

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

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.

factor in providing the incentive to produce the movie, and copyright protection of these products serves copyright law's incentive function.

17. This incentive-preserving function of copyright protection is especially important for organizations like The AP that invest in many different forms of intellectual property, many of which are unlikely to yield substantial financial benefit. For example, The AP invests in creating thousands of photographs every month, only a few of which will generate any significant revenue for The AP. But the revenues from those few that are highly successful are necessary to cover the costs associated with creating the thousands of photographs that are less successful. In other words, because it is not possible *ex ante* to determine which works will be successful in generating revenues, the incentive to invest in creating a large portfolio of works depends on the expectation that *some* of the works will be successful in generating even if others meet with limited or no success. The economic returns from those few works that turn out to be successful therefore must provide the incentive to invest in creating the large portfolio of works in the first place. Moreover, a large portfolio of works is itself a substantial benefit to potential users, because it provides them with the valuable option to select from among thousands or millions of images the ones that best suit their purpose.

18. Fair use permits unauthorized uses of copyrighted materials in a narrow range of circumstances that are usually consistent with promoting economic efficiency.⁸ Broad application of fair use, however, would reduce compensation to copyright owners, which in turn would undermine the incentive to create new works in the first place, which is clearly inconsistent with the basic rationale for copyright protection. From an economic perspective, then, fair use should generally be limited to uses where (1) the purported fair use does not

8. Landes & Posner, *The Economic Structure of Intellectual Property Law*, Chapter 4. 115-123,

substitute either for the original copyrighted work or follow-on works that the original author would himself expect to license or pursue, and/or (2) transactions costs or other considerations would make conventional licensing unlikely or inefficient.⁹

19. Factor four considers the total economic harm to the copyright holder, including not only the economic return that would have been earned had the infringer himself licensed his use, but also any returns that would be earned were the author in the future able to license others to create works similar to the use at issue. Accordingly, factor four considers the potential revenues at stake from the infringement at issue in the case, and also considers the economic harm to the copyright holder that would result if the challenged use were to become widespread.

B. PERMITTING WIDESPREAD UNAUTHORIZED USES OF THE AP'S IMAGES WOULD UNDERMINE THE AP'S INCENTIVES TO INVEST IN AND BUILD ITS IMAGES DATA BASE

20. The AP has made substantial investments in AP Images, the licensing operation that markets and “sells” the images in The AP’s product portfolio.¹⁰ The AP’s *APix Business Plan v. 092903* sets out its business plan for the then (2003) still-nascent AP Image Exchange (“APix”), described as a “full service photo agency exclusively dedicated to the global sales and marketing of The AP’s imagery . . . managed to maximize revenue and contribution of the photo product across [The] AP.”¹¹ The business plan anticipated significant investments in technology

9. This does not mean that fair use should never be applied in a circumstance where a given use deprives an author of some expected return, since the resulting harm might be justified on other grounds. For example, in the case of parodies, fair use may be the only way to foster the creation of a given work. The job of factor four, however, is to account for the economic incentives at stake in that choice. Other fair use considerations are then designed to weigh those incentive implications against copyright law’s other valid objectives.

10. Although AP Images uses the term “sells” images, it in fact grants non-exclusive licenses and retains the copyright.

11. AP0005775

to improve the quality of its images, to establish a searchable database for the photographs, and to create a platform for making the images available for licensing. In 2003, technology capital expenditures alone were anticipated to be \$2.5 million in the first two years and \$4.8 million dollars in the first five years.¹² The *AP Images Strategic Plan 2007 – 2009* anticipated continued investment and revenue growth.¹³ AP Images' capital expenditures were approximately \$2.8 million in the three years 2007 through 2009, and it generated more than \$111 million in revenue over that same three-year period.¹⁴

21. In order to generate these licensing revenues, The AP not only makes significant capital investments and expenditures on marketing and distributing its images each year, but it also invests in the acquisition of new images and engages the services of professional photographers to create new images. Although The AP licenses its images to its members and subscribers for immediate news-related uses, I understand that the revenues generated from those parties are not sufficient to support the level of The AP's ongoing investments in building its database of images. Indeed, I understand that The AP's principal objective in extending the image database to include photographs that go beyond the images The AP sends to its member/subscribers for news-related uses is to increase the revenues it receives from users outside its member/subscriber base¹⁵ in order to support its news-related activities, for which revenues are shrinking.¹⁶

12. AP0005816

13. AP0005598-5601

14. AP0006814

15. See "AP Images Strategic Plan, 2007 – 2009," AP0005572 – 5602.

16. See <http://paidcontent.org/article/419-ap-launching-newspaper-industry-campaign-to-protect-news-content/>.

C. THE HARM TO THE AP OF PERMITTING UNAUTHORIZED USE OF ITS COPYRIGHTED IMAGES EXTENDS BEYOND THE AP'S LOST LICENSING REVENUES FOR THE PARTICULAR IMAGE

22. Mr. Fairey's unauthorized use of the Obama Image cost The AP at a minimum the licensing fees it would have gotten from Mr. Fairey. But from an economic standpoint, the harm considered under fair use analysis extends far beyond just those lost fees. Mr. Fairey used one of The AP's copyrighted images to create products that are of the same nature as and compete with the uses for which The AP licenses its images to others for authorized uses. The AP regularly licenses such photographs for a wide range of commercial and non-commercial uses to publishers, graphic designers, merchandisers, advertising agencies, and political campaigns, for, among other things, books, posters, advertisements, buttons, T-shirts and other merchandise, including, for example, a photograph of President Obama for use on a tote bag.¹⁷ The AP's ability to earn revenue from these many downstream uses would substantially erode if copyright law were to deem these uses non-infringing.

23. Thus, the harm to The AP of permitting Mr. Fairey's unauthorized use extends beyond its effect on the revenues that The AP could have earned by licensing the Obama Image alone. The AP estimates that it adds more than 4,000 images a day to its database, which today has approximately 8.6 million unique images, at an annual cost of photo acquisition and production of more than \$56 million in 2009, and more than \$247 million over the four year period 2006 – 2009.¹⁸ However, relatively few images in the database succeed in generating

17. AP0002615; The Associated Press's First Amended Answer, Affirmative Defenses and Counterclaims, ¶94. Blake Sell also explains in his expert report that the AP licenses its images for a variety of different purposes, including both commercial and editorial uses. Expert Report of Blake Sell, November 2, 2010, at ¶¶75-81.

18. AP0011063.

licensing revenues for The AP – most are licensed for modest amounts. Moreover, it is difficult and probably not possible *ex ante* to determine which works will be successful in generating substantial license fees. The incentive to invest in creating and preserving a large number of images and in developing effective ways to make them available to potential users is determined by the expectation that some of the works will be very successful even if others meet with limited or no success.¹⁹ Thus, the revenues generated by the few works that turn out *ex post* to be successful or “winners” provide the incentive to invest in a large number of works, many of which will generate little or no licensing revenue.

24. Available data bear this out. Of the 8.6 million unique images in the database, I understand that only 1.36 million were downloaded even *once* in all of 2009.²⁰ More than 7.2 million of the images – almost 84 percent – were never downloaded at all. And of those that were downloaded, I understand that only 67, comprising a trivial percent, were downloaded more than 200 times.²¹ But some images nevertheless provide significant revenue. The AP has licensed some images for very significant amounts, typically for commercial advertising uses to which a very different, and much higher, pricing scale is applied.²² For example, I understand that the AP licensed an image of Al Yeganeh, the inspiration for the “Soup Nazi” character on the hit television show, *Seinfeld*, to Mr. Yeganeh on an exclusive basis for \$30,000.²³ Other

19. For example, of the ten images of Mr. Obama produced in conjunction with the National Press Club event, only two generated licensing fees in excess of \$500. Preliminary Expert Report of Kathleen M. Kedrowski, October 1, 2010, Exhibit F.

20. Conversation with James Gerberich. This calculation excludes use of the images that are “pushed” to subscribers in connection with AP’s wire service.

21. Conversation with James Gerberich.

22. Conversation with Farah DeGrave.

23. AP0002636

examples include images of Tiger Woods that The AP licensed on a non-exclusive basis to Accenture for commercial advertising for \$25,000, and an image of President and Mrs. Obama at the 2009 Inauguration that The AP licensed to Apple Computer on a non-exclusive basis for commercial advertising purposes for \$15,000.²⁴

25. Thus, it is the licensing fees generated by a few images that end up supporting The AP's expenditures on creating, maintaining, and expanding its vast database of protected expression. Permitting unauthorized use of the very images that prove to be economically successful, like Mr. Fairey's unauthorized use of the Obama Image, could therefore substantially undermine the economics of the entire business, which in turn would erode, if not eliminate, The AP's incentive to continue developing and building its image licensing operations.

26. In short, permitting broad unlicensed use or "fair use" of The AP's images without compensation would lower 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 and also more broadly to engage in its general news-gathering activities around the world. Consequently, the breadth and depth of the product it offers would necessarily decline.

27. This would be an undesirable outcome not only for The AP, but also for the many individuals and entities who rely on The AP to provide images that they cannot themselves directly acquire – including artists like Mr. Fairey himself, artists who depend on content-providers like The AP to provide source materials that can then be made into derivative works. Such users have, as Mr. Fairey acknowledged, a "symbiotic relationship" with these content-

24. Conversation with Farah DeGrave.

providers.²⁵ Thus, users like Shepard Fairey, who rely on images created by others as the key input for their own works and who insist that such uses do not require a license, would be in the long run among the bigger losers.²⁶

IV. THE EXPERT REPORT SUBMITTED BY JOHN JAROSZ IGNORES THE HARM TO THE AP OF PERMITTING UNAUTHORIZED USE OF ITS COPYRIGHTED IMAGES

28. In his expert report, Mr. Jarosz states that he was asked to address four questions which I paraphrase here:

- a. What was the nature and magnitude of the impact on the market for the copyrighted Garcia photo of Mr. Fairey's use of the photo?
- b. What would a reasonable royalty for the use of the photo have been at the time of the infringement?
- c. To what extent did Mr. Fairey's use of the photo produce commercial benefits?
- d. To what extent were the profits that Mr. Fairey earned as a result of his use of the image attributable to the properties of the original work?

29. In his expert report, Mr. Jarosz does not state clearly the parameters of the "but-for" world he is assuming – that is, the world in which Mr. Fairey did not infringe The AP's copyright. In order to answer the question of reasonable royalty, however, he concludes that Mr. Fairey would have been willing to license the Obama Image, and The AP would have been willing to license it to him, for an initial fee of no more than \$3,000.²⁷ Therefore, I assume that, in the but-for world, Mr. Fairey and The AP would have agreed to an initial license for the image, and Mr. Fairey would have used the image in a manner similar to that he used in the

25. Deposition of Frank Shepard Fairey, March 17, 2010, at 633 – 634.

26. Mr. Fairey depends on such images as the bases for his own work. In his deposition, Mr. Fairey testified, not surprisingly, that "the more images that are available as references, the better." *Id.* at 637 – 638.

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

actual world. With this assumption, I address below the answers he offers to each of these questions and I explain why I conclude that they are incorrect.

A. MR. JAROSZ UNDERSTATES THE IMPACT ON THE AP'S MARKET OF PERMITTING UNAUTHORIZED USE OF ITS COPYRIGHTED IMAGES

30. Mr. Jarosz offers three explanations for his conclusion that Mr. Fairey's infringement of the Obama Image probably had little impact on The AP's market for the original image. First, Mr. Jarosz explains that "there were substantial differences in the purposes for which the images were created" Second, Mr. Jarosz explains that The AP's lost revenue was likely just the small *initial* licensing fee that The AP would have obtained from Mr. Fairey. Third, Mr. Jarosz explains that Mr. Fairey's use of the image "enabled The AP to earn more than \$20,000 on sales of art prints of the image."²⁸

31. Mr. Jarosz's conclusion and three explanations are flawed. First, even assuming the Obama poster was created for the sole purpose of promoting the Obama campaign for the presidency, its use for that purpose falls squarely within the boundaries of The AP's contemplated uses for the images in its database. At the moment a photograph is taken it is very difficult to foresee every possible future use. But, as Mr. Sell identified in his expert report concerning the photograph-licensing industry, the AP's specific purpose for including a photograph in its AP Images database is to license it for all of the uses that arise, whatever they may turn out to be.²⁹ Thus, even if The AP was not specifically planning to have this photo licensed for Mr. Fairey's exact use, The AP was more generally motivated to make, save, and ultimately distribute the photo in the hopes of licensing it to users exactly like Mr. Fairey.

28. Expert Report of John C. Jarosz, October 1, 2010, ¶133.

29. Expert Witness Report of Blake Pembroke Sell, November 2, 2010, ¶69.

32. Second, Mr. Jarosz's analysis of the licensing fees that The AP would have received from Mr. Fairey is based on a small sample of licenses that have significant limitations on both the time within which the image may be used and the number of derivative works and copies that may be created from it. Specifically, the license for the Palestinian woman that Mr. Jarosz examined was limited to a term of one year and the production of no more than 5,000 t-shirts and 500 illustration prints. Even if Mr. Fairey's initial license of the Obama Image would have had similar terms, Mr. Fairey's use of the Obama Image significantly exceeded those limits. For example, I have reviewed data published on auction results by Artnet.com, which has a database of over 4 million illustrated auction prices for fine art and design. The database contained 133 images for works by Shepard Fairey that have or will soon appear at auction, of which fourteen incorporate the Obama Image, including a 36"x24" HOPE screen print, edition of 1,000; a 36"x24" HOPE offset lithograph, edition 600; 9"x12" PROGRESS silkscreens, edition 400; 36"x24" PROGRESS screenprints, edition 350; and a 18"x24" "PROGRESS" poster, edition not specified.

33. The editions for these uses alone total more than 2,350 images, far in excess of the 500 permitted by the license for the image of the Palestinian woman, and thus these uses would have required a follow-on license to the initial license. Moreover, this excludes the large number of copies of the Obama image that Mr. Fairey licensed for use on t-shirts and other merchandise. I understand that Mr. Sell, who is an expert in the photography-licensing industry, explains in his report that The AP likely would have taken into consideration the *ex post* success of the Obama Image and set royalties for the follow-on license that exceeded those for the initial

license.³⁰ Mr. Jarosz's analysis, therefore, fails to account for any revenue after his hypothetical initial and limited licensing deal.

34. Mr. Fairey, in turn, likely would have been willing at that point to agree to continuing and higher royalties based on the continued commercial sales of items that used the Obama Image. By that point in his negotiations with The AP, Mr. Fairey's image would have already gained considerable popularity and achieved commercial success, making it highly unlikely that he would discontinue that use and, similarly, very likely that he would have been willing to agree to a revenue-sharing agreement in order to continue and expand that use.

35. Third, Mr. Jarosz makes much of the fact that the AP was able to earn \$20,000 by selling prints of the Obama Image, but he misunderstands the importance of that fact. When a major motion picture studio makes a movie based on a pre-existing book, the movie almost always increases demand for the book. Yet, copyright law nonetheless requires that the motion picture studio obtain permission from the book's author. That is, book authors are not forced to accept as compensation only the revenues they happen to collect as a result of increased book sales. Instead, the book's author and the motion picture studio negotiate over how to share the revenue generated by the motion picture, the sale of add-on products like action figures, and so on. This revenue is part of the value generated by the original book, and giving the book's author the opportunity to receive part of that value fits into the basic incentive rationale for copyright. Thus, the \$20,000 that The AP earned through the sale of art prints is not some windfall that undermines The AP's economic claim; it is instead exactly the type of financial returns for which factor four accounts.

30. Expert Witness Report of Blake Pembroke Sell, November 2, 2010, ¶129.