



Book review

Intellectual Property as Property Rights:

Lessons from

*Property Rights Dynamics*¹

edited by Donatella Porrini and Giovanni Ramello

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1. Introduction

Property Rights Dynamics is a collection of essays edited by Donatella Porrini and Giovanni Ramello on various topics in property rights theories from notable scholars of the field. The chapters are grouped into three parts. Part I concerns some new theories of property rights, Part II is about various aspects of extending the property paradigm to human body and intellectual property, and Part III covers related issues such as competition law, marital property and sleeping owners. The focus on the dynamics of property rights offers a useful reference point for those interested in studying the evolving boundaries of property rights.

The book opens with an introductory chapter by Donatella Porrini and Giovanni Ramello titled “Property rights dynamics: Current issues in law and economics” which provides an overview of property rights theories and the research questions discussed in the collection. Porrini and Ramello note that in many human societies *de facto* property rights predate *de jure* property rights, and property rights appear regularly whenever the problem of rival uses is manifested. However despite the regular occurrences of a property rights concept, the actual nature of property rights varies widely across different social groups and time periods, and thus no single universal definition for property rights exists. Indeed, the design, allocation and enforcement of property rights often involve a complex set of issues that different societies managed in a variety of ways. Changes over time in the demands of society require corresponding redefining of the nature of property rights. As such, the history of property rights is a dynamic and ever-changing one. To study and understand the precise functions of property rights, the best we could accomplish is to take snapshots of a given time and socio-economic condition.

In Western society, property rights are seen as necessary devices for preserving individual liberties and for facilitating market exchanges. Following Coase (1960), property rights are generally acknowledged to play an important role in attaining

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efficiency by correcting market failures and making private and public interests meet. Coase's discovery has also led to the belief that property rights is the "right", and probably the only solution for tackling any market failures in whatever context they might appear.

Nevertheless, some critics point out that this interpretation of Coase has given rise to rent-seeking opportunities, particularly in the context of intellectual property, with the consequence of an overall negative impact on social welfare. Therefore, it is important to pay a greater attention to the nature of the new subject matters of property rights, the economic context in which they are enforced, as well as how they affect the market structure and behaviours of the relevant economic agents. A proper understanding of the various idiosyncratic features of property rights can bear great insights on the divergence between theory and real-world economic implications.

2. Functional Property and Entropy

The second chapter, "The fall and rise of functional property", by Francesco Parisi retraces the history of property rights from ancient to modern times. According to him, in the beginning all properties were in the commons. When human population increased and resources became scarce, conflicts among competing resource use happened more frequently. Hence, the concept of property rights was born to overcome such conflicts. Parisi argues that the property rights regime in land was not uniform throughout history, but changes from a functional regime to a spatial regime, and back and forth again. When property rights first arose, the rights were functional. For example, overlapping uses of land are allowed, depending on the use and the person using it. Thus the hunter holds hunting privileges and the livestock breeder holds grazing rights over the same parcel of land. As time passed, in an agricultural economy, the functional property regime was abandoned in favour of a spatial property regime, where a single owner holds all rights pertaining to a defined piece of land. During the feudal era, property rights in land were not absolute, but dependent upon one's position in the feudal hierarchy of the claimant. Only the *tenant in demesne* had possessory rights of the land, while all the other parties served as intermediaries in the collection of fees and granting of services and protection. In the eighteenth century, with the rise of industrialisation and the closing of the feudal era, fragmentation of property rights came to an end. The codified civil law ensures unity in functional, physical and legal aspects of land property. Only those property rights that are recognised by the legal system may be created and transacted, even though this restriction conflicted and curtailed the freedom to contract. Parisi's explanation for this rise of unity in property rights is that it is to prevent entropy in property rights—a topic which is covered by the same author in another chapter in this book.

Although Parisi's account deals with real property, the historical lesson of the functional property regime should not be lost, since it could shed much light even on intellectual property rights. It can be said that intellectual property exhibits less unity in property rights compared to real property. Apart from having fewer restrictions on how intellectual property rights may be licensed or assigned to different parties, non-contractees may also stake claim to the use of an intellectual property without consent, as long as that use falls within a set of 'functions'. Under the American doctrine of fair use, a consumer or other producer may use a copyrighted work without prior consent, if

the activity falls within what the courts and the law consider as fair use.³ In English copyright law, the Copyright, Designs and Patents Act 1988 prescribes a catalogue of situations where use of a copyrighted work is permitted without prior consent when certain conditions are satisfied. Therefore, it can be concluded that areas of intellectual property rights such as copyright, and to some extent patent, allow encroachment by other users based on the nature of the use, and hence, the functional property regime is an apt characterisation of this aspect of the property rights.

The basic idea behind Francesco Parisi's second contribution titled "Entropy and the asymmetric Coase theorem" is that over time, property rights fragment into multiple ownerships, i.e. entropy. This is due to asymmetric costs between breaking a property up and recombining various fragments together. It is to be noted that fragmentation could happen physically as in partitioning a plot of land into smaller plots, as well as functionally or legally as in granting control over different aspects of a property to separate individuals. Parisi observes that legal systems develop various mechanisms to combat entropy in property rights. For example, recording systems forfeit unrecorded claims against innocent third party purchasers. The use of liability rules remedy such as damages on atypical rights is a case in point. Non-conforming property arrangements may be subjected to time limitations, whereby at the limitations come into force, the non-conforming property reverts back to the original owner.

The US Supreme Court decision of *New York Times v. Tasini* is a good example of using a liability rule to solve a fragmented property problem. In that case, newspaper publishers licensed articles written by independent writers to be published in the print version of their newspapers, without explicitly including the licence to reproduce articles from the newspapers in electronic form. When newspaper publishers started to include the articles in electronic databases, the plaintiffs sought compensation for copyright infringement. The majority of the Supreme Court decided for the plaintiffs but awarded only compensation but no injunction against the copiers. This allows publishers to continue using the articles without having to negotiate with thousands of individual authors under the threat of getting an incomplete database.⁴

3. Incomplete Property

Antonio Nicita extends the concept of incomplete contract, developed in New Institutional Economics, to property, giving birth to the concept of incomplete property. The chapter titled "On incomplete property: A missing perspective in law and economics?" defines incomplete property in two senses of the term: property rights are not completely defined, and secondly, enforcement of rights is not always possible. Nicita explains this incompleteness in efficiency terms. The core of the property rights over well-defined uses ensures certainty and promotes efficient usage of the property. In the periphery, uses are rivalrous in nature and property rights are only to be determined *ex post*, to save on *ex ante* transaction costs.

³ On the economic reasoning for fair use, see Gordon (1982).

⁴ For a fuller treatment of *New York Times v. Tasini* with an anticommons analysis, see Parisi and Ševčenko (2001).

Careful examination of property law does indeed reveal the nature of this incompleteness. Novel conflicts and claims over property rights are only established upon adjudication, while commonly exercised rights are usually laid down in statutes. Hence, incomplete property necessitates some form of judge-made law, whether the legal system is common law or civil law. Incomplete property can also be observed in copyright law. Apart from well-established rights, such as the right to control reproduction, the American copyright doctrine of fair use allows the judiciary to carve out specific exemptions to copyright protection—in essence, removing a copyright owner's property rights into the commons—upon satisfaction of a list of four factors.⁵ Myriad of activities have been successfully made a claim under this fair use doctrine; they include home videotaping for time-shifting purpose,⁶ photocopying⁷ and parody.⁸ Although the system of copyright exceptions in the United Kingdom employs rigid statutory exemptions unlike the more flexible approach in the United States, judicial pronouncements still play a role in defining the outer limits of copyright exceptions. For example, in respect of the fair dealing exception, courts still have to look at the specific circumstances to determine whether a particular dealing is fair.⁹

4. Marital Property

In “Treatment of marital assets: Common-law property rights and EU harmonization”, Anthony Dnes argues in favour of division of marital property according to a rebuttable presumption of division based on a mathematical formula, such as equal division, subject to the terms of an existing pre-nuptial agreement. The intuition for this insight comes from the Coase Theorem. Given low transaction cost of bargaining prior to marriage, parties could enter into a binding agreement on how to divide their marital property in the event of a divorce. If parties choose not to have a pre-nuptial agreement, the statutory presumption applies. Dnes argues that this is superior to the English approach of giving judges wide discretion in dividing marital property at the time of divorce. Having agreed rules of division is similar to expectation damages in breach of contract. Dnes nevertheless cautions that the presumption should apply only to new marriages when such a rule comes into force, and not retrospectively, so as to prevent inappropriate marital expectations which distort the incentives to divorce.

If marriage contracts are relational contracts, so are labour contracts. Dnes' precept about the division of marital property could equally be applicable to labour contracts involving creative production. When creators and innovators are involved in joint production with other creators or innovators, or as employees in a firm, it would be efficient for parties to enter into a “pre-nuptial” agreement regarding their creative efforts, or failing to, the law should state a default rule on division of returns from such

⁵ US Copyright Act 1976, s. 107.

⁶ *Sony Corporation of America v. Universal City Studios, Inc.*, 464 US 417 (1984).

⁷ *Williams & Wilkins Co. v. United States*, 487 F.2d 1345 (Ct. Cl. 1973).

⁸ *Campbell v. Acuff-Rose Music, Inc.*, 510 US 569 (1994).

⁹ *Universities UK Ltd. v. Copyright Licensing Agency Ltd.* [2002] RPC 36, para. 34.

a relation. Fortunately, the positions in copyright law and patent law with regards to employee's contribution as well as joint production are fairly clear, albeit one-sided. In English law on copyright, works of an employee in the course of employment belong to the employer unless agreed otherwise.¹⁰ Likewise, a similar rule applies in the case of patents.¹¹ For creations where a contract for services—as in the case of independent contractors—apply, the creator-contractor is the intellectual property owner unless a prior agreement exists that transfers the ownership of the intellectual property to the contractee.¹²

5. Sleeping Owners

In many regions of the new federal states of Germany, one can observe the peculiar phenomenon of dilapidated and abandoned buildings situated amidst prime development. These occurrences are the subject of Jurgen Backhaus' analysis in "Failing property rights—The problem of sleeping owners in the city". The author offers a few suggestions as to why the problem of sleeping owners occurs. These reasons include owners having low or zero opportunity cost of selling the property because of restrictions imposed on ownership, e.g. ownership of church buildings. Another is that some owners are holding on to properties without investing in improving them when the overall increase in land value due to adjacent developments outweighs the decrease of value due to neglect. However, Backhaus notes that such a strategy is only exercised by owners who face no opportunity cost of capital and no tax liability, of which one such example is the city or local authority itself. Based on the latter reasoning above, Backhaus explains that not investing in improving abandoned buildings is a form of negative externality on adjacent buildings when land value is depressed by the presence of dilapidated buildings. If the sleeping owner is the city itself, traditional policy solutions of zoning ordinance, public auction of delinquent property and property tax based on potential land rental would not be effective against the sleeping owners.

The problem of *sleeping owner* parallels the problem of orphan works and abandonware in copyright. Orphan works and abandonware are published works still under copyright protection but are no longer commercially available for one reason or another (Khong, 2007). Although orphan works and abandonware do not impose a negative externality on other copyright works, society suffers because of deadweight losses from under-utilisation. Similar to the case of sleeping owners, the solutions to the orphan works problem may include a system of compulsory licensing for works no longer published, or a copyright exception for limited and non-commercial use, and annual registration and renewal system such that the registration fee encourages copyright owner to keep a work registered only if it profitable for him to do so.

¹⁰ UK Copyright, Designs and Patents Act 1988, s. 11(2).

¹¹ UK Patents Act 1977, s. 39.

¹² UK Copyright, Designs and Patents Act 1988, s. 11(1), the exception being an equitable ownership rule established in *R. Griggs Group Ltd. & Ors. V. Evans & Ors.* [2004] EWHC 1088 (Ch).

6. Intellectual Property as Property Rights

Ugo Mattei and Andrea Pradi's chapter on "A comparative law and economics perspective in the global era" is a critic of the simplistic view of property rights based on a particular interpretation of the Coase Theorem. According to this interpretation, a well-defined system of property rights will take care of externalities, since parties will always bargain to reach an efficient solution. Mattei and Pradi are particularly critical of the extension of the natural law's property logic to the so-called intellectual property. Echoing similar concerns of earlier writers, they argue that the property rights logic is ill-suited to public good character of information. Unfortunately, the authors fall short of offering a concrete alternative to the pre-existing paradigm. One possible solution that the authors might perhaps find acceptable is to temper the existing intellectual property law with greater state regulations—such as restricting the subject matters of protection, severely limiting the duration of copyright protection, mandating more compulsory licensing and granting more user-friendly concessions under fair use and fair dealing rules—in order to curb the ill-effects of monopoly power.

Boldrin and Levine's piece on "Intellectual property and the efficient allocation of social surplus from innovations" is an essay which effectively punches holes in the usual property rhetorics used to justify intellectual property. It is in the same vein as their highly acclaimed *Against Intellectual Monopoly* book. Boldrin and Levine are an unusual pair of economists who demonstrate considerable understanding and insights into intellectual property law. On the US Supreme Court's opinion in *Eldred v. Ashcroft*, 537 US 186 (2003), the authors successfully point out the flaws in the arguments advanced by the justices. For example, with regards to the equal treatment argument on retrospective term extensions, the authors show that it makes no economic sense once this argument is applied to other economic activities such as taxation. They explain that this argument will also not hold water in respect of copyright term reduction.

Boldrin and Levine then turn their attention to Landes and Posner's (2003) argument that intellectual property promotes not only the creation of works, but also maintenance of works. The latter's thesis is that without intellectual property, there will be overuse of a work, such as the Mickey Mouse character, and "the value of the character might plummet." Boldrin and Levine attack Landes and Posner's misunderstanding of pecuniary externality. When a work such as the Mickey Mouse character lapses into the public domain, competition will force the market price down. The law of demand kicks in and consumers will consume more, or more consumers will have the opportunity of consuming the work. Producers of various versions of Mickey Mouse will instead face an externality, but this externality is merely pecuniary as its effect is on the price that can be extracted from the market. Consumers' demand will be satisfied earlier, since it is now cheaper to enjoy Mickey Mouse, and it is this phenomenon that Landes and Posner inaccurately call 'congestion'.

Robert P. Merges takes on the question of financial services patents in "The uninvited guest: Patents on Wall Street". He traces the rise of patents on financial services in the United States and its possible implications. He concludes with an optimistic note, not based on empirical evidence but on intuition, that the financial services sector will eventual come to terms with the existence of these patents and will adjust their business methods accordingly. In fact, Merges predicts, it will do the

financial services sector some evolutionary good as a random and unexpected shock in the form of patent protection is introduced into financial sector's humdrum ecosystem.

At the hinterland of the property and intellectual property landscape is the question of the human body, which is the subject charted by Majoney and Clark in their article, "Property rights in human tissue". In particular, the authors examine three related issues: the patenting of genetic material, compensation of tissue sources, and the control of tissue sources over the use of their tissue. On the subject of patenting of genetic material, the main thrust of the chapter is the fear that proprietisation would lead to the tragedy of anticommons in the biomedical industry (Heller and Eisenberg, 1998). The authors recount the various arguments for and against payment for human tissue, and conclude in favour of payment. As on the issue of control over tissue, the authors are in favour of restricting the right of the tissue source to order destruction of their removed tissue on life-saving humanitarian grounds.

The chapter on "The ongoing copyright as an essential facility saga" by Paul Torremans provides a detailed account of how European competition law regulates intellectual property markets, particularly the market for copyrighted information. The chapter examines European cases concerning the essential facility doctrine and whether refusal to license intellectual property could amount to an abuse of dominant position.¹³ The author displays cautious optimism that the courts are taking a restrictive approach to the application of competition law to the legitimate exploitation of intellectual property.

Finally, Harnay and Marciano in their essay titled "Intellectual property rights and judge-made law: An economic analysis of the production and diffusion of precedent" discuss the economic and social incentives in the production of judicial decisions outside the traditional economic incentive structure of property rights. They conclude that the institutional arrangements, norms and customs that govern the judicial community in common law countries, as well general expectation of reciprocity establish the conditions for the production of judge-made law.

7. Conclusion

The twelve articles in *Property Rights Dynamics* can be nicely grouped into two categories: those which are directly concerned with intellectual property and those which are not. What is interesting about the latter category is that the property rights principles explored therein are also applicable to intellectual property, as the discussion above shows. Issues such as functionality, entropy, incompleteness, relational property and abandonment have relevance in the theory of intellectual property.

Another way of grouping the articles is whether they support the view of intellectual property as a property rights. Boldrin and Levine's article is clearly in the 'anti' camp. Mattei and Pradi, and to some extent, Merges as well as Torremans' articles can be read as providing a weak support of that view. In this respect, two things are noteworthy when discussing the economics of intellectual property. The first is that

¹³ The cases discussed are *Maxicar v. Renault* [1990] 4 CMNLR 265; *Volvo v. Veng* [1989] 4 CMLR 122; *Magill's case* [1995] 4 CMLR 718; *Ladbroke v. European Commission* [1997] 5 CMLR 309; *IMS Health v. NDC Health* [2004] 4 CMLR 1543; and, the *Microsoft* case.

monopoly rights associated with intellectual property are broader than the exclusionary rights associated with physical property. In this sense, intellectual property is monopolistic in nature. Secondly, notwithstanding that intellectual property laws enable various forms of commercial dealing in the intellectual property, intellectual property is intrinsically different from other traditional forms of property such as land, as use of intellectual property is non-rivalrous in nature. With this in mind, there are strong justifications on welfare grounds to limit the property rights in intellectual property, either by restricting the scope or subject matter of intellectual property, or by using competition law to regulate the conduct of owners when exploiting intellectual property.

Property Rights Dynamics is a worthy reference for scholars interested in property rights and intellectual property rights. As is usual in a collection of this nature, some articles are more readable than others. Nevertheless, the diverse background and philosophical approaches taken by the contributors give this book an overall interesting mix. It is worth noting that the editors have also successfully kept spelling and stylistic mistakes to a minimum.

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