found that the Louisiana Act was preempted because “The provision in Louisiana's License Act, which permits a software producer to prohibit the adaptation of its licensed computer program by decompilation or disassembly, conflicts with the rights of computer program owners under § 117 and clearly ‘touches upon an area’ of federal copyright law.” *Id.*, at 269. The Fifth Circuit, unlike the district court in the same case, reached this conclusion without referring to section 301(a), but instead by relying on Supreme Court precedence regarding the conflict preemption of the Patent Act. This is likely a unique decision because the Louisiana Act might have allowed enforcement of provisions that were not contractually accepted (“[the] license agreement was a contract of adhesion which could only be enforceable if the [Louisiana License Act] is a valid and enforceable statute.” *Id.* at 269). This can also explain how the same court, only three years later, and without even mentioning its previous decision in *Vault Corp. v. Quaid Software*, held that contracts, as such, are not preempted by copyright. *Taquino v.*

never interpreted Section 301. Lower courts however adopted a two-part test for analyzing preemption claims under Section 301:

*First, the work of authorship in which rights are claimed must fall within the “subject matter of copyright” as defined in §§ 102 and 103 of the [Copyright] Act. [Second,] [t]he statute also requires that a state law create “legal or equitable rights that are equivalent to any of the exclusive rights within the general scope of copyright as specified in section 106” if it is to be preempted.*<sup>88</sup>

Thus, the first part of the test required the court to determine if the work in question is “within the subject matter of copyright.” Courts agree that this test must be broadly applied and it must include works that are not protected by copyright, or else states would be free to protect non-protected elements, including facts and ideas, without taking into account the federal policy embodied in the Copyright Act. The Sixth Circuit summarized the dominant approach by stating that “the scope of protection afforded under copyright law is not the same as the scope of preemption. Rather ... the shadow actually cast by the Copyright Act’s preemption is notably broader than the wing of its protection.”<sup>89</sup> There is a broad consensus that contracts over “writings,” whether protect by copyright or not, fall under this first part of the test<sup>90</sup> and therefore their preemption of lack thereof depends on the

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Teledyne Monarch Rubber, 893 F.2d 1488, 1501 (5th Cir. 1990). The only other decision by an appellate court that applied conflict preemption with the copyright act to a contractual claim is Davidson & Associates v. Jung, 422 F.3d 630, 638-39 (8th Cir 2005). In that case the court, in a relatively short decision, partly relied on section 301(a) and decisions that interpret it and partly on conflict preemption and the decision in *Vault Corp. v. Quaid Software*.

<sup>88</sup> Harper & Row Publishers, Inc. v. Nation Enterprises, 723 F.2d 195, 199-200 (2d Cir. 1983) rev’d on other groups, 471 U.S. 539 (1985).

<sup>89</sup> Wrench LLC v. Taco Bell Corp., 256 F.3d 446, 454 (6th Cir. 2001).

<sup>90</sup> I am aware of one decision in which a court held that a contract claim was not preempted just because “[plaintiff’s] cause of action is based upon ... implicit provision of the contract which does not arise out of the subject matter of copyright.” Acorn Structures, Inc. v. Swantz, 846 F.2d 923, 926 (4th Cir. 1988). This decision includes an exceptionally short discussion on preemption (174 words, reversing a long — 2221 words — and thorough decision of the district court) that future courts struggled with. See, e.g., ProCD, Inc. v. Zeidenberg, 908 F. Supp. 640, 657 (W.D. Wis. 1996) (suggesting, incorrectly, that in Acorn the 4<sup>th</sup> Circuit held that copyright cause of action is not “equivalent” to copyright infringement); ProCD, Inc. v. Zeidenberg, 86 F.3d 1447, 1454 (7th Cir. 1996) (same); Frontline Test Equip., Inc. v. Greenleaf Software, Inc., 10 F. Supp. 2d 583, 593 (W.D. Va. 1998) (suggesting, incorrectly, that “The Fourth Circuit’s careful analysis ... in the Acorn claim seems ... more in agreement with Professors Melville and David Nimmer, who state persuasively, ... [that] preemption should continue to strike down claims that ... complain directly about the reproduction of expressive materials.”); Wharton v. Columbia Pictures Indus., Inc., 907 F. Supp. 144 (D. Md. 1995) (finding, in the 4<sup>th</sup> Cir. jurisdiction, that a contract is preempted by the Copyright Act without referring to *Acorn v. Swantz*).

In later decisions regarding the preemption of other state cause of actions the Fourth Circuit interpreted the first prong of test for preemption under section 301(a), United States ex rel. Berge v. Board of Trustees of the Univ. of Alabama, 104 F.3d 1453 (4th Cir.1997), but it never reverse,

second part of the test.

### C. The Extra Element Test

The more controversial part of the preemption analysis is the second prong, which requires the court to determine whether state law creates “legal or equitable rights that are equivalent to any of the exclusive rights within the general scope of copyright as specified in section 106.” The rights under section 106 are the exclusive rights: reproduction, adaptation, distribution, public display, and public performance. Thus, in the second stage of the analysis, the court must decide if the rights created by state law are equivalent to the exclusive rights. Courts uniformly use the extra element test to make that determination. Under this test:

*When a right defined by state law may be abridged by an act which, in and of itself, would infringe one of the exclusive rights, the state law in question must be deemed preempted. Conversely, **when a state law violation is predicated upon an act incorporating elements beyond mere reproduction or the like, the rights involved are not equivalent and preemption will not occur.***<sup>91</sup>

Courts made it clear that not every extra element will suffice but instead required that “the ‘extra element’ changes the ‘nature of the action so that it is qualitatively different from a copyright infringement claim.’”<sup>92</sup> Indeed, practically every state cause of action will be somewhat different from copyright cause of action and therefore, if every minor difference will preclude preemption then section 301(a) will be meaningless.<sup>93</sup>

The analysis of torturous interference with contractual relationships in *Harper & Row Publishers, Inc. v. Nation Enterprises* is a good and often cited example for applying section 301(a). In that case the defendant copied part of President Ford’s memoirs, of which the plaintiff was the copyright owner. Consequently, the plaintiff lost potential income from a licensing agreement with a third party. The plaintiff sued under both copyright law and torturous interference with contractual relationships. This is a common fact pattern in copyright-infringement cases because reproduction and distribution of copyrighted work typically interferes with the copyright owner’s ability to commercialize the work. The Copyright Act thus allows the copyright owner to recover all the lost income due to the infringement.<sup>94</sup> In *Harper & Row*, however, the Second Circuit rejected the copyright infringement claim because the defendant’s actions were shielded by the fair use defense.<sup>95</sup>

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modify, or cleared up its precedent in *Acorn v. Swantz*.

<sup>91</sup> *Harper & Row Publishers, Inc. v. Nation Enterprises*, at 199-200, emphasis added.

<sup>92</sup> *Computer Associates Int’l, Inc. v. Altai, Inc.*, 982 F.2d 693, 716 (2d Cir. 1992).

<sup>93</sup> Christina Bohannon, *Copyright Preemption of Contracts*, 67 MD. L. REV. 616 (2008).

<sup>94</sup> 17 U.S.C. § 504(b) (2012).

<sup>95</sup> This part of the Second Circuit decision was reversed by the Supreme Court. *Harper & Row*

The torturous interference with contractual relationship claim was held to be preempted by section 301(a). The Second Circuit held that there is significant similarity between that claim and copyright infringement claim. It noticed that the elements of torturous interference are not identical to those of copyright claim because the first requires the plaintiff to prove that the defendant knew about the contractual relationship and the latter does not require the plaintiff to prove any knowledge by the defendant.<sup>96</sup> However, the court held that this difference is too insignificant and insufficient to prevent preemption.

#### *D. Applying the Extra Element Test to Contractual Claims*

Applying the extra element test to a contractual cause of action is not trivial. While preemption analysis typically addresses an alleged conflict between a statutory or regulatory scheme of a state and that of the federal government, contracts are the result of private ordering.

There are nevertheless more than 200 reported decisions that applied the extra element test to a contractual cause of action. While those decisions include numerous examples of internally conflicting reasoning or decisions that deviated, typically without notice, from binding precedents, two main approaches to the extra element test seem to have emerged. They will be called the no-contract-preemption approach and the partial-contract-preemption approach.

##### 1. The no-contract-preemption approach

The no-contract-preemption approach suggests that contractual consent is the extra element that saves contracts from preemption. In other words, because liability under the Copyright Act does not depend on the defendant's consent and liability for breach of contract does, the two are different. This approach was first suggested in *Taquino v. Teledyne Monarch Rubber*,<sup>97</sup> in which the court enforced a promise of a former employee to refrain from using certain promotion materials of

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*Publishers, Inc. v. Nation Enterprises*, 471 U.S. 539 (1985).

<sup>96</sup> Lack of knowledge is not a defense for copyright infringement. In fact, copyright infringement can be subconscious. *ABKCO Music, Inc. v. Harrisongs Music, Ltd.*, 722 F.2d 988 (2d Cir. 1983).

<sup>97</sup> 893 F.2d 1488, 1501 (5th Cir. 1990). In this decision the court cited two earlier authorities (*Smith v. Weinstein*, 578 F.Supp. 1297 (S.D.N.Y.1984) and a section from NIMMER OF COPYRIGHT), but those sources did not suggest that the contractual promise is the extra element. There are decisions by district courts that predated *Taquino* that implied that contracts are never preempted by section 301(a) but their reasoning did not survive the test of time. *See, e.g., Litoff, Ltd. v. Am. Exp. Co.*, 621 F. Supp. 981, 986 (S.D.N.Y. 1985) (suggesting without reasoning and in (wrongful) reliance of NIMMER ON COPYRIGHT, that a breach of contract claim is qualitatively different from a copyright claim); *Rachel v. Banana Republic, Inc.*, 1985 WL 26030 (N.D. Cal.) (suggesting that "Congress apparently did not intend by [section 301(a)] to bar parties from seeking enforcement of such a contract" reasoning that the Judiciary House Report in connection with the enactment of the Copyright Act of 1976 stated so. Unfortunately, the court did not notice that the language that the House Report referred to was omitted from the final version of Section 301.)

his former employer. The court held that “[the] action for breach of contract involves an element in addition to mere reproduction, distribution or display: the contract promise made by [defendant], therefore, it is not preempted.”<sup>98</sup>

Consent is always a required element in a contractual cause of action.<sup>99</sup> Therefore, if consent is a sufficient element in itself to be an extra element under the second prong of the preemption analysis, then the decision in *Taquino* implies that contracts will never be preempted by the Copyright Act.

A similar reasoning<sup>100</sup> suggests that contracts are not preempted because “[a] copyright is a right against the world. Contracts, by contrast [are not] so contracts do not create ‘exclusive rights.’”<sup>101</sup> This approach was first suggested in possibly the most famous decision on copyright preemption of contracts: *ProCD v. Zeidenberg*.<sup>102</sup> In this decision Judge Frank Easterbrook, writing for the Seventh Circuit, enforced a contract that restricted the distribution of a database collected by the plaintiff.

In recent years the no-contract-preemption approach, with its two forms of reasoning, became the dominant one among the federal appellate courts. It has been adopted by the Fifth,<sup>103</sup> Seventh,<sup>104</sup> Eleventh,<sup>105</sup> and the Federal Circuit.<sup>106</sup> While

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<sup>98</sup> 893 F.2d at 1501.

<sup>99</sup> Restatement (Second) of Contracts § 17 (1981) (“the formation of a contract requires ... a manifestation of mutual assent ...”).

<sup>100</sup> While the two forms of reasoning discussed in these paragraphs are phrased differently, I tend to see them as “the same side of the same coin.” One on hand, at first look, the reasoning seems different. The *Taquino* court uses the extra element test to suggest that the rights under contracts are “not equivalent” while the *ProCD* court argued that contractual rights are not “exclusive rights.” However, in assent, the extra element under the *Taquino* reasoning – consent – is the exact thing that makes the contractual rights inapplicable against the world, which, pursuant to the *ProCD* reasoning, make them non-exclusive. However, whether one sees these decisions as different or not, in practice they lead to the same result: contracts are never preempted by section 301(a).

It should be noted that in *ProCD* the Seventh Circuit stated that “we think it prudent to refrain from adopting a rule that anything with the label ‘contract’ is necessarily outside the preemption clause: the variations and possibilities are too numerous to foresee,” *id.*, at 1455, but, as others have pointed out, because contracts always create rights in personam, the reasoning of *ProCD* necessarily leads to the conclusion that all contracts survive preemption. The Seventh Circuit might meant, although it did not state so explicitly, that a claim that is labeled “contractual” but is actually something else, requires a different analysis. *See supra* note 87.

<sup>101</sup> *ProCD*, *supra* note 7, at 1454.

<sup>102</sup> *Supra* note 7.

<sup>103</sup> *Taquino*, *supra* note 97 (suggesting that consent is an extra element).

<sup>104</sup> *ProCD*, *supra* note 7 (suggesting that contractual rights are not exclusive and thus not preempted)

<sup>105</sup> *Lipscher v. LRP Publications, Inc.*, 266 F.3d 1305, 1318 (11th Cir. 2001) (citing *ProCD* and noting that “As the Seventh Circuit has stated, claims involving two-party contracts are not preempted because contracts do not create exclusive rights, but rather affect only their parties ... We find the Seventh Circuit's reasoning to be persuasive.”)

<sup>106</sup> *Bowers v. Baystate Technologies, Inc.*, 320 F.3d 1317, 1325 (Fed. Cir. 2003) (“This court believes that the First Circuit would follow the reasoning of *ProCD* and the majority of other courts

the Ninth Circuit did not expressly stated that every contract is shielded from preemption it is likely the dominant approach in that circuit as well.<sup>107</sup> As suggested,<sup>108</sup> on somewhat different ground, contracts seems to survive preemption under the Fourth Circuit’s precedent as well.

## 2. The partial-contract-preemption approach

In contrast with the no-contract-preemption approach, some courts have held that the contractual consent itself does not “change the nature of the action so that it is qualitatively different from a copyright infringement claim”<sup>109</sup> and therefore it cannot be, by itself, the extra element that precludes the finding of preemption. Therefore, under this approach, the court should examine the contractual promise to explore if it is “qualitatively different” from copyright infringement claim.

Furthermore, under this approach, supported by *NIMMER ON CONTRACTS*, the

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to consider this issue. This court, therefore, holds that the Copyright Act does not preempt Mr. Bowers' contract claims.”) It should be noted that some of the cases that the Federal Circuit cited, such as *Wrench LLC v. Taco Bell*, 256 F.3d 446 (6th Cir. 2001), explicitly rejected the *ProCD* approach. The Federal Circuit ignored those differences, cited to *ProCD*’s broad approach, and adopted it.

<sup>107</sup> While the Ninth Circuit dealt with the copyright preemption of contracts more than any other appellate court, its caselaw on the issue is less clear and somewhat less consistent than that of other federal appellate courts.

In *Montz v. Pilgrim Films & Television, Inc.*, 649 F.3d 975 (9th Cir. 2011) an en banc panel of that court held that a promise to pay for an idea (a *Desny* type claim) as well as a promise not to use an idea are not preempted. The court used a broad language and suggested that the promise itself is the extra element. It also rejected the dissent approach which distinguished between a promise to pay and a promise to refrain from future use. However, the majority did not **expressly** state that **every** contractual promise will be an extra element. A similar approach was adopted by the Ninth Circuit in *Grosso v. Miramax Film Corp.*, 383 F.3d 965 (9th Cir. 2004) and *Benay v. Warner Bros. Entm’t, Inc.*, 607 F.3d 620 (9th Cir. 2010). In another decision, *Altera Corp. v. Clear Logic, Inc.*, 424 F.3d 1079, 1089 (9th Cir. 2005), the Ninth Circuit stated that “[m]ost courts have held that the Copyright Act does not preempt the enforcement of contractual rights ... We find the logic of these cases persuasive here.” While this seems to be consistent with the approach taken by the Seventh Circuit in *ProCD*, to which the Ninth Circuit referred, one of the decision that the Ninth Circuit cited was *Nat’l Car Rental Sys., Inc. v. Computer Assocs. Int’l*, 991 F.2d 426 (8th Cir.1993), which actually did not hold that all contracts are shielded from preemption. Thus the meaning of the statement “we find the logic of these cases persuasive” is not perfectly clear. There is more than one logic in “these cases.” Moreover, the discussion in *Altera v. Clear Logic* seems problematic because while the court discussed the preemption of contracts, the cause of action before it was actually tortious interference with contracts, which is a separate and very different cause of action with a different preemption analysis, *see supra* notes 94-95. *See also MDY v. Blizzard*, *supra* note 36, 629 F.3d, at 957-58 (deciding a preemption of tortious interference with contracts claim by using a preemption of contracts caselaw).

While the Ninth Circuit could certainly clear up its reasoning, the overall theme in these decisions seems to support the no-contract-preemption approach. Indeed, at least since the passage of the Copyright Act of 1976, the Ninth Circuit never held that a contract is preempted by copyright.

<sup>108</sup> *See supra* note 90.

<sup>109</sup> *See supra* note 92.

court should examine whether the promise only regulates an action that is part of the exclusive rights: reproduction, adaptation, distribution, or public performance or display of the work. If it does, it is preempted.<sup>110</sup>

Two Sixth Circuit cases can demonstrate how this approach is applied. In *Wrench v. Taco Bell*<sup>111</sup> the court discussed the preemption of a Desny type claim: whether an implied-in-fact contract that allegedly required the defendant to pay the plaintiff if the defendant uses plaintiff's ideas for an advertising campaign is enforceable. The Sixth Circuit expressly rejected the *ProCD* reasoning and the approach that contracts are never preempted and instead examined the contract itself. Following that examination the Court concluded that because the promise that it is asked to enforce is a promise to pay, because payment (or being paid) is not an exclusive right, and because it "does change the nature of the action so that it is qualitatively different from a copyright infringement claim"<sup>112</sup> then it is not preempted.

In contrast, in *Ritchie v. Williams*<sup>113</sup> the defendant allegedly breached a promise to transfer certain copyrighted songs to the plaintiff by transferring them to a third party. The Sixth Circuit held that because the contract regulates the distribution and public performance of copyrighted goods, and as distribution and public performance are exclusive rights under the Copyright Act, the plaintiff's contractual claim is preempted.<sup>114</sup>

This approach, which required the court to examine the content of the contract to determine whether or not it is preempted, was the dominant one prior to the Seventh Circuit decision in *ProCD*. However, as explained above, this is not the dominant approach among appellate courts anymore. The only federal appellate court that explicitly rejected the no-contract-preemption approach is the Sixth Circuit. The Eighth Circuit precedent seems to also favor the partial-contract-

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<sup>110</sup> *Wrench LLC v. Taco Bell Corp.*, 256 F.3d 446, 457 (6th Cir. 2001) ("If the promise amounts only to a promise to refrain from reproducing, performing, distributing or displaying the work, then the contract claim is preempted."); David Nimmer, Elliot Brown & Gary N. Frischling, *The Metamorphosis of Contract into Expand*, 87 CAL. L. REV. 17, 48 (1999) ("[W]hen a breach of contract cause of action ... is used as a subterfuge to control nothing other than the reproduction, adaptation, public distribution, etc., of works within the subject matter of copyright, then it too should be deemed preempted").

<sup>111</sup> *Wrench*, *supra* note 110.

<sup>112</sup> *Id.*, at 456.

<sup>113</sup> 395 F.3d 283 (6th Cir. 2005).

<sup>114</sup> It may be argued that this holding is nothing more than a dictum because the court also held that the cause of action was created in 1990 and the litigation commenced only in 2001, which makes it barred by the statute of limitation. The Sixth Circuit did not directly address this difficulty and discuss the preemption argument at length. *Cf.*, *Ritchie v. Williams*, Case No. 01-71712 (E.D. Michigan, Feb. 03, 2003) (holding that the claim arose in 1990 and is barred by the statute of limitation although also holding, without much reasoning and without citing any authority or even the statute, that the contractual claim "clearly is based in copyright," \*19, and thus preempted).

preemption approach. While this precedent was established in 1993,<sup>115</sup> several years before *ProCD*, the Eighth Circuit has not reverse it<sup>116</sup> and therefore this approach is the binding precedent in the Eighth Circuit.

### 3. The Second Circuit and the Southern District of New York

The Second Circuit, which is commonly considered, together with the Ninth Circuit, one of the two most prominent courts of appeals in copyright law,<sup>117</sup> has not yet adopted the no-contract-preemption approach or the partial-contract-preemption approach.

This is surprising. Copyright preemption of contracts was discussed by the Southern District of New York, which is subject to the appellate jurisdiction of the Second Circuit, more than in any other court. The numerous decisions of this district court are almost evenly split between the two approaches. In fact, the two most important and highly-cited decisions of Southern District of New York on this topic were delivered just a few months apart. In April 1996, Judge Allen Schwartz held, in a long and well-reasoned opinion, that “a breach of contract claim is preempted if it is merely based on allegations that the defendant did something that the copyright laws reserve exclusively to the plaintiff (such as unauthorized reproduction, performance, distribution, or display).”<sup>118</sup> In other words, this decision adopted the partial-contract-preemption approach. In August 1996, Judge Michael Mukasey held, in another long and well-reasoned opinion, that “[p]rotection from breach of contract ... is not equivalent to copyright protection because a contract claim requires an ‘extra element’ ... that renders the claim qualitatively different from a claim for copyright infringement: a promise by the defendant.”<sup>119</sup> Thus, this decision adopted the no-contract-preemption approach. These two decisions are frequently cited by judges in the Southern District of New York when ruling on copyright preemption of contracts.<sup>120</sup>

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<sup>115</sup> *Natl. Car Rental*, *supra* note 8, 991 F.2d at 431-35.

<sup>116</sup> There is only one case since *Natl. Car Rental* in which the Eighth Circuit addressed copyright preemption of contracts. In *Davidson & Associates v. Jung*, 422 F.3d 630 (8th Cir 2005) the Eighth Circuit applies a conflict preemption doctrine to find that a promise to refrain from reverse engineering is not preempted. The Court cited decisions that use the no-contract-preemption approach and those that use the partial-contract-preemption approach and did not choose which one it preferred. Therefore, it seems that *Natl. Car Rental*, which clearly adopted the partial-contract-preemption approach, is the binding precedent in the Eighth Circuit.

<sup>117</sup> Howard B. Abrams, 2 *The Law of Copyright* § 15:59.

<sup>118</sup> *Am. Movie Classics Co. v. Turner Entm't Co.*, 922 F. Supp. 926, 931 (S.D.N.Y. 1996)

<sup>119</sup> *Architectronics, Inc. v. Control Sys., Inc.*, 935 F. Supp. 425, 438 (S.D.N.Y. 1996). It should be noted that in June 1996 the Seventh Circuit delivered its opinion in *ProCD*. While it clearly affected the *Architectronics* court (that cite to it), it is of course not a binding precedent within the Second Circuit.

<sup>120</sup> In *BanxCorp v. Costco Wholesale Corp.*, 723 F.Supp.2d 596, 614 (S.D.N.Y.2010) the court acknowledged that “[c]ourts in this district have continued to disagree how to analyze preemption of breach of contract claims.” In *Canal Image UK Ltd. v. Lutvak*, 773 F. Supp. 2d 419, 441 (S.D.N.Y.



Considering the prominence of the Southern District of New York and how often and yet inconsistently it ruled on the issue, it is truly surprising that the Second Circuit did not yet deliver a binding precedent on this issue. There are only two cases that were decided by the Second Circuit on this topic. In 1984, in *Smith v. Weinstein*<sup>121</sup> the Southern District of New York held that a Desny type claim — an implied-in-fact promise to pay for an idea for the movie “Stir Crazy” — was not preempted because “[a] party may by contract agree to pay for ideas ... Rights under such an agreement are qualitatively different from copyright claims, and their recognition creates no monopoly in the ideas involved.”<sup>122</sup> The Second Circuit affirmed without an opinion. It is however unclear if the decision suggests that a promise to pay for an idea is not preempted or is the decision stands for the proposition that contracts are not preempted, as such, because they “create no monopoly.”

It took the Second Circuit 28 years to address the issue again. In *Forest Park Pictures v. Universal Television Network, Inc.*<sup>123</sup> the court addressed another Desny type claim and held it not preempted because the implied-in-fact contracts did not limit an action that is an exclusive right, because contracts do not create a right against the world, and because the court finds an extra element in the promise to pay. Thus, this reasoning adopted both approaches. The Second Circuit did notice that other appellate courts chose rules that either lead to the preemption of all contracts or that allowed the preemption of some of them. However, it found that regardless of the approach it chose, the Desny claim will not be preempted. It therefore did not adopt either of these two approaches, and did not resolve the inconsistency and split of authorities in the Southern District of New York.

### PART III: INSPIRING THE APPROACHES TO PREEMPTION: A STORY OF TWO NARRATIVES

The previous Part presents the two approaches in the caselaw to copyright preemption of contracts. This Part suggests that while these two approaches — the no-contact-preemption approach and the partial-contact-preemption approach — are significantly different from one another both are supported by well-established narratives in copyright law discourse. These narratives answer the question “what is copyright” and give different answers with different emphases.<sup>124</sup>

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2011) the court examined this disagreement and cited six decisions that followed the *Architectronics* approach (no-contract-preemption) and four other decisions that adopted the *Am. Movie Classics* (partial-contract-preemption) approach, before choosing to adopt the latter. There are [more than 20 decisions] from the Southern District of New York on this issue.

<sup>121</sup> 578 F. Supp. 1297 (S.D.N.Y. 1984).

<sup>122</sup> *Id.*, at 1307.

<sup>123</sup> 683 F.3d 424 (2d Cir. 2012).

<sup>124</sup> The question “what is copyright,” or more accurately “what does copyright (or intellectual property in general) resemble” has been fiercely debated the intellectual property literature in recent years. The answers include property, a competition regulatory scheme, a welfare policy, and more.

There are many narratives in copyright discourse. For example, copyright discourse in continental Europe is dominated by natural rights narratives.<sup>125</sup> In contrast, copyright discourse in the United States is first and foremost instrumental: copyright law is not perceived as desirable in itself but as a means to promote other objectives, and in particular the need to encourage the creation and distribution of creative works.<sup>126</sup> However, even within this discourse, there are different narratives and different ways to describe the nature of copyright law. This Part focuses on two narratives: The first describes copyright law as a system that creates proprietary rights in certain intangible assets. The second describes copyright law as a system that creates a "delicate balance" between different competing interests, and in particular those of the creators and users (including users that become creators) with respect to a particular work.

These two narratives typically complete one another but in some cases, such as preemption of contracts, they push in different directions. The problem, this Article argues, is that those narratives, or metaphors, while useful and not inaccurate in themselves, can be taken to the extreme and can lead to undesirable legal rules. The two approaches to contracts preemption therefore might fail to consider Benjamin Cardozo's warning: "Metaphors in law are to be narrowly watched, for starting as devices to liberate thought, they end often by enslaving it."<sup>127</sup>

#### *A. Copyright as Property*

Copyright law creates rights against the world in certain intangible assets. As these rights allow the right-holder to exclude some users from engaging in many common activities with respect to the intangible asset, and as they are backed up by a wide range of remedies including injunctions and criminal sanctions, they are quite commonly classified as property rights. The property right narrative uses this classification and describes copyright law as a legal system that creates property rights in certain intangible goods. This narrative, at least in its simple form, focuses on the copyright owner and the rights that he or she has against the world.

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*See, e.g.*, ADAM MOSSOFF, *INTELLECTUAL PROPERTY AND PROPERTY RIGHTS* (2014); Mark A. Lemley, *Property, Intellectual Property, and Free Riding*, 83 *TEX. L. REV.* 1031 (2005); Tom W. Bell, *Authors' Welfare: Copyright as a Statutory Mechanism for Redistributing Rights*, 69 *BROOK. L. REV.* 229 (2003).

<sup>125</sup> *See generally* Ginsburg, *supra* note 31.

<sup>126</sup> *See generally* *Mazer v. Stein*, 347 U.S. 201, 219 (1954) ("The economic philosophy behind the clause empowering Congress to grant patents and copyrights is the conviction that encouragement of individual effort by personal gain is the best way to advance public welfare"); *Golan v. Holder*, 132 S. Ct. 873, 901 (2012) (Breyer J., dissenting) ("This utilitarian view of copyrights and patents, embraced by Jefferson and Madison, stands in contrast to the 'natural rights' view underlying much of continental European copyright law").

<sup>127</sup> *Berkey v. Third Ave. Ry. Co.*, 155 N.E. 58, 61 (N.Y. 1926). *See also* Justin Hughes, *Copyright and Incomplete Historiographies: Of Piracy, Propertization, and Thomas Jefferson*, 79 *S. CAL. L. REV.* 993, 1054-60 (2006).

The property narrative can be traced back many decades.<sup>128</sup> For example, in mid-19<sup>th</sup> century the Supreme Court stated that “The copy-right is an exclusive right to the multiplication of the copies, for the benefit of the author or his assigns, disconnected from ... any ... physical existence ... as said by Lord Mansfield in *Millar v. Taylor* ‘a property in notion, and has no corporeal tangible substance.’”<sup>129</sup> In that case the court used that analogy to clarify that copyright, like other property rights, can, in some cases, be foreclosed and subject to the rights of creditors.<sup>130</sup>

In another early decision the Supreme Court stressed that the main goal of copyright law is to create property rights in order to incentivize the creator to create:

*While the nature of the property and the protection intended to be given the inventor or author as the reward of genius or intellect in the production of his book or work of art is to be considered in construing the act of Congress, it is evident that to secure the author the right to multiply copies of his work may be said to have been the main purpose of the copyright statutes.*<sup>131</sup>

Indeed, it appears that the starting point is that intellectual property, and specifically copyright, like other property rights, grants the owners a certain level of control over their assets, including the right to trade their goods.

Property rights are generally transferable<sup>132</sup> and so are intellectual property rights, which are transferable and licensable.<sup>133</sup> In fact, transferability lies at the

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<sup>128</sup> Justin Hughes for example explored three centuries of referring to copyright law as property in both England and later in the United States. Hughes, *supra* note 127, at 1008.

Some traces of this approach which places the creator at the heart of copyright policy can be found in the federalist papers. For example in Federalist 43 James Madison wrote that the Intellectual Property Clause of the Constitution is desirable because “The public good fully coincides ... with the claims of individuals.”

<sup>129</sup> *Stephens v. Cady*, 55 U.S. 528, 530 (1852).

<sup>130</sup> *Id.*, at 531 (discussing copyright and stating that “No doubt the property may be reached by a creditor’s bill, and be applied to the payment of the debts of the author”).

<sup>131</sup> *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339, 347 (1908). *See also* *Am. Tobacco Co. v. Werckmeister*, 207 U.S. 284, 298-99 (1907) (“[T]he statute must be read in the light of the intention of Congress to protect this intangible right as a reward of the inventive genius that has produced the work”).

<sup>132</sup> *See generally* 2 William Blackstone, *Commentaries on the Laws of England* 10 n.2 (Edward Christian ed. 12th ed. 1794) (“Upon whatever principle the right of property is founded, the power of giving and transferring seems to follow as a natural consequence”); *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373, 383 (1911) (“The right of alienation is one of the essential incidents of a right of general property in movables”).

<sup>133</sup> 17 U.S.C. § 201 (2012). In fact, there are only very few places in which the Copyright Act explicitly states that a right is not transferable, waivable, or licensable and it is quite clear that Congress did not see such broad restrictions favorably. Even moral rights, which are non-waivable in most countries, are waivable under U.S. law .17 U.S.C. § 106A (e) (2012). The Copyright Act is absolutely silent regarding the transferability or waivability of other crucial elements in copyright law such as the idea-expression distinction or fair use. The right of the author to terminate a transfer

heart of the theoretical justification for copyright: because society provides intellectual property rights to encourage the author to invest the resources needed to create the work, it is necessary to allow the author to trade those rights and receive compensation.

The implications of this narrative, at least in its simple form, on the enforceability of contracts seem clear. If the purpose of copyright law is to create a property regime that gives rewards to the authors for their work, then trade should be encouraged. Therefore, creative contracting over copyrighted goods, which allows authors to form specific income maximizing arrangements, is socially desirable as it helps promote the goals of copyright law. The property narrative can further support such reasoning because it might encourage comparison to other forms of property, and especially real property, in which transferability, including by creative contractual arrangements, is allowed, and in many cases, encouraged.

### *B. The Property Narrative and the Coase Theorem*

The property narrative fits well with libertarian economic ideology which advocates greater reliance on property and contract law as a tool to facilitate market transactions and thus cabinet the role of the government.<sup>134</sup> Indeed, contracts, according to this view, manifest personal autonomy and enable individuals to determine their own arrangements for governing their lives without being subject to the general arrangements prescribed by the government. Thus, intervention in the freedom of contracts and in the rights of individuals to alienate their property cannot only endanger economic freedom, but also other and broader concepts of freedom, including personal liberty.<sup>135</sup>

The Coase Theorem, which is at the core of the economic analysis of law movement, in its simple form, can support a similar approach. Indeed, contracts improve the contracting parties' utility and therefore, without externalities, they

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of copyright after several decades is one of the only instances under U.S. law for which the law provides that it "may be effected notwithstanding any agreement to the contrary." 17 U.S.C. §§ 203 (a)(5) (2012). It is however quite clear that American courts are hostile to such mandatory arrangement and interpret them narrowly. See Peter S. Menell & David Nimmer, *Judicial Resistance to Copyright Law's Inalienable Right to Terminate Transfers*, 33 COLUM. J.L. & ARTS 227 (2010). The Property narrative is, in my view, one of the main explanations to this hostility.

<sup>134</sup> This approach is also not new. See, e.g., Sir G. Jessel, M. R., in *Printing and Numerical Registering Co. v. Sampson*, L. R. 19 Eq. 462, 465 (1875) ("men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by courts of justice"); see also Rose D. Friedman & Milton Friedman, *TWO LUCKY PEOPLE: MEMOIR*. 605 (1998) (property rights are "the most basic of human rights and an essential foundation for other human rights").

<sup>135</sup> See, e.g., 1 John Gabriel Woerner, *A TREATISE ON THE AMERICAN LAW OF ADMINISTRATION* 3 (Little, Brown & Co., 2d ed. 1899) ("Alienability is of the essence of property; an infringement of my right or power to alienate my property is therefore a limitation upon my free will, and to that extent a violation of my personal liberty, because my free will finds realization in property").

improve social welfare.<sup>136</sup> Contracts create these welfare improving norms without relying on the decisions of public entities, which might, whether intentionally or not, make decisions that are not welfare maximizing.<sup>137</sup> Specifically, the Coase Theorem suggests that as long as transaction costs are low enough, and given well-defined property rights, individuals will re-allocate their initial rights in a way that will maximize social welfare. In other words, according to the Coase Theorem, given the existence of an efficient market, the role of the legal system (and the state itself) is very limited. It must only clearly define the initial allocation of property rights and enforce contracts between parties.

This approach is reflected Judge Easterbrook's decision in *ProCD*. For example, in an article defending his *ProCD* ruling Judge Easterbrook argued that "Patent law, copyright law, trademark law, and the law of contracts (of which trade secrets are a branch) **create or employ property rights in information** so that the producer of intellectual property can charge more than marginal cost, and thus cover the total cost of producing and disseminating the works."<sup>138</sup> He went on and explained that "although one can say that property rights in information are social constructs, so are property rights in cattle. **They set the stage for contracts; they do not prevent contracts.**"<sup>139</sup>

Indeed, the logic of Judge Easterbrook relies on the property narrative and the Coase Theorem. If copyright norms are perceived as setting out initial allocation of proprietary rights, then, the argument goes, once the parties have reached their own private agreements, it should be assumed that the agreements maximize the parties' utility, and, in the absence of significant externalities, create arrangements that will maximize social welfare. These contracts should therefore be enforced. In other words, this approach perceives copyright norms as fault rules.

### C. The "Delicate Balance" Narrative

While the property narrative seems to place the authors and their interests at the center of copyright policy, the delicate balance narrative places their interests on one side of the scale and requires balancing them against the interests of the general public, and specifically those who use their work.<sup>140</sup> This narrative perceives copyright law as a system that creates a "delicate balance" between the competing interests of authors, who might seek stronger market power, and users, who seek

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<sup>136</sup> See Richard Epstein, *The Disintegration of Intellectual Property? A Classical Liberal Response to a Premature Obituary*, 62 STANFORD LAW REVIEW 455, 502 (2010) ("Finding a systematic negative externality generated by these restrictions [on contractual freedom] is needed for justifying their imposition").

<sup>137</sup> See Frank H. Easterbrook, *Contract and Copyright*, 42 HOUS. L. REV. 953, 956 (2005) ("it is best to leave contract design to the market, where incentives are aligned rather than ignored").

<sup>138</sup> *Id.*, at 962, emphasis added.

<sup>139</sup> *Id.*, at 964, emphasis added.

<sup>140</sup> Those users might also be authors, e.g., a parodist, or not. This distinction, which is commonly discussed in the context of the fair use defense, will be further explored in Part V *supra*.

affordable access to protected works.<sup>141</sup>

This narrative has been well-established in copyright discourse for many years. In 1932, for example, the Supreme Court stated that:

*The limited scope of the copyright holder's statutory monopoly, like the limited copyright duration required by the Constitution, reflects a balance of competing claims upon the public interest: Creative work is to be encouraged and rewarded, but private motivation must ultimately serve the cause of promoting broad public availability of literature, music, and the other arts. The immediate effect of our copyright law is to secure a fair return for an 'author's' creative labor. But the ultimate aim is, by this incentive, to stimulate artistic creativity for the general public good.*<sup>142</sup>

In *Sony v. Universal* the Supreme Court stated:

*[I]t is Congress that has been assigned the task of defining the scope of the limited monopoly that should be granted to authors or to inventors in order to give the public appropriate access to their work product. Because this task involves a difficult balance between the interests of authors and inventors in the control and exploitation of their writings and discoveries on the one hand, and society's competing interest in the free flow of ideas, information, and commerce on the other hand, our patent and copyright statutes have been amended repeatedly.*<sup>143</sup>

The Court explained that these principles, which focus on the public welfare, are not new and can be traced back to earlier sources. For example, the house report that preceded the Copyright Act of 1909 suggested that “[i]n enacting a copyright law Congress must consider ... two questions: First, how much will the legislation stimulate the producer and so benefit the public, and, second, how much will the

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<sup>141</sup> It should be noted that while the balance narrative has been used in copyright discourse for many centuries, the Supreme Court first used the term “delicate balance” in the context of copyright law in a case that did not involve users. In that case, the balance was between the rights of authors and the rights of distributors. *See Stewart v. Abend*, 495 U.S. 207, 230 (1990) (“It is not our role to alter the delicate balance Congress has labored to achieve”). Indeed, the focus in this Part is on the balance between the interests of authors and users but according to this narrative copyright law balances between the interests of many constituencies. *See generally* 17 U.S.C. §§ 111, 112, 114-116, 203, 801 (2012).

<sup>142</sup> *Fox Film Corp. v. Doyal*, 286 U.S. 123, 127 (1932)

<sup>143</sup> *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417, 430 (1984). This paragraph was often cited by courts and commentators. *See, e.g.*, *Harper & Row Publishers v. Nation Enterprises*, 471 U.S. 539, 580 (1985); *Eldred v. Ashcroft*, 537 U.S. 186, 213 (2003). It should be noted that the “difficult balance” or “delicate balance” narrative is sometime used not just to explain the balance created by copyright law between the interests of different groups but also to stress that such a balance is created by Congress and not by courts. *See, Sony* and *Stewart*. While I’m skeptical that this is an accurate description of the ways copyright law was developed (or should be developed) a full analysis of this aspect of this narrative is beyond the scope of this Article.

monopoly granted be detrimental to the public?”<sup>144</sup> Indeed, this narrative can be traced back decades and even centuries in judicial opinion, legislative documents, and academic writing.<sup>145</sup>

It is important to note that the delicate balance narrative does not just claim that copyright law, as a whole, creates this delicate balance but the specific doctrines within copyright law reflect that balance too. Thus, for example, in one case the Supreme Court suggested that the detailed statutory rules regarding public performance as well as the rules regarding the length of copyright protection reflect this balance.<sup>146</sup> The Second Circuit stated that the tests regarding substantial similarity, which were all set by judicial precedents, reflect this “delicate balance.”<sup>147</sup>

The influence of the delicate balance on the partial-contract-preemption approach is clear. If copyright law reflects a delicate balance, courts should be hesitant to allow the parties to deviate from these arrangements. Perceiving this balance as nothing more than default rules thus seems undesirable. Moreover, because copyright owners drafted many of the contracts that deviate from the norms of copyright law, these contracts seem to reflect systematic deviation from this delicate balance. It is therefore not surprising that the delicate balance narrative and metaphor was commonly used by proponents of the partial-preemption approach.<sup>148</sup>

#### PART IV: THE FAILURE OF THE TWO APPROACHES TO PREEMPTION

Courts use either the partial-preemption-approach or the no-preemption-approach to resolve disputes over the copyright preemption of contracts. Both approaches are inspired by well-established narratives in copyright law discourse.

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<sup>144</sup> H.R.Rep. No. 2222, 60th Cong., 2d Sess. 7 (1909)

<sup>145</sup> See, e.g., *Cary v. Longman*, 1 East\*358, 362 n; (b), 102 Eng. Rep. 138, 140 n. (b) (1801) (“We must take care to guard against two extremes equally prejudicial; the one that men of ability, who have employed their time for the service of the community, may not be deprived of their just merits, and the reward of their ingenuity and labour; the other that the world may not be deprived of improvements, nor the progress of the arts be retarded”); Robert A. Gorman, *Copyright Protection for the Collection and Representation of Facts*, 76 HARV. L. REV. 1569, 1571 (1963) (“the copyright law represents a balance of the individual’s interest in reaping the fruits of his intellectual efforts and the public’s interest in having his works disseminated”); See also Zechariah Chafee, Jr., *Reflections on the Law of Copyright*, 45 COL. L. REV. 503 (1945).

<sup>146</sup> *Twentieth Century Music Corp. v. Aiken*, 422 U.S. 151, 156 (1975) (“The limited scope of the copyright holder’s statutory monopoly, like the limited copyright duration required by the Constitution, reflects a balance of competing claims upon the public interest: Creative work is to be encouraged and rewarded, but private motivation must ultimately serve the cause of promoting broad public availability of literature, music, and the other arts”)

<sup>147</sup> *Warner Bros. Inc. v. Am. Broad. Companies, Inc.*, 720 F.2d 231, 245 (2d Cir. 1983) (“The ‘substantial similarity’ that supports an inference of copying sufficient to establish infringement of a copyright ... is a term to be used in a courtroom to strike a delicate balance between the protection to which authors are entitled under an act of Congress and the freedom that exists for all others to create their works outside the area protected against infringement”).

<sup>148</sup> See, e.g., Nimmer, Brown & Frischling, *supra* note 110, at 48.

This Part however suggests that each of them fail to offer a reasonable desirable rule regarding preemption of contracts.

The no-contract-preemption approach takes the property metaphor to its extreme and places too much trust in the market without fully appreciating the minefield of market failures in which copyrighted works are being created and distributed, and the unique characteristic of intangible non-rivalrous property rights. The partial-contract-preemption approach, on the other hand, does not offer a coherent, full description of the nature and rationale of the “delicate balance” that copyright law creates and thus it gives too little guidance as to which copyright norms could be contracted around and which could not. Consequently, the test that the partial-contract-preemption approach provides for preemption does not adequately distinguish between promises that should and should not be preempted.

*A. The Failure of the Partial-Contract-Preemption’s Test*

The partial-contract-preemption approach relies on the delicate balance narrative to suggest that copyright creates a balance between competing interests and that this balance cannot be so easily be altered by contracts, especially standard-form-agreements written by one party. This is, however, only part of the argument. If one believes that some aspects of this delicate balance cannot be contracted around, then some legal rule should be offered to distinguish those norms that can and cannot be contracted around. In other words, because, as explained in Part I, contracts serve an important function in copyright industries, then in most cases contracting over copyrighted goods should be typically desirable and enforceable. Thus some guidance should be provided as to how to identify those unusual contractual promises that should be preempted.

The rule that is commonly used by the partial-contract-preemption approach to identify contracts that should be preempted states that contractual promises that have to do with an action that is an exclusive right, such as reproduction or adaptation, should be preempted.<sup>149</sup> This Section shows that this rule cannot appropriately and reasonably separate contractual promises that should and should not be preempted. Not only is this rule difficult to apply, but, more importantly, in many cases it is overbroad — leading to the preemption of contracts that are reasonable and common, and in other cases, overly narrow — not preempting contracts that are problematic if one is to preserve the delicate balance created by copyright law.

1. Randomness and over-narrowness

The analysis in Section I.B of this Article can shed light on the shortcomings of the partial-contract-preemption test.

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<sup>149</sup> See, *supra* \_\_\_\_.



	Within copyright subject matter	Outside copyright subject matter
Actions that are exclusive rights		
Actions that are not exclusive rights		

The analysis suggests that contracts may allow the copyright owners to extend their rights into areas that are not part of copyright law, as represented in the chart above. Expansion can occur in three main directions: along the horizontal axis — governing unprotected elements such as facts and ideas, along the vertical axis — governing activities that are not exclusive rights, and finally, contracts can target actions that are explicitly excluded by a specific defense.

The partial-contract-preemption approach’s test focuses just on the horizontal axis, suggesting, in assent, that the copyright law has a monopoly on certain **actions** (e.g., reproduction and distribution) and therefore contractual promises over these actions are preempted. However, the test says nothing about expansion along the vertical axis. Thus, any contractual promise that limits the buyer or user of copyrighted goods in a way that does not involve the exclusive rights, escapes preemption.

The exclusive rights, however, do not cover basic actions such as usage or payment, and therefore the test is narrow and allows many troubling contracts to be enforced. For example, a contract that limits how many times a user can read a book, while heavily criticized by proponents of the partial-contract-preemption approach,<sup>150</sup> seems to survive this test.

Moreover, drawing a distinction between actions that are part of the exclusive rights and those that are not is somewhat random in this context and easy to circumvent. *Natl. Car Rental v. Computer Associates*<sup>151</sup> demonstrates this claim. In this case, Computer Associate (CA) sold data-processing software to National Car Rental (National) under a contract that prohibited National from allowing third parties to use the software. National processed data of affiliated companies and argued that its promise not to do so is preempted by the Copyright Act and it is

<sup>150</sup> Nimmer, Brown & Frischling, *supra* note 148, at 55.

<sup>151</sup> *Supra* note 8.

therefore unenforceable. The district court agreed and held that this promise prevents National from transferring the product to others and thus it regulates the distribution of information goods. The district court perceived the contractual promise as a prohibition on lending and because distribution is an exclusive right (that is limited by the first sale doctrine)<sup>152</sup> held that the contract is preempted.<sup>153</sup> The Eighth Circuit reversed, reasoning that the contract also prohibited National from processing third parties' data on its own computer, which has nothing to do with distribution. Therefore, ruled the Eighth Circuit, it allowed CA to control an activity that is not an exclusive right. Thus, because the contract expanded the right of the copyright holder, it was saved from preemption.<sup>154</sup>

The difference between the ways that the district court and the Eighth Circuit characterized the contract seems both arbitrary and counterintuitive. It makes little sense that the further the contract expands the rights of the copyright owner, the more likely it is to evade preemption.<sup>155</sup>

Preempting contractual obligations only when they regulate actions that are exclusive rights is not just arbitrary but it also offers an easy way for contract-drafters to escape preemption. This is most evident with respect to the duty to pay. Paying (or getting paid) is not an exclusive right and therefore any promise by a user to pay seems to automatically avoid preemption.<sup>156</sup> It is, however, quite easy to characterize almost any contractual obligation in terms of a duty to pay. Take, for example, the facts of *ProCD*. As explored above,<sup>157</sup> in this decision, which was heavily criticized by some of the proponents of the partial-contract-preemption

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<sup>152</sup> 17 U.S.C. § 109(a) (2012). This doctrine *inter alia* permits the owner of a copy of copyrighted good to lend it to others.

<sup>153</sup> *Nat'l Car Rental Sys., Inc. v. Computer Associates Int'l, Inc.*, CIV. 3-91-321, 1992 WL 5959 (D. Minn. Jan. 17, 1992) *rev'd*, 991 F.2d 426 (8th Cir. 1993).

<sup>154</sup> *Nat'l Car Rental*, *Supra* note 8.

<sup>155</sup> It should be noted that under modern caselaw the court should have considered other arguments that are probably as random. When National used the software to process the data of third parties it created a copy of it on its computer's Random Access Memory. This copy, at least under a long line of cases in the Ninth Circuit, infringed on the reproduction rights of CA, unless its creation was permitted by a license. *See, e.g.*, *MAI Systems Corp. v. Peak Computer, Inc.*, 991 F.2d 511 (9th Cir. 1993). Thus, if the license's prohibition on usage for the benefits of third parties is drafted as a condition, this usage is not just an infringement of contract but also a copyright infringement. This proposition creates a difficulty for the partial-contract-preemption approach's test. Does a restriction on the use of software escape preemption because use is not an exclusive right or does the fact that use involves copying, which is an exclusive right, make the contractual claim preempted? From a practical point of view this question might not be as significant because the copyright owner would typically be satisfied with a copyright cause of action, if such is available.

<sup>156</sup> This argument — that a duty to pay is not an exclusive right — is broadly used in the caselaw to justify the enforcement of questionable contracts. This is, for example, the common argument for enforcing a *Desny* claim, *see supra* \_\_\_\_\_. There are courts, however, that held that payment is not distinctive enough to save an otherwise problematic agreement from preemption. *See, e.g., infra* note 187.

<sup>157</sup> *See, supra* \_\_\_\_.

approach,<sup>158</sup> the Seventh Circuit enforced a contract that prohibited the defendant from commercially using an unprotected database. Under the partial-contract-preemption test, a court would need to decide whether “commercial use” is tangled with reproduction (an exclusive right) which would make the contract preempted. This is a difficult question in itself that quite possibly would lead to the enforcement of the contract. However, even if an obligation to refrain from commercial usage is preempted, it seems that by a simple change the contract would make it enforceable: if the contract would have included a promise by the defendant to pay the fair market value of any commercial use, then preemption almost certainly be avoided. The value of commercial use might have been in the millions and thus such a contract could probably have created the same effect as the heavily criticized contract in *ProCD* — preventing Mathew Zeidenberg from free riding ProCD’s massive investment in collecting factual information.<sup>159</sup>

Indeed, the partial-contract-preemption test allows many far reaching contracts to escape preemption. In fact, the contracts that are the most likely to fail this test are what I have called in Part I “redundancy contracts”: those contracts that prohibit the defendant from taking an action that is already copyright infringement. In many of those cases, the plaintiff had a valid copyright infringement claim and thus the preemption ruling will have little practical effect.<sup>160</sup> Indeed, it seems undesirable for a doctrine to mainly affect redundancy contracts that only rarely raise real policy concerns.

## 2. Overbreadth

The partial-contract-preemption test is sometimes overbroad. The test seems to imply that copyright law has a monopoly over the reproduction, distribution, and public display and performance of certain works, which is inconsistent with both the traditional and reasonable role of contracts and other legal doctrines.

Information, whether fixed or not, whether creative or not, is quite often subject to human interaction that has little to do with copyright law. It is therefore not surprising that other legal norms regulate information in these contexts.

Confidentiality and exclusivity arrangements might be the most obvious

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<sup>158</sup> See, e.g., Wendy J. Gordon, *Intellectual Property as Price Discrimination: Implications for Contract*, 73 CHI.-KENT L. REV. 1367, 1378-86 (1998); Nimmer, Brown & Frischling, *supra* note 110, at 42-63 (1999); Mark A. Lemley, *Beyond Preemption: The Law and Policy of Intellectual Property Licensing*, 87 Cal. L. Rev. 111, 147-51 (1999); Benkler, *supra* note 46, at 429-35 (1999); Julie E. Cohen, *Copyright and the Perfect Curve*, 53 VAND. L. REV. 1799, 1812 (2000). See also Randal C. Picker, *Easterbrook on Copyright*, 77 U. CHI. L. REV. 1165, 1178 (2010) (“ProCD is the opinion that the copyright casebooks love to hate.”).

<sup>159</sup> Some have suggested the partial-contract-preemption’s test should be expanded to include payment as well because each exclusive right inherently includes a right to be paid for a license. See, e.g., Bohannon, *supra* note 93. This approach is was not adopted in the caselaw. [TBA: an explanation why this might create an over-broad test]

<sup>160</sup> See *supra* \_\_\_\_.

examples. Reporters pay their sources in return for an exclusive story. The sources promise not to distribute their stories to others. Similarly, my research assistant collected and distributed factual information that I used in writing this Article. He promised to give this information exclusively to me. An inventor who has a brilliant idea would like a venture capital company to enter a joint venture with her, and so she requires the venture capitalist to sign a non-disclosure agreement before the idea is disclosed. Company A would like to acquire company B and so it must conduct due diligence. Company B would share this confidential information only subject to company A's promise not to disclose it to others. All those contractual promises are common, reasonable, and are required for the operation of various businesses. However, all these promises regulate the distribution (and in many cases the reproduction) of information goods (in most cases, not protected by copyright). These promises therefore clearly fall within the scope of the partial-contract-preemption test, and yet, it would be preposterous not to enforce them because they allegedly create a right that is equivalent to the exclusive rights under the Copyright Act. In fact, the entire legal field of trade secrets is based on legal obligations to refrain from distributing certain information.

Indeed, historically, copyright law was perceived as just one non-exclusive way to control the reproduction and distribution of information goods. For example, *Fiest v. Rural*,<sup>161</sup> in which the Supreme Court held that factual information is not protected by copyright even when its collection is labor-intensive, sparked a debate over the protection of databases in the United States. Some have suggested that Congress should use its Commerce Clause power to provide protection to databases, possibly similar to the protection afforded by the European Union's Directive on the Legal Protection for Databases (Database Directive), adopted in 1996.<sup>162</sup> Congress has never passed such legislation. The main argument against these initiatives is that additional legislation is not needed because other legal norms provide sufficient incentive to create databases. Professor Miriam Bitton, for example, explored how certain norms of, inter alia, criminal law, trade secret, trademark, unfair competition, tort, and contracts allow creators to prevent some forms of free riding and thus collect a decent return on their investment in collecting data.<sup>163</sup> This analysis suggests that copyright law was not and probably should not be perceived to have absolute monopoly over legal arrangements that limit distribution of information goods.<sup>164</sup>

[TBA: discussion on some of the alternative tests to identify promises that

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<sup>161</sup> 499 U.S. 340 (1991).

<sup>162</sup> [TBA]

<sup>163</sup> Miriam Bitton, *A New Outlook on the Economic Dimension of the Database Protection Debate*, 47 IDEA 93, 147-166 (2006).

<sup>164</sup> It is interesting to note that in some cases the same people who criticize ProCD also opposed these legislative initiatives that were designed to protect databases on the ground that such legislation is not needed.

should be preempted. In particular discuss Michael Kenneally’s suggestion that contracts that look like property right (i.e., standard-form-agreements) should be preempted and Christina Bohannan’s suggestion to use waiver doctrine and preempted waivers that protect the interests of the public. The problem with Kenneally’s approach is that it is probably overbroad because some standard form agreements seem desirable and some do not. This approach, which was offered by others including by Judge Dyk’s dissent in *Bowers v. Baystate Technologies*, is also inconsistent with the treatment of standard-form-agreements in other areas of the law. From an abstract perspective, Bohannan’s approach seems attractive. The problem is that it seems to rephrase the general concern (some copyright norms should not be contracted around) but it provides too little guidance as to how to apply this test. When Bohannan does apply this test to certain specific situations the analysis gets tricky. She, for example, assumes that courts can, on a case by case basis, decide whether a contracts improve access]

*B. The Conflict between Copyright Policy and the No-Contract-Preemption Approach*

The previous Section suggests that the partial-contract-preemption approach has failed to come up with a convincing test that would appropriately draw a line between contracts that should be preempted and those that should not. Some might be tempted to conclude that this failure vindicates the view that all contracts must survive preemption — the no-contract-preemption-approach. Such a conclusion is misguided.

While it is true that coming up with a test that would reasonably identify those contracts that should be preempted under section 301(a) is extremely difficult, maybe impossible, this is not the only type of preempted that should be considered. Conflict preemption should also be examined. Indeed, limiting preemption to those contracts that are “equivalent to any of the exclusive rights”<sup>165</sup> might make all contracts evade explicit preemption, but it will not necessarily mean that enforcing them, would not “stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress”<sup>166</sup> and thus preempted. This Section explains how the no-contract-preemption approach can indeed conflict with copyright policy. The next Part explores specific situations in which such a conflict may arise.

The No-Contract-Preemption approach has clear advantages. First, it is easy to administer. The competing approach — the partial-contract-preemption approach — requires the court to examine the contract itself and then to apply a test, typically a vague one, to decide whether the contract is preempted. The no-contract-preemption approach is much simpler. Because contracts are never preempted the courts do not need to examine the contractual promises or to apply any complex

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<sup>165</sup> 17 U.S.C. § 301(a).

<sup>166</sup> *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941).

test.

More significantly, the no-contract-preemption approach celebrates the ideas of freedom of contracts. It allows parties to deviate from the default statutory arrangements where those arrangements do not maximize the parties' wellbeing.<sup>167</sup>

This approach, however, has significant shortcomings. While it is partly inspired by an observation that most (although not all) commentators accept — that copyright law creates property right — the nature of these specific property rights should make reliance on the market questionable. While freedom on contracts is generally socially advantageous, in some situations it can lead to undesirable results, especially in those areas in which market failures are common, such as the markets for copyright goods. This world is so far removed from the Coasian world that reliance on the notions of the Coase Theorem, or even the use of the Theorem's narratives, might be misleading.

Some characteristics of the markets for copyrighted goods make unrestricted freedom of contract especially concerning. These markets suffer from a host of market failures including high transaction costs, significant externalities, and monopoly pricing. However, for analyzing the effects of contractual freedom, the most significant characteristic of copyrighted goods is probably that information goods are not just the product of the creative process but they are also an input in it.<sup>168</sup> Therefore, the broader the scope of copyright protection and the stronger those rights are, the higher the income of the author, but, at the same time, the higher the costs of creation too. The no-contract-preemption approach allows the authors to have appropriate certain usage and have stronger control over their works and therefore it is expected to increase the income of authors but also their costs of creation.

However, as further discussed in Part V below, there is no reason to assume that the benefits to creation from broader protection will be similar to the added costs. It is fair to assume that some elements of protection will generate more profits than costs and some would not. Intuitively, it is reasonable to suspect that the prohibition on literal copying creates significant benefits to authors that outweigh the costs to future authors but that keeping ideas in the public domain, while denying authors an income source, more significantly reduces the costs of creation.<sup>169</sup>

If that observation is correct, then it makes sense that behind the veil of ignorance, authors, as a group, would want the law to set a certain level of protection of their works which is less than full protection. That desired level of

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<sup>167</sup> See, e.g., *supra* Section III.B; Richard Epstein, *supra* note 136; Rub, *supra* note 69, Section VI.D (arguing that allowing a software company to sell cheap student-version software, which limits transferability, is socially desirable).

<sup>168</sup> Jessica Litman, *The Public Domain*, 39 EMORY L.J. 965, 966 (1990) (“To say that every new work is in some sense based on the works that preceded it is such a truism that it has long been a cliché.”).

<sup>169</sup> This intuition is discussed at length, in the context of contractual freedom, in Part V *infra*.

protection might include limitations of literal copyright but not on the copying of ideas. This argument can therefore explain certain norms of copyright law. Therefore, from this perspective, some of the norms of copyright law represent a social contract: a contract regarding the level of protection between all authors — past, present, and future.<sup>170</sup>

This brings about a collective action problem. As a group, behind the veil of ignorance, authors might want to place limitations on the ability of all authors to control certain aspects of their work. However, once a work is created, it might be in the best interest of each author to have as strong of a protection as possible. Thus, it is possible that it will be in the best interest of the authors, as a group, to keep ideas in the public domain while it will be in the best interest of each author that the ideas expressed in her own work will not be used by others, at least not without compensation. Therefore, authors might like to control aspects of their work that go beyond the socially optimum level and contracts might be able to help them do so.<sup>171</sup> A law that disallows such appropriation might therefore be socially desirable.

Therefore, the no-contract-preemption approach might lead to socially undesirable equilibrium. The conflict between copyright policy and between unlimited freedom-of-contracts seems real. However, this is only the first step in the analysis. It might explain why some contracts might conflict with copyright policy and might not maximize social welfare but, like the partial-contract-preemption approach, it does not provide guidance to help identify contracts that should and should not be preempted. The next Part suggests a few such guidelines.

#### PART V: A MARKET FAILURES APPROACH TO THE PREEMPTION OF CONTRACTS: THE TRAGEDY OF THE ANTICOMMONS

The previous Part concludes by suggesting that the no-contract-preemption approach is undesirable because it ignores certain attributes of the market for copyrighted goods. Consequently, it was argued that enforcing certain contracts is socially undesirable and should be preempted. It thus vindicated certain aspects of the delicate balance narrative as a way to promote social welfare by setting an

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<sup>170</sup> The idea of copyright norms as social contract was suggested by Margaret Radin in MARGARET JANE RADIN, *BOILERPLATE: THE FINE PRINT, VANISHING RIGHTS, AND THE RULE OF LAW* 170-173 (2013).

<sup>171</sup> This proposition might be counterintuitive for some readers but there are many examples to such situations. This is, in many respects, another version of the famous prisoner's dilemma. Like the prisoners in that famous problem, an author needs to decide whether to defect — in this case, contractually limit the ability of future authors to use her work, or cooperate — not have these contractual limitations in place. The author might ask herself the following two questions: if all other authors (including the authors whose work I used in creating my work) defect, should I defect and limit future authors? The answer is of course yes. Similarly, if all other authors cooperate, the author should still defect. Therefore, defection is the dominant strategy of each author, but this leads to social inferior result — too much control over creative work.

efficient level of control over the future exploitation of creative works. However, not every norm of copyright law reflects this balance, and in some cases, it can be socially desirable to subject certain norms — whether reflecting this balance or not — to the flexibility offered by freedom of contracts. Therefore, only a more detailed analysis of the failures of the markets for copyrighted goods, and the effects of contractual freedom on these markets can provide guidance regarding the scope of preemption of contracts. This Part presents such analysis and shows that while preemption will not be common, in some cases the tragedy of the anticommons — a form of a market failure — both explains certain copyright law norms and justifies preemption of certain contradicting contracts. This Part concludes that standard form agreements that are inconsistent with those doctrines of copyright law that set a threshold for liability of creators — in particular the idea-expression distinction and the tests for substantial similarity — should typically be preempted as conflicting with copyright policy.

#### A. *The Tragedy of the Anticommons in Copyrighted Goods*

This Section presents the problem of the tragedy of the anticommons, explains why it is especially troubling in the markets for copyrighted goods, and finally, shows how current copyright law norms significantly mitigate the problem. Later sections explore the effects of contractual freedom on this market failure.

“A resource is prone to underuse in a ‘tragedy of the anticommons’ when multiple owners each have a right to exclude others from a scarce resource and no one has an effective privilege of use.”<sup>172</sup> In other words, when effective usage of a resource is contingent on the consent of several individuals a form of a hold-up problem might emerge, which can lead to an underuse of the resource. A tragedy of the anticommons can emerge in many situations, including the usage of stores in post-communist Russia,<sup>173</sup> effective biomedical research,<sup>174</sup> creation of real estate servitudes,<sup>175</sup> and resolving air traffic congestion in the United States.<sup>176</sup>

The non-rivalrous nature of information goods makes this problem more complex in the context of intellectual property law including copyright law.<sup>177</sup>

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<sup>172</sup> Michael A. Heller & Rebecca S. Eisenberg, *Can Patents Deter Innovation? The Anticommons in Biomedical Research*, 280 SCI. 698, 698 (1998).

<sup>173</sup> Michael A. Heller, *The Tragedy of the Anticommons: Property in the Transition from Marx to Markets*, 111 HARV. L. REV. 621 (1998).

<sup>174</sup> Heller & Eisenberg, *supra* note 172.

<sup>175</sup> Ben W. F. Depoorter and Francesco Parisi, *Fragmentation of Property Rights: A Functional Interpretation of the Law of Servitudes*, 3 GLOBAL JURIST FRONTIERS ART., 19 (2003).

<sup>176</sup> MICHAEL HELLER, *THE GRIDLOCK ECONOMY* 8-9 (2008).

<sup>177</sup> See generally Heller & Eisenberg, *supra* note 172 (discussing the problem in the context of patent law); HELLER, *supra* note 176, at 9-11 (discussing this problem in the production of copyrighted documentary films); Molly Shaffer Van Houweling, *Author Autonomy and Atomism in Copyright Law*, 96 VA. L. REV. 549 (2010) (discussing the problem of fragmentation in digital creation); Guy A. Rub, *Stronger Than Kryptonite? Inalienable Profit-Sharing Schemes in Copyright Law*, 27 HARV. J.L. & TECH. 49, 115-24 (2013) (discussing the problem in the context of



Information goods are intangible and therefore (with certain exceptions) non-rivalrous: they can be used by one without interfering with the usage by others. For example, Alice and Bob can listen to the same song at the same time without interfering with one another's usage. Rivalrous goods are different: Alice and Bob cannot drive the same car, or eat the same apple without affecting — and typically interfering — with one another. The non-rivalrous nature of information goods has many benefits: it is much cheaper to let Alice, Bob, and many others use the same non-rivalrous good at the same time than to let many individuals share rivalrous goods. However, it also creates some unique challenges.

The non-rivalrous nature of information goods makes it easy to use information goods as an input in the creative process.<sup>178</sup> Non-rivalry allows hundreds of authors to use *Romeo & Juliet* as an input in their creative process without interfering with each other. This also means that any single creative work can use a tremendous number of other information goods as input, which is impractical in rivalrous creation.

This Article, for example, cites to a few hundreds resources. In researching for this Article, the author read hundreds of decisions and articles, all of which serve as input in the process of writing this Article. Those hundreds of resources each used hundreds of information goods as input in their creative process as well. In fact, like most authors, I can be, and I undoubtedly am, unaware of some of the input to my work. I did not read all the resources that my resources use and I might use certain terms or theories without remembering or even knowing their exact source.

The non-rivalrous nature of information goods makes it all possible. It allows me to use (i.e., cite or quote) a resource without preventing others from using the same resource. Indeed, if any use would have interfered with the use of others, then using hundreds of resources as input would be socially nightmarish.

Enters copyright law and, with it, the possibility of a tragedy of the anticommons. If copyright law creates property rights in information good — and it does — and if the tragedy of the anticommons theory warns us against competing rights with respect to one asset — and it does — how can the creative process effectively operate? In other words, if the tragedy of the anticommons suggests that the more consents needed to effectively create or use a resource, the higher the likelihood of underuse, then how can a system that is based on massive usage of copyrighted materials operate?

The answer is that several doctrines in copyright law — and in particular the idea-expression distinction and the substantial similarity test — address this very problem. While the mechanisms of these doctrines do, indeed, differ from one another, they both have a somewhat similar effect on the creative process. Both create a threshold for using information goods in the creative process. Usage that does not meet this threshold does not require the consent of the previous authors.

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termination rights).

<sup>178</sup> See *supra* \_\_\_\_.

This threshold filters most of the input in the creative process. In other words, most of the inputs in the creative process are either ideas, which are not protected pursuant to the idea-expression distinction,<sup>179</sup> or short segments from expressive works that do not meet the threshold for illicit reproduction set by the substantial similarity test.<sup>180</sup> Indeed, the idea-expression doctrine allows me to use arguments from articles I read in my research and the substantial similarity test allows me to quote from them.<sup>181</sup>

Moreover, usage that does pass this threshold is relatively easy to identify. While it would be close to impossible to identify all the information goods that are used in this Article, or in most other creative endeavors for that matter, it is much easier to identify just those resources that cross the threshold set by these doctrines — those resources from which I copy enough to justify liability under copyright law. There are typically only few such resources (in this Article, for example, there are none) and their usage is rarely unknown.<sup>182</sup>

### *B. The Role of Transaction Costs*

At first blush, the discussion in the previous Section may seem to support making the idea-expression distinction and the substantial similarity test part of the mandatory copyright law and to refuse to enforce any contract that is inconsistent with any of these doctrines. However, because some contracts do not raise anticommons concerns, this conclusion would be premature and — as explained below — overbroad.

The tragedy of the anticommons is a problem of high transaction costs. Indeed, “in a world of costless transactions, people could always avoid commons or anticommons tragedies by trading their rights.”<sup>183</sup> The same logic holds in the context of copyrighted goods. If transaction costs are negligible, then the idea-expression doctrine as well as the substantial similarity test might not be needed to avoid the tragedy of the anticommons. Even without these doctrines, in a zero transaction cost world, an author can identify the copyright owners of all the resources she uses and negotiate a license with each of them. In reality, however, in

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<sup>179</sup> 17 U.S.C. § 102(b) (“In no case does copyright protection ... extend to any idea”).

<sup>180</sup> *Arnstein v. Porter*, 154 F.2d 464, 472 (2d Cir. 1946) (“Assuming that adequate proof is made of copying, that is not enough; for there can be ‘permissible copying,’ copying which is not illicit.”)

<sup>181</sup> [Add: Short quotations might also be covered by the fair use defenses.]

<sup>182</sup> Of course, there are exceptions to this rule. Copyright law literature is full of them. They includes works that copy many other resources in a way that might constitute copyright infringement. *See, e.g.*, LAWRENCE LESSIG, *THE FUTURE OF IDEAS: THE FATE OF THE COMMONS IN A CONNECTED WORLD* (2001); HELLER, *supra* note 176. They also include examples to subconscious illicit copying. *See, e.g.*, *ABKCO Music, Inc. v. Harrisongs Music, Ltd.*, 722 F.2d 988 (2d Cir. 1983). Those situations exist and they are interesting and sometimes troubling and they might justify the attention they receive from copyright scholars. However, compared with the entire world of creation, these situations are probably uncommon.

<sup>183</sup> *Heller & Eisenberg, supra* note 172, at 698.

the context of copyrighted work for the reasons explored above this idea is absurd. Transaction costs rise as the number of contracting parties increases and therefore, it is practically impossible to imagine a set of contracts that will cover every use of every information good in each new work.

### C. Preemption of Contracts

The discussion in the previous Section explains why it is desirable to exclude ideas and certain minimal copying from the scope of the *in rem* norms of copyright law. Can the same logic apply to contracts, which only create *in personam* rights? This Section shows that some contracts raise such concerns and some do not. The distinction depends on whether the contracts are private or public by nature.

Private contracts — agreements that are tailored by the parties to their needs — typically do not raise anticommons concerns. Such agreements are negotiated and therefore, it is likely that the numbers of such contracts and the number of contracting parties in these contracts are both small. But standard-form agreements are public by nature.<sup>184</sup> Such agreements are drafted once and are subsequently entered with multiple parties, typically hundreds or thousands. Entering into these agreements is extremely easy and can occur even without fully noticing it,<sup>185</sup> but negotiating around standard-form agreements is very difficult. In contrast, private agreements can typically be easily renegotiated. The parties usually know each other and, as indicates by their past ability to negotiate an agreement, are expected to be able to renegotiate it, if needed.

In contrast, from a copyright policy perspective certain standard-form agreements can raise concerns that would justify preemption. As explained above, authors use many information resources in her works. If such usage can be subject to restrictive standard-form-agreements, which are easy to enter and difficult to contract around, then each author will be subject to countless contractual promises. Consequently, if standard-form-agreements contract around the mechanisms that allow copyright norms to avoid the tragedy of the anticommons — the idea-expression distinction or the substantial similarity test — a tragedy of the anticommons is likely to arise.

Desny claims are examples of private contracts over ideas that do not seem to raise transaction costs or tragedy of the anticommons concerns. As explained above,<sup>186</sup> Desny claims arise after the plaintiff pitches an idea, for example for a movie or a TV show, to the defendant and the defendant rejects the idea but later uses it. Under state law there is an implied-in-fact contractual promise of the defendant to pay the plaintiff in such a case. This situation does not seem to raise significant transaction costs or tragedy of the anticommons concerns because the

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<sup>184</sup> See generally, Henry E. Smith, *Modularity in Contracts: Boilerplate and Information Flow*, 104 MICH. L. REV. 1175 (2006).

<sup>185</sup> See RADIN, *supra* note 170.

<sup>186</sup> *Supra* note \_\_.

limited number of pitches that authors are exposed to. It seems likely that producers — the typical defendants in Desny claims — will be able to identify those ideas and pay their originators. Moreover, producers can effectively protect themselves by explicitly negotiating different arrangements with those who pitches ideas to them.<sup>187</sup>

Compare this with a standard-form agreement that is attached to a product and limits the use of ideas.<sup>188</sup> For example, a contract that states “by reading Harry Potter you promise to compensate J. K. Rowling prior to using any idea expressed in this book” should raise serious concerns from copyright law policy perspective. When the contract appropriates every small idea and when it is entered with thousands of parties, the chances for the emergence of a tragedy of the anticommons are high. As explained above, authors (in this case, primarily authors of fantasy works) use hundreds of information goods as resources in their work and creating legal barrier over such use of these resources raises significant anticommons concerns.<sup>189</sup> The high transaction costs problem does not allow negotiation around the numerous standard-form agreements to clear the rights prior to commercialization.<sup>190</sup>

It is important to note that not every standard form agreement over copyrighted goods should be preempted. For example, elsewhere<sup>191</sup> I have argued that there are

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<sup>187</sup> Desny claim could be extended in a way that would make them more problematic, for example, if state law was to recognize an implied-in-fact promises to compensate in more trivial situations that go beyond a full pitch (for example, if such a promise is found with respect to any idea that is mentioned in front of the producer or her team). However, this would make a Desny claim look much different from an implied-in-fact contractual claim and more like a property rights in ideas, which raises other serious preemption concerns. *See generally* Moore v. Lightstorm Entm't, 2013 WL 4052813 (D. Md. Aug. 9, 2013) (finding an implied-in-fact claim to pay for the idea that might have led to the production of the movie “Avatar” preempted, partly because of insufficient “level of bilateral negotiation.” The analysis in this Section suggests that it would be preferable to hold that in that case the existence of the implied-in-fact contract was not proved, than to hold, in sharp contrast with other decisions include a binding precedent, *see supra* note \_\_\_, that it is preempted).

<sup>188</sup> [TBA: Explanation that there is a contractual acceptance issue in here. Sometimes it is easy to overcome this problem and sometime not. Viral contracts are one way in which sellers overcome this difficulty. In addition to establish acceptance there can be a difficulty of proving acceptance.]

<sup>189</sup> [TBA: Explanation that in many cases competitive pressure will not be able to, by itself, restrain such practices. First, it is unlikely that potential fantasy book authors will read the standard-form agreements and only buy books that do not limit future authors. Second, even if authors would like to take the restrictions found in a standard-form agreement into account, information goods are experience goods and therefore it is difficult to estimate whether the work is worth the restriction before consuming it and accepting the agreement. Third, future authors are just a small subset of the entire group of potential buyers of information goods and therefore they might not be able to generate enough competitive pressure to restrict inefficient overbroad agreements.]

<sup>190</sup> [It is true that breaching such a promise entail limited remedies — mainly expectation damages and possibly specific performance — but this seems to only marginally mitigate the problem].

<sup>191</sup> Rub, *supra* note 69, section VI.D.

significant social benefits in enforcing a standard form agreements in which students promise not to transfer cheap students' edition software to third parties or radio stations promise not to transfer free promotion music CDs. Standard-form agreements, by their nature, always raise some concerns. They are typically not read and thus can raise the transaction costs and be a trap for the unwary, and they might evade competitive pressure. Therefore, I have argued that these contracts should be subject to legal scrutiny to make sure they are fair and possibly to incentivize their disclosure<sup>192</sup> but, subject to these restraints, they do not affect the rights of future creator and do not raise anticommons concerns.

Accordingly, this analysis suggests that some contracts can raise anticommons concerns and should therefore be preempted. In particular, standard-form agreements that contract around the idea-expression distinction or create liability for minor copying can cause a market failure and should typically be preempted.

#### D. [Other concerns:]

[In this Section I would like to suggest that the tragedy of the anticommons is just one phenomenon that might require conflict preemption analysis, although it might be the more troubling one. I do not plan to fully analyze all of them but I would like to at least mention and briefly discuss a few more:

##### 1. Censorship.

A contract may limit the ability to criticize a work. Consider, for example, a contract that states “by reading this book you agree not to criticize it” or “by watching this TV show (or this political speech) you agree not to create a parody thereof.” Such a contractual promise raises serious concerns but these concerns have only incidental connection with copyright law. True, copyright law can foster this type of censorship and some mechanisms within copyright law, and in particular the fair use defense, partly address similar concerns.<sup>193</sup>

Limitations on censorship, however, are almost as likely to emerge in areas that have nothing to do with copyright. Physicians and lawyers, for example, might have their clients sign a standard-form agreement that prohibit negative criticism.<sup>194</sup> Similarly, non-disparagement clauses are common in many employment agreements and sometimes outside of them, for example, as part of settlement

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<sup>192</sup> Rub, *supra* note 69, section VI.D (suggesting that the doctrine of unconscionability should be used to prevent enforcement with respect to some standard form agreements that limit transferability); *See also* Ian Ayres & Alan Schwartz, *The No-Reading Problem in Consumer Contract Law*, 66 STAN. L. REV. 545 (2014) (claiming that the law should mandate disclosure of unfavorable terms that are beyond the buyers' expectations).

<sup>193</sup> *See generally*, Wendy J. Gordon, *Fair Use As Market Failure: A Structural and Economic Analysis of the Betamax Case and Its Predecessors*, 82 COLUM. L. REV. 1600 (1982).

<sup>194</sup> [Discuss Eric Goldman's work on how copyright law actually helps these claims in the online sphere. This is mainly an anecdote. The solution to this problem is within copyright law not by preempting other causes of action.]

agreements. These provisions raise concerns that touch upon the First Amendment, public policy, unconscionability, asymmetric information and facilitation of consumers' choice, and more. Such concerns probably justify not enforcing many of those agreements.<sup>195</sup> However, this issue has only incidental connection with copyright policy and therefore, copyright preemption is probably not the tool to deal with such contracts.

2. Anti-competitive concerns.

This is a complex topic because copyright law itself bestows monopoly power. Therefore contracts that deal with this monopoly power, such as exclusivity agreements, which might sometime raise antitrust concerns in other contexts, are quite common in copyright industries. Pro-competition antitrust policy might justify not enforcing some contracts. In particular, contractual limitations on reverse engineering might, in some cases, justify legal scrutiny. However, situations in which serious anti-competitive concerns are raised might be rare partly because copyright law typically grants only a weak monopoly power. It is possible that antitrust law may better handle these unusual situations.

3. Over-incentives and distributive effect.

Contractual norms in copyrighted goods are not new but modern technology makes such contracts more feasible and common. This phenomenon should be considered in designing copyright policy. Copyright law is calibrated to provide adequate incentives given certain available modes of creation and distribution. The desired scope of copyright protection is, and always has been, affected by the cost of creation, the cost and possibilities of distribution, the difficulty in piracy, and so on.<sup>196</sup>

If nowadays it is easier to distribute copyrighted goods subject to contractual limitations that allow the author to extract more income, then it is possible that the incentives to create are too high. This is not a trivial argument to make because the change in the feasibility of contracting is just one effect of modern technology on copyright policy. Other changes, such as easier and more common piracy, might more than balance this change.

Even if incentives are too high, it is doubtful that copyright preemption is the solution. There are norms within copyright law that seem much more harmful to the public goods and that can be restricted if incentives are indeed too high. Shortening the length of protection, for example, might be a much more desirable way to

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<sup>195</sup> See generally, Alan E. Garfield, *Promises of Silence: Contract Law and Freedom of Speech*, 83 CORNELL L. REV. 261 (1998).

<sup>196</sup> See Guy A. Rub, *Contracting Around Copyright: The Uneasy Case for Unbundling of Rights in Creative Works*, 78 U. CHI. L. REV. 257, 274 (2011) ("The relative efficiency of copyright rules depends on extraneous factors, and in particular on the current technologies that allow the creation, copying, and distribution of information goods as well as their costs").

recalibrate incentives.<sup>197</sup>

Broader contractual covenants can also raise certain distributive concerns. Such contracts can encourage creating and distributing works that allow authors to attach restrictive contracts and indirectly discourage other forms of creation. Thus, for example, it can encourage more digital distribution and less physical distribution. Intuitively, it is doubtful if this phenomenon, by itself, justifies preemption. The relative attractiveness of various modes of distribution commonly changes with technology. In addition, if contracts increase the income and the costs of authors, then even if they are generally desirable, they can be harmful to those who create not for profit. In many respects, this is a transaction cost problem but it might justify special treatment of those authors. The practical magnitude of this problem is unclear but it is possible that not-for-profit authors were never sued for a breach of such contracts.]

#### CONCLUSIONS

The relationship between contracts and copyright policy is complex. In many respects, the two complete each other but in some cases contracts provide norms that affect the creation, distribution, and usage of works that copyright law leaves unregulated. This Article explores this relationship and describes the two approaches that are currently used in the caselaw: the no-contract-preemption approach and the partial-contract-preemption approach.

While these two approaches are inspired by well-established narratives in copyright discourse, they fail to provide a convincing test to guide courts as to how to reconcile the tension between copyright policy and the freedom of contracts. This Article rejects the no-contract-preemption approach, as one that does not fully appreciate the unique features of the markets for copyrighted goods and thus fails to recognize the ways in which copyright policy tackles these unique considerations. Indeed, in some cases, the conflict between some contracts and copyright policy justifies preemption.

This Article also rejects the tests that have so far been offered by the proponents of the partial-contract-enforcement approach. These tests are sometimes too narrow, sometimes too broad, and in many cases partly arbitrary. Instead this Article suggests that the market failures in the markets for copyright goods should be analyzed in order to see when and what kind of contracts interfere with the doctrines of copyright law that tackle these failures. This Article applies this approach to the problem of the tragedy of the anticommons. It suggests that standard-form-agreements that contract around the idea-expression distinction or the test for substantial similarity should typically be preempted. Fully negotiated contracts, on the other hand, should not be preempted. Future research can shed

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<sup>197</sup> See Rub, *supra* note 196, at 275-76 (explaining that because the long length of protection is so socially harmful a regime that broadens price discrimination and shortens copyright duration is superior to a regime that prohibits price discrimination and extends copyright duration).

light on additional areas in which contracts might need to be preempted in order to preserve copyright policy.