

EXHIBIT A
TO CROWTHER DECLARATION
IN SUPPORT OF ONE 3 TWO, INC.'S
MOTION IN LIMINE NO. 4
PART I

**IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK**

Plaintiff/Defendant,

v.

**SHEPARD FAIREY AND OBEY GIANT
ART, INC.,**

Counterclaim Defendants,

And

**THE ASSOCIATED PRESS,
Cross Claim
Plaintiff/Defendant.**

**EXPERT REPORT OF WILLIAM M. LANDES
NOVEMBER 2, 2010**

I. INTRODUCTION AND OVERVIEW

A. QUALIFICATIONS

1. I, William Landes, am the Clifton R. Musser Professor Emeritus of Law and Economics at the University of Chicago Law School. I received a Ph.D. in Economics from Columbia University in 1966. Since that time I have taught economics on the faculties of Stanford University, Columbia University, the Graduate Center of the City University of New York, and the University of Chicago. I was a tenured professor at the University of Chicago Law School from 1974 to 2009, when I retired, and where since my retirement I continue to teach a course in intellectual property, a seminar in art law and a workshop in judicial behavior.

2. I have published extensively on a variety of topics related to the general subject of economic analysis of law, including torts, antitrust, legal procedure, intellectual property, art law and judicial behavior. In the area of intellectual property, I am co-author with Richard A. Posner of a book entitled *The Economic Structure of Intellectual Property Law* (Harvard University

Press, 2003), which contains two chapters on the economics of art law, and I have also published a survey paper.¹

3. From 1991 to 2000 I served as Editor of *The Journal of Legal Studies*, and from 1975 to 1992 I served as an Editor of *The Journal of Law and Economics*, both of which are leading academic journals in the field of law and economics. I have served on the Editorial Board of the *Journal of Cultural Economics*. I served as President of the American Association of Law and Economics in 1992-1993 and I was recently elected a fellow of the American Academy of Arts and Sciences.

4. In addition to my academic experience, I have been Chairman and Chairman Emeritus of Lexecon, an economics consulting firm that I co-founded in 1977 with Richard A. Posner and Andrew Rosenfield. Lexecon was later merged with the firm Compass to form Compass Lexecon. A copy of my curriculum vitae that lists my publications and identifies cases in which I have testified in the past four years is attached as Exhibit A to this report.

5. I am being compensated for my time at the rate of \$1100 per hour. My compensation does not depend on the outcome of this case.

B. OVERVIEW

6. Counsel for The Associated Press (“The AP”) has asked me to respond to the report submitted by Mr. Fairey’s economic expert, Mr. John Jarosz, and in particular his conclusion that Shepard Fairey’s unauthorized use of The AP’s copyrighted photograph (the “Obama Image”) as the source image for a graphic work depicted on various items of merchandise (including but not limited to posters, t-shirts, hoodies, stickers, internet downloads, cell-phone wallpapers, et cetera) and in various artworks is unlikely to have an adverse economic

1. Landes and Levine, “The Economic Analysis of Art Law,” *Handbook of the Economics of Art and Culture I*, (Ginsburgh & Throsby, ed. 2006), 211 – 252.

effect on The AP. Mr. Fairey claims that his use of the Obama Image is a “fair use” under Sec. 107 the 1976 Copyright Act, which sets out the following four factors that should be considered in determining whether a use is a fair use:

Notwithstanding the provisions of sections 106 and 106A, the fair use of a copyrighted work, including such use by reproduction in copies or phonorecords or by any other means specified by that section, for purposes such as criticism, comment, news reporting, teaching (including multiple copies for classroom use), scholarship, or research, is not an infringement of copyright. In determining whether the use made of a work in any particular case is a fair use the factors to be considered shall include:

- a. The purpose and character of the use, including whether such use is of commercial nature or is for nonprofit educational purposes;
- b. The nature of the copyrighted work;
- c. The amount and substantiality of the portion used in relation to the copyrighted work as a whole;
- d. The effect of the use upon the potential market for, or value of, the copyrighted work.

7. I focus in this report on the fourth fair use factor, which measures (a) the impact an unauthorized use might have on the market for the original work itself; (b) the impact an unauthorized use might have on the market for follow-on work based on the original work, including derivative work and adaptations; and (c) the impact a fair use holding more generally would have on the previously described markets for the copyright holder’s works in general if that holding were to apply repeatedly over time in similar circumstances.

8. As part of my work in this matter I, or my staff at my direction, have reviewed court filings and discovery materials produced in this matter. In addition, my staff has held conversations with AP personnel. Exhibit B lists the materials on which I have relied in forming my conclusions and AP personnel that my staff interviewed.

9. The facts as I understand them are as follows. In 2008, Shepard Fairey created a series of limited edition artworks, posters and ancillary merchandise based on a digital copy of a

photograph of President Obama, who at the time was a junior Senator from Illinois. Mr. Fairey downloaded the photograph from Google Images. The AP holds the copyright in the original image (the “Obama Image”), which was created by an AP staff photographer, Mannie Garcia. Mr. Fairey did not seek a license from The AP to use the copyrighted photograph, which shows Senator Obama looking up and to his left, with lights shining down on his face, but instead reproduced the image without The AP’s permission and credit. Mr. Fairey claims that he chose the Obama Image because “he wanted to work from an image of Obama that was ‘Presidential’ and in which Obama was ‘gazing off into the future, saying, ‘I can guide you.’”²

10. Mr. Fairey reproduced the Obama Image to create graphic renditions of the image with either the word “hope” or the word “progress” added in capital letters beneath the image of Obama. He reproduced the image for a series of posters for sale on his website, obeygiant.com, and shortly thereafter he posted the image for download from that website, reserving, as discussed below, commercial rights in the image through his claim of copyright. Mr. Fairey and his companies then reproduced the Obama Image on a variety of commercial merchandise, including t-shirts and sweatshirts that were distributed and offered for sale by counterclaim defendant Obey Clothing, the exclusive licensee for clothing that incorporate Mr. Fairey’s designs and trademarks. I understand that Obey Clothing sold clothing merchandise bearing Mr. Fairey’s Obama image that did not include the words “hope” or “progress.” Mr. Fairey also reproduced the image in several artworks, many of which were sold to private collectors, including one that was donated by a collector to the Smithsonian Institution.

II. SUMMARY OF CONCLUSIONS

11. I understand that Mr. Fairey claims that his use of the particular Obama photograph should be considered a “fair use” under Sec. 107 the 1976 Copyright Act, which

2. Amended Answer and Affirmative Defenses of Plaintiffs and Counterclaim Defendants, ¶127.

permits unauthorized uses of copyrighted materials in a narrow range of circumstance. I explain in this report the economic benefits from copyright protection; the benefits from extending such protection to derivative works or adaptations of an original work; the economic rationale for the fair use doctrine; and the economic rationale of the fourth fair use factor specifically.³ I also explain the economic harms at stake in this litigation, all of which I understand to be relevant to fair use analysis under factor four. Although I teach and have taught intellectual property courses at the University of Chicago Law School, I am not a lawyer, and the opinions I express in this report do not reflect legal conclusions. Rather, they reflect my views as an economist about the issues described above.

12. My principal conclusions are that:

- Copyright protection for an original work of authorship, including the right to make derivative works or adaptations, increases the incentive to create copyright-eligible work by enabling an author to capture the financial and other returns that his or her work makes possible in the first place.
- In this case, copyright is performing its traditional function by protecting The AP's financial investment in creating copyrighted images, which in turn provides The AP with the incentive to create, promote, distribute, and maintain a large and valuable portfolio of copyrighted images.
- Factor four of fair use analysis accounts for copyright law's incentive purpose by focusing on the financial returns the copyright holder would earn but for the unauthorized copying.

3. See Landes & Posner, *The Economic Structure of Intellectual Property Law*, Chapters 6 and 9.

- In this case, the potential financial returns properly considered under factor four are substantial; therefore, deeming Mr. Fairey's unauthorized use of the Obama Image a fair use would reduce the AP's future incentive to create, promote, distribute, and maintain its copyrighted images.
- Applying fair use in this case would not only harm The AP, but appears unnecessary. Here there was an economically viable licensing channel for Mr. Fairey's various uses: Mr. Fairey could have readily licensed the Obama Image to create the Obama poster and the related commercial products at issue in this litigation. The AP was willing to offer him a license at terms that he would have been willing to accept.⁴ Thus, although fair use may, in certain circumstances, make possible an economically-efficient outcome – for instance, allowing innovative uses that would be cost-prohibitive if the relevant copyright holder's permission were required – that is not the case here.
- The analysis that Mr. Jarosz presents in his expert report fails to support his conclusion that Mr. Fairey's reproduction of the Obama Image caused minimal financial harm to The AP.
- I understand from industry expert Blake Sell's expert report that Mr. Jarosz's analysis of the income that The AP would have earned had Mr. Fairey licensed his use fails to take into account the fact that an initial license from The AP is typically inexpensive but also typically limits the scale of the initial licensed use.⁵ Licensees who want to extend their use beyond that initial limit must come back to The AP to negotiate and pay for

4. Expert Report of John C. Jarosz, October 1, 2010 at ¶110.

5. Expert Witness Report of Blake Pembroke Sell, November 2, 2010 at ¶¶132-134.

additional rights. Mr. Fairey would have had to do that in this case; and that lost licensing revenue is part of the harm to the AP in factor four analysis.

- Mr. Jarosz's analysis of the income that The AP would have earned had Mr. Fairey licensed his use also fails to address under factor four the larger impact that broadly applying fair use to reproductive uses like Mr. Fairey's use would have on the market for licensing The AP's vast database of images – a market that The AP has built and continues to build through substantial effort and financial investment.
- Permitting widespread unauthorized uses of The AP's images like Mr. Fairey's use of the Obama Image under the banner of fair use is likely to result in substantial financial injury to The AP and to undermine The AP's ability and incentive to preserve and maintain the quality of the images it already owns, to acquire and preserve images created by third parties, and to engage photographers to create new images. The quality of The AP's product would decline, reducing its value to users.
- Mr. Jarosz's conclusion that Mr. Fairey's motivation for using and actual use of the Obama Image was non-commercial is incorrect, because Mr. Fairey's use was in fact commercial: From the outset, Mr. Fairey kept for himself the commercial rights in the poster image. He profited directly from his reproduction of the image (through sales of the posters, art works, and other items) and he has profited indirectly as well, for instance through increased fame. Moreover, Mr. Fairey's intent is irrelevant under a proper economic analysis of factor four, because, no matter what Mr. Fairey's intended, the effects of Mr. Fairey's actions imposes a commercial harm on The AP.
- Mr. Jarosz provides no basis for his conclusion that the success of the works based on the Obama Image stem almost entirely from Mr. Fairey's contributions. In contrast, I present

empirical analysis that suggests that the Obama Image and the overall promotion efforts connected with President Obama's candidacy contributed substantially to the success of the works.⁶

13. My report is organized as follows. Section III explains the economic benefits of copyright protection, including protection for derivative works that are based on the original copyrighted work. Sections IV also briefly outlines the economic basis for the "fair use" doctrine in general and, in particular, factor four. Section V then explains why the analysis presented in the report submitted by John Jarosz, Mr. Fairey's economic expert, is flawed and fails to support his conclusion that Mr. Fairey's reproduction of the Obama Image caused minimal financial harm to The AP.

III. GRANTING COPYRIGHT OWNERS THE EXCLUSIVE RIGHTS TO THEIR WORKS INCREASES THE INCENTIVE TO CREATE NEW WORKS

A. THE INCENTIVE EFFECTS OF COPYRIGHT PROTECTION

14. The economic rationale for copyright protection is to provide incentives for firms and individuals to create original works of authorship (such as books, computer software, art works, photographs, music and so forth). To explain, creating a copyrightable work involves time, money and effort (sometimes called "the cost of expression"). In the absence of copyright protection, the party who created a new work would be unable to prevent others from copying and appropriating the work for their own benefit without paying for it. As a result, the original creator would have difficulty covering the costs of creating the work, which would reduce the incentive to create the work in the first place and, more generally, would reduce the incentive to

6. The expert report of Professor Laurie Dahlberg, an expert in photography and art history, provides an analysis of the elements of Mr. Fairey's image that are attributable to the underlying source image, the Obama Image. Expert Report of Laurie Dahlberg, November 2, 2010 at ¶¶42-44. In her expert report, Professor Dahlberg also demonstrates that Mr. Fairey routinely copies pre-existing photographs to create his works. *Id* at a82.

create new works, and so would lead to a reduction in the number and quality of new creative works.⁷ By limiting the ability of others to copy or to make unauthorized uses of the work, copyright enables the creator of the work to receive a return on his effort and investments, which in turn provides an incentive to create the work in the first place.

15. Because the returns from derivative works are part of the stream of benefits that the original work creates, the incentive benefits from copyright protection also apply to derivative works. Indeed, for some copyrighted works, derivative products might be a major source of the financial returns to the original copyright owner (for example, revenues from a movie that is based on a book).

16. To illustrate this point, consider a motion picture company that invests in creating a science fiction movie. Copyright gives the company the exclusive right to authorize a video game based on the film's plot and to produce action figure toys based on the film's characters. These derivative products may be a significant factor in the overall economics of the project. That is, it costs a great deal of money to create and distribute a major motion picture, including, among other things, to pay salaries for the original authors, the screenwriters, the actors, the producers, the director, stage hands, set designers, distributors, and more. Investors who provide that capital – and take the risk of failure – might well need the expectation of not only box office revenue but also returns from sales of various related products like t-shirts, action figures, and video games. It follows, then, that the revenue from these derivative products may be a key

7. To be sure, some original works would be created even in the absence of copyright protection. For example, there may be substantial benefits from being recognized as the creator of the work, or from being first in the market, or the copies may be of inferior quality. Still, given the ease of copying and the difficulty of employing private measures to prevent copying, we would expect fewer new works to be created in the absence of copyright protection.