

## “DIGITAL RIGHTS MANAGEMENT” BEST LEFT TO PRIVATE CONTRACT

by

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*The Problem.* The evident boom of interest in copyright (as well as all forms of intellectual property) is not a function of detached intellectual curiosity. It is driven by the fact that the low cost of copying and the high volume of creative material has created enormous opportunities for profit, both for those who create the new works, and for those who would like to copy it free of charge. That tension is not new in the area: indeed it is inherent in it. The corner solution (of perpetual property rights) makes for eminently good sense with physical property, where long term exclusive rights are the norm. Those rights create the maximum incentive for production and reduce the transaction costs in policing the boundaries of the rights in question. But they do not limit the use of the property once it is created, because physical property, unlike intellectual property, does obey the law that you can't eat your cake and have it too. Strong private property rights thus make for optimal decisions on the consumption/investment frontier. But intellectual property can be kept and consumed simultaneously, so that its entrance into the commons, once created, does not create a free-for-all. Rather, it creates public domain property which in the long run can prove perfectly stable.

Exactly when private copyrights should enter the public domain has been the subject of enormous controversy with the passage of the Copyright Term Extension Act, Pub. L. No. 105-298, 112 Stat. 2827. But that issue is really quite collateral to this one, which asks the question: what forms of protection should be available to copyrights during any period of unquestioned validity? In dealing with that issue, the point of departure in all cases is this question: notwithstanding the obvious differences between tangible and intangible property, to what extent do the rules of tangible property carry over to copyrights and to other forms of intangible property?

In answering this question, every system faces two inquiries. Both of these reassert themselves in copyright law, no matter how primitive or advanced the basic technology. Question one has to do with the protection that is afforded copyright from misappropriation. Clearly the system cannot survive if outsiders are entitled to equal access with insiders to copyrighted materials during the protected period. But just how far does that exclusion go, and by what means can it be protected? Question two has to do with the mechanisms for the voluntary transfer of copyright, either by sale or by license. Here again a system that allows only for exclusion and use, but not for disposition, is stillborn at birth. Fortress copyright will have no takers. What is needed are methods for fast and effective conveyances of total or partial interests in copyright to allow for the full realization of all potential gains from trade. The trick here is to minimize transaction costs so as to increase the net gain from these voluntary transactions, to the benefit of copyright holders and their transferees or licensees simultaneously. Let us look a bit closer at both these items.

*Boundaries.* In one sense the boundary conditions with respect to copyright seem to be easy: follow the common law rules with respect to trespass: keep off unless invited in. Now it turns out, however, that

these boundary conditions at common law are not as hard and fast as they might appear. Indeed much of property law in land consists of rules that are designed either to relax or expand the boundaries of real estate when the original hard-edged quality of the system leads to inefficient resource use that cannot be cured by voluntary transactions, owing to the high transaction costs of reassigning rights. Here are just a few examples of how these boundaries have been altered. The live-and-let live rule relaxes the boundary conditions to allow for low-level reciprocal nuisances for the prosaic reason that no one wants a regime of absolute silence if it means that they are not allowed to utter a word or set a table. The rules on overflight prevent the endless blockades of airspace. The rules against eavesdropping allow for the protection of privacy without the creation of walls. The rules on lateral support prevent land from tumbling down when neighbors build close to the property line. In each of these cases the need to transact with multiple parties creates enormous hold out problems which can be obviated by a subtle redefinition of rights that works to the long-term advantage of all.

The same kind of issues apply with respect to intellectual property. No one could report on the events of the day if each person had the exclusive right to use his own name and likeness. And no one could issue any criticism of literary or musical works if they could not quote passages or play portions thereof. It is for that reason that the doctrine of *fair use* allows these items to be used in limited fashion without the consent of the owner: who would believe a book review if he knew that it was written with the express written consent of the author? It is doubtful that anyone, least of all the entertainment industry, questions these instances of fair use because they involve situations in which the user has not set himself up as a substitute supplier of the copyrighted work. On balance an active critical market stimulates interest in the various arts, so that any short-term losses to an individual author are more than offset by the systematic gains that ripple throughout the system as a whole. Yet this same argument has no particular purchase in the case of patents, which allows no parallel justification for infringing uses. Yet, owing to the nature of the subject matter, it has its own separate exceptions to the categorical rule on infringement, such as those statutory exemptions for experimental use for pharmaceuticals.

Now in some cases the claims for fair use do not raise questions of criticism or commentary; rather they involve efforts by individuals to shift, either in time or space, copyrighted materials for their own use. Thus one might want to tape-record a show for later viewing — put aside for the moment that it also allows one to bleep out the commercials. Or one might want to rearrange the tracks on one or multiple CDs for listening in some preferred order. So long as those activities are all that is at stake, the doctrine of fair use should apply. Each of these transformations increases the utility of the purchase to the buyer of the protected material. None of them cut into the opportunities of the copyright holder to sell or license its own materials to other parties. Ideally, a copyright vendor would like to be able to hold out for sale an infinite array of packaged materials for home consumption, but the costs of production make this prohibitive. But so long as the buyer is willing to invest in that form of individuation himself, then he should on average be prepared to pay a larger sum for the product than if this privilege were denied. Hence it is easy to see why any well drafted sale or license arrangement should explicitly allow for these options, which makes this second variation on the doctrine of fair use redundant.

The difficulty here comes from another quarter. The ability to reproduce and reorganize can be used for two ends. In addition to enhancing the value for the initial purchaser or licensee, it could allow for sale, barter or exchange of the same product to another individual. It was that barter or gift system through a central agency that defined the Napster system. It is that form of barter or gift, without the central command post that defines peer-to-peer networks which carry so much traffic today. There is no real viable claim that these extensive gift, barter or sale networks count as fair use. They fall neither within the class of cases that involve limited use for criticism or discussion. Nor do they fall into the class of repackaging for one's own use, without foreclosing the markets open to others. The only question here therefore is what is the best way to shut these practices down in order to preserve the value of the copyright, a practical task that is far easier with Napster than it is with peer-to-peer networks.

At this point we face one of the great questions that face any system of property. When violations of

property rights have been committed or are threatened, a set of repetitive damage actions does the owner of the property little good. What one wants is an injunction against future trespasses or nuisances. If the harms have been committed or are imminent, that relief is easy to get, at least against a single person. But even in the land cases, it is far more difficult to see what remedies should be imposed when large numbers of individuals each have a small chance of committing various kinds of harm. Everyone cannot be kept off of the highway just because one person is apt to run through someone's front fence. So the problem is whether there is any kind of structural remedy that will allow us to identify high-risk users or uses and to restrain them without attacking the ordinary uses that individuals are entitled to make. The question is how to control two kinds of error: remedies that are given when they are not needed or allowable versus remedies that are not given when they are needed. Much of the criticism that I would level against the environmental movement rests on the simple proposition that the permit systems intervene too quickly, and cut off too much legitimate real estate development for too little social gain.

The same problem arises with the question of whether any regulatory fix could prevent illicit copying. Here most of the proposals are designed to deal with coercive restrictions on the operation of the various boxes that play digital materials. The effort is to constrain the box so that it will operate only if it receives the appropriate key for operation. If imposed by government, this system will easily run the risk of cutting too deeply: it will prevent the use of all sorts of legitimate transfers of information outside of copyright in order to prevent the widespread abuse of file-sharing that is, without question, a legitimate industry headache. The reason why this debate will never reach a final resting place is because the only sensible criterion does not yield unambiguous results. The losses from illicit copying are huge, so that the error of insufficient protection is large. But the losses for comprehensive control over hardware are every bit as great, if not greater. When both types of errors are large, then it is painful to choose between them because the losers will always be unhappy.

***Voluntary Transfer.*** It does not follow, however, that no alternative methods of control exist. In this regard, the key may well come, at least for the future, by ducking the initial question of boundary, and looking at the second issue: what are the efficient modes of voluntary transfer. In this regard, we face exactly the same problem that we did with the boundary protection issues. To what extent do the precedents in ordinary contract cases work in this area? The source of the problem can be simply stated. There is no real agreement as to what rules should govern ordinary transfers outside the digital world. We have had numerous cases of consumer goods that have been subject to arbitration clauses or to clauses that limit the collection of consequential damages. Yet the Uniform Commercial Code (UCC) has posed two large obstacles against the creation of effective contractual regimes in these areas.

First, the UCC has numerous provisions which assume that plaintiffs will have a full judicial trial that allows them to recover consequential damages which returns them to a situation as if the contract breach never occurred. In fact, virtually all voluntary contracts opt for a very different regime: lower prices, arbitration clauses, and limitations on consequential damages that limit the buyer to repair or replacement. These restrictions are not intended to stymie consumer preferences but (in the *ex ante* world) to satisfy them. Any benefit that the aggrieved consumer gets *ex post* must be paid for *ex ante*. At that point, most consumers do not want to pay for these goods, especially the careful ones who avoid troubles but would be required to subsidize more litigious consumers. Second, the mechanisms of UCC 2-207 unwisely displaces the common law rules of offer and acceptance. Under the older regime, the buyer who used or consumed goods with knowledge of the limitations imposed by the seller took subject to those limitations. In the new world, use with knowledge may not count as acceptance. Since neither side has acquiesced in the terms demanded by the other, the default provisions of the UCC take over and we have no arbitration and huge potential liabilities.

But what is good *ex post* is bad policy *ex ante*, so that the constant effort to subvert the familiar terms (most people have bought multiple items) leads to the wrong rules on damages and arbitration. Some of these issues may not matter for copyright cases where the consumer is the prospective defendant, but not the prospective plaintiff. But the anticontractual bias carries over to other areas.

The key point here is that an outright sale is a very crude way to maximize the value of some assets. The history of land use law shows that greater value can be gotten out of any specific asset if it can be divided into components that can cater to limited preferences. Just how these divisions are made depends on the preferences of potential users, and the ability of the system to monitor disputes between different individuals who share the same asset. With real estate, the creation of estates in land, the division between life tenants and remainders, for example, did much to improve the value of land. But that system is very crude, because it requires two or more users of a single asset to enjoy their holdings sequentially. They could seek to avoid this consequence by mortgages on their partial interests, but these transactions were difficult to arrange, owing to the uncertainty about the duration of the two estates. It was therefore a great advance to put real estate behind trusts (or in corporations and partnerships) where the patterns of beneficial ownership could be more subtly divided and managed. Securitization with respect to loans is yet another way in which thin slices maximize value.

***Private Contracts, Not Mandates.*** The digital rights management techniques are becoming available to allow for more complex divisions of copyrighted material. So much of the difficulty arises from the fact that the traditional rules allowed only for the outright sale of copyrighted property. That could easily make sense when it was not possible to copy copies. But it makes far less sense when that process becomes the commonplace threat that it now is today. In these circumstances, a better system of resource allocation will come if more complex licensing systems are put into place. Right now, the individual who buys a movie ticket cannot reproduce the film for resale or even reuse. It is a single use. Today it seems possible that copyrighted works could be transferred to users under licenses that allow for a limited number of uses, or which allow for unlimited uses, but are wedded to a single machine, or cluster of machines, to which they are in some sense branded. It seems clear that consumers will pay less for material that is so circumscribed. But by the same token, this system induces parties with low demands to buy packages of smaller uses; and it will reduce the level of illicit transfers, thus eliminating the pressures that might be placed on mandating precautions that are built into hardware.

So long as there is a vigorous market in competition within the various media, we should not worry about the specter of monopoly any more than we worry about this in those contexts in which cell phone users are charged by the minute under a rich variety of plans that thrive in what has become the more competitive and successful branch of the telecommunications market. Systems like this could require payment in advance, and could easily require supplemental payments for additional use. They could also contemplate shut-off of services for nonpayment, thereby raising the consumer protection issues just mentioned above, with arbitration and consequential damages. But no matter what the details of the technology, the point here seems clear. The pressure to have direct regulation on the media player to prevent the unauthorized use of content will be all the greater if we do not allow private contract, with its array of monitoring, metering and allocating, to work without direct regulatory interference. Thus this system could easily be arranged to allow for the shifting by time and space across machines, as is often the case right now. But it could also prevent unauthorized transfer and duplication, and adopt, where appropriate limitation devices tied to the number of plays or the period of use.

All interested parties should welcome the technology to expand private choice. It will induce production of a greater array of copyrighted material, and reduce the pressure on direct systems of social regulation that promise to overshoot the market and to embody all the regrettable rigidities of any government regime that is subject to bureaucratic arthritis and factional intrigue, old themes indeed, even in the digital age.