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# Droit de Suite: Just How Sweet is it?

By Asher Tanenbaum

## I. Introduction

### A. The Issue to be Discussed

The primary purpose of United States copyright law is “[t]o promote the Progress of Science”.<sup>1</sup> Copyright law incentivizes the progress of science through a set of six exclusive rights available for the owner’s exploitation of his copyright.<sup>2</sup> At the behest of Congress, the Copyright Office is currently reviewing the creation of a new right for creators of visual artworks (VAs)<sup>3</sup> that would require a royalty payment to be paid to a creator upon secondary sales of his VAs.<sup>4</sup> This paper analyzes the impact such a law may have on the creation of and market for VAs and concludes that it would be imprudent to add this royalty right because the negative effects would be greater than the benefit obtained.

In 1920 France became the first nation to create the proposed royalty right, which is widely referred to by its French name *Droit de Suite* (DdS).<sup>5</sup> A handful of countries followed suit

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<sup>1</sup> U.S. Const. art. 1, § 8 cl. 8. The term “science” as used in Clause 8 refers not to science in the modern sense, but in an archaic meaning that refers to works that are copyrightable matter.

<sup>2</sup> 17 U.S.C.S. § 106 (2012). These are the right to distribute, reproduce, make derivative works, publicly display, perform, and transmit.

<sup>3</sup> See 17 U.S.C.S. § 101 (2012) (defining visual art). VAs are anything from sculpture or painting to a cartoon or conceptual art. Basically, it is anything that can be considered artwork and not something like a book or lyrics.

<sup>4</sup> Comment Notice, 77 Fed. Reg. 58175 (Sept. 19, 2012).

<sup>5</sup> THE COUNCIL OF EUROPE FRENCH-ENGLISH DICTIONARY 100, (F.H.S. Bridge ed., Council Press of Europe 1994) (defining *Droit de Suite* as the “right to trace or follow property into the hands of a third person”) (quotes in original).

in proceeding years<sup>6</sup> and the European Union recently mandated a DdS right by member states.<sup>7</sup> In 1976, California became the only United States jurisdiction where creators have DdS rights.<sup>8</sup> Australia joined these ranks in 2009 when it created DdS rights for creators of VAs.<sup>9</sup>

In the United States, the creator of any copyrighted work currently has no control over or rights arising from secondary sales of a work itself due to the First Sale Doctrine (FSD). Once purchased, the new owner can largely use or sell a work as he pleases.<sup>10</sup> By contrast, DdS laws give VA creators a royalty interest in secondary sales and would partially negate the FSD,<sup>11</sup> which could impact the primary and secondary VA market. As with most laws, the terms<sup>12</sup> of any DdS law will be a strong determinant of its success or failure because these will influence whether its costs are greater or lesser than the benefits it creates.

In the countries with DdS, the DdS laws generally contain six elements.<sup>13</sup> First is the time period in which the right is in effect for, which is usually co-equal with the copyright duration.

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<sup>6</sup> U.N.E.S.C.O. COPYRIGHT DIVISION, DROIT DE SUITE, 1 (United Nations Educational, Scientific, and Cultural Organization) (1949), <http://unesdoc.unesco.org/images/0014/001439/143961eb.pdf> (last visited Dec. 6, 2012) (citing Belgium in 1921, Czechoslovakia in 1926, Poland in 1935, Uruguay in 1937, and Italy in 1942).

<sup>7</sup> Council Directive 01/84, 2001 O.J. (L 272) 32 (EC).

<sup>8</sup> Cal. Civil Code § 986 (2012). *Invalidated by* Estate of Graham v. Sotheby's, Inc., 860 F. Supp. 2d 1117 (2012) (finding the statute unconstitutional on the grounds that it violates the dormant commerce clause).

<sup>9</sup> The Resale Royalty Right for Visual Artists Act, 2009, C. 2009A00125 (Austl.).

<sup>10</sup> The FSD is found in 17 U.S.C.S. § 109 (2012). The FSD arose from judicial precedent but Congress codified it in 1976. Some minor exceptions are found in 17 U.S.C.S. § 106A but they are not germane to this paper.

<sup>11</sup> The FSD would be partially negated in the sense that the owner does not now possess the complete ability to use the work as he pleases because he will not receive the entire sales amount but will have to hand over part of it to a creator. It is also possible that a creator may receive some type of say in how the work is used or sold if the creator possesses a contingent legal interest in the work by dint of his DdS right.

<sup>12</sup> A discussion of the many possible permutations of a DdS law is important for an understanding of how DdS would work, but it will not be discussed in this paper due to space constraints.

<sup>13</sup> The European Union's Council Directive 01/84, 2001 O.J. (L 272) 32 (EC) is a good example to look to for the elements of a DdS statute. Using a hypothetical example, DdS works as follows: A 5% royalty will be paid on a work that sells at auction in France for \$10,000 that was created by Picasso since his works are still under copyright protection, despite the fact that the owner of the work purchased the work for the same \$10,000 amount he is receiving. *See also* The Resale Royalty Right for Visual Artists Act, 2009, C. 2009A00125 (Austl.).

Second is a minimum sales amount whereby any sales at or above that amount require the DdS royalty to be paid on the sale. Third is the royalty percentage rate that usually attaches to the entire sales amount rather than only gains. Fourth is that the royalty right generally attaches only to auction sales rather than all sales. Fifth is that the royalty right attaches only to sales taking place in the jurisdiction with the DdS right rather than the residency of the parties. And the sixth is that the work must be a VA. Each country varies in the exact terms, but every DdS law addresses these six items.

The literature on DdS is quite extensive with many rehashing similar arguments premised upon DdS being an equitable right for artists or unfair to buyers.<sup>14</sup> Little attention appears to go towards examining the effectiveness of DdS as an incentive or through an economics perspective. This is partly because while there is some data that can be used to compare the economic impact of DdS on countries that have it as compared to those that do not, it is much more difficult to compare the potential effects of DdS if it is implemented because each country has its own unique dynamics.<sup>15</sup> It is not so easy to move away from discussing equity or unfairness when there is not so much data to use for either discussion.

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<sup>14</sup> See e.g. Jean-Luc Piotraut, *An Author's Rights-Based Copyright Law: The Fairness and Morality of French and American Law Compared*, 24 *Cardozo Arts & Ent L.J.* 54 (2006) (comparing the moral underpinnings of much of French copyright law as compared to American copyright law); Michael B.Reddy, *The Droit de Suite: Why American Fine Artists Should Have the Right to a Resale Royalty*, 15 *Loy. L.A. Ent. L.J.* 509 (1995) (looking at the origins of DdS); Jennifer B. Pfeffer, Comment, *The Costs and Legal Impracticalities Facing Implementation of the European Union's Droit de Suite Directive in the United Kingdom*, 24 *Nw. J. Int'l L. & Bus.* 533 (2004) (discussing DdS in terms of common-law rights); Thomas M. Goetzl & Stuart A. Sutton, *Copyright and The Visual Artist's Display Right: A New Doctrinal Analysis*, 9 *Colum.-VLA Art & L.* 15 (1985) (examining how DdS can affect owners and buyers); Shira Perlmutter, *Resale Royalties for Artists: An Analysis of the Register of Copyrights' Report*, 16 *Colum.-VLA J.L. & Arts* 395 (1992) (criticizing THE REPORT, *infra* note 15, for using theoretical examples to balance against real-life examples).

<sup>15</sup> Among these reasons is that prices fluctuate regardless of market conditions, work quality changes, demand for certain types of works and artists shifts, and general factors related to macro-economic forces. In essence, since VAs are not commodities and are all different it is extremely difficult to isolate the factors impacting a market to compare and contrast different markets, let alone a single market pre- and post-DdS.

There are several recurring sources used in this paper, two of which are the most important. The primary document is a 1992 report issued by the Copyright Office, referred to as THE REPORT,<sup>16</sup> that examined DdS to analyze whether Congress should implement it. THE REPORT is analogous to the report Congress recently requested the Copyright Office to issue.<sup>17</sup> To help analyze the economic effects of DdS the article *An Economic Theory of Avant-Garde and Popular Art, or High and Low Culture* is very useful.<sup>18</sup> These are the two primary sources that have informed this paper.

This paper analyzes DdS primarily through the lens of economic theory and principles, which should shed some new light on the topic because economic analysis is often absent from the existing literature. The analysis proceeds through a dual framework of the impact of DdS first on creators and second on buyers. To understand the full picture an examination of both sides' positions must be examined for proper insight into the full scope of DdS's impact.

Because neither group of creators nor buyers is itself a monolithic group, this paper further splits each group into three types of creators and buyers, respectively, that will be used to better understand the effects on the groups of which buyers and sellers are composed.<sup>19</sup> The three types of creator are Career Creator, Hobbyist, and Unique Creator and will be described in Section II. The three types of buyers are Beauty, Investor, and Brag and will be described in

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<sup>16</sup> REGISTER OF COPYRIGHTS, DROIT DE SUITE: THE ARTIST'S RESALE ROYALTY (Library of Congress) (1992) [Hereinafter THE REPORT], available at [http://www.copyright.gov/history/droit\\_de\\_suite.pdf](http://www.copyright.gov/history/droit_de_suite.pdf) (last visited Dec. 9, 2012).

<sup>17</sup> See *supra* note 3.

<sup>18</sup> Tyler Cowen & Alexander Tabarrok, *An Economic Theory of Avant-Garde and Popular Art, or High and Low Culture*, S. Econ. J. 67(2), 232 (2000).

<sup>19</sup> The existence of both of these sets of three types is not a rule, but it helps to distinguish between the different motivations of generally distinct types of creators and buyers.

Section III. Understanding why each of these groups act as they do should lead to a strong grasp of how DdS uniquely affects creators and buyers and the respective subgroups.

### B. Organization of the Paper

Part II focuses on incentives and how they work in theory and practice. Part II-A of this paper looks at the purpose of copyright law in the United States and how DdS may impact the incentives that currently underpin copyright law such that DdS may result in a negative or positive change in output relative to those goals. Part II-A concludes that DdS is not an effective incentive because it works differently than existing incentives. Part II-B examines the ways that DdS will impact the type and quality of VAs created compared to creations under existing incentives by comparing how the three types of creators react differently to incentives. Part II-B concludes that DdS will not improve or change the quality or quantity of VAs created.

Part III examines how buyers and sellers in the marketplace for primary and secondary sales of VAs would be impacted by and react to a DdS right. Part III-A looks at how DdS shifts the rewards for risk-taking and concludes that this could have a strong impact on the market. Part III-B looks at whether buyers will pay a discounted purchase price to make up for DdS potentially taking later gains and concludes that this is unlikely to occur. Part III-C examines whether the location of sales would move outside of the United States with DDS and concludes that this is not very likely. Part III-D concludes that DdS would have an overall negative effect on the market largely because of how it shifts the current risk-reward balance of a VA purchase.

Part IV concludes that DdS should not be implemented because the overall social utility of DdS is below that of the status quo given the purposes of copyright law in balancing creators' incentives against the overall public benefit obtained from the works created because of those

incentives. Ultimately, DdS fails because the benefit to creators individually is too speculative and its incentive-effect to increase output is low while its potential impact on the market in the form of playing with risk and reward is strong, causing the costs of DdS to outweigh the benefits.

## II. The Relationship of Droit de Suite and Incentives to Create

As described in Part I, the essence of copyright law is to provide to creators incentives and legal protection to exploit those incentives so that creators will produce more and better works than would be created absent those incentives. At heart, it is meant not to enrich creators but to enrich American society as a whole.<sup>20</sup> Thus, a proposed incentive such as DdS must increase creators' contributions to society. If it does not, then DdS is simply an extra cost placed on society for which society receives no more than before in return.

Looking at incentives through the lens of the three types of buyers will be helpful. The first type of creator, Career Creator, primarily seeks financial success by reaching the biggest market or making VAs that are certain to have a more definite immediate sales value. This group is mostly comprised of creators for whom creation is their primary job or at least a successful hobby that provides steady income. The second type of creator, Hobbyist, strives to create simply for enjoyment.<sup>21</sup> Hobbyists are comprised mostly of creators who are not market-seeking but for

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<sup>20</sup> *Twentieth Century Corp. v. Aiken*, 422 U.S. 151, 156 (1975) *superseded on other grounds by* 17 U.S.C.S § 110(5) (2012):

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>21</sup> Jacey, *supra* note 23, at 1574 (“Other artists do not create for an audience but rather for themselves. For them, the need to write or paint is an integral part of their personality.”).

whom a sale is a nice side benefit.<sup>22</sup> The third type of creator, Unique Creator, seeks to be different and unique in quest of recognition. Unique Creators are professional creators and those whom create seriously as a hopefully-successful hobby. Depending on the type of creator, the same incentives play different roles in their ability and decision to create.

### A. Incentives for Creation

Incentives are the key to how United States copyright law promotes new creations. This subsection examines how they fulfill this purpose by looking at (1) how incentives work, (2) DdS as an intersection of equity and incentive, and (3) at which creators DdS benefits the most. The prior three sections are wound-up in (4) with a recap of the salient points.

#### 1. The Effect of Incentives

The six right currently granted to creators by copyright law allow creators to exploit their works and thus act as incentives to create. All creators are given these rights because works of even minimal creativity are deemed to be of overall benefit to society no matter the uniqueness of what the work gives to society.<sup>23</sup> Incentives encourage creation by giving a successful creator the financial ability to continue to create and to cover the costs of creating. While copyright law is not grounded in equity,<sup>24</sup> there is a sense of fairness inherent in these rights such that it would

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<sup>22</sup> Sixty percent of recreational artists sold a work in 2008 and there are 600,000 professional and 3.2 million recreational artists. ARTISTS & ART MATERIALS USA 2009 EXECUTIVE SUMMARY 2 (International Art Materials Trade Association, Cornelius, N.C.) (2009).

<sup>23</sup> Feist Publ'ns, Inc v. Rural Tele. Servs. Co., 499 U.S. 340, 345-46 (1991):

To be sure, the requisite level of creativity is extremely low; even a slight amount will suffice. The vast majority of works make the grade quite easily, as they possess some creative spark, "no matter how crude, humble or obvious" it might be. Originality does not signify novelty; a work may be original even though it closely resembles other works so long as the similarity is fortuitous, not the result of copying. To illustrate, assume that two poets, each ignorant of the other, compose identical poems. Neither work is novel, yet both are original and, hence, copyrightable.

<sup>24</sup> See *supra* note 20.

be unfair to a creator not to possess them while allowing others to freely reap the benefit of the creator's efforts.<sup>25</sup> Incentives thus encourage creation.

If incentives work properly, successful creators will gain more financially than unsuccessful creators and will be able to create more works while unsuccessful creators will be unable to afford to continue pursuing a career as a creator.<sup>26</sup> In effect, it is comparative advantage at work.<sup>27</sup> This pattern sometimes falters when certain creators are very innovative and their works are undervalued initially because their work is not yet appreciated, limiting their ability to succeed financially and potentially increase their production. A number of now-famous creators suffered this fate throughout the centuries.<sup>28</sup> While incentives may falter in a few instances like these, most creators who fail to gain financially in their lifetimes will never be important or appreciated. Consequently, the desired incentive-effect works the vast majority of the time by rewarding successful creators by giving them greater ability to continue to create and not rewarding unsuccessful creators whose work, by dint of the lack of a market,<sup>29</sup> is less useful to society than successful creators' works, thereby limiting their ability to create.

## 2. Droit de Suite: Incentive or Equitable Right?

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<sup>25</sup> *Int'l News Serv. v. Assoc. Press*, 248 U.S. 215, 244 (1918) (citing *Morris v. Ashbee*, L.R. 7 Eq. 34 (1868)) (“[N]o one has a right to take the results of the labour and expense incurred by another for the purposes of a rival publication, and thereby save himself the expense and labour of working out and arriving at these results by some independent road.”).

<sup>26</sup> Linda Jacey, *Of Bread and Roses and Copyrights*, 1989 Duke L.J. 1532,1572 (1989) (relating statistics about the difficulty of pursuing a career solely as a creator).

<sup>27</sup> Comparative advantage is an economic principle which essentially states that those who are more successful and better at doing something will continue to do so while those who are not will leave and find something to which they are better suited to produce.

<sup>28</sup> Jacey, *supra* note 23, at 1572 (using Van Gogh as an example). See also JEFFREY MEYERS, *IMPRESSIONIST QUARTET: THE INTIMATE GENIUS OF MANET AND MORISOT, DEGAS AND CASSATT* (Houghton Mifflin Harcourt) (2005) (telling how the artists in the title were often derided for their VAs during their careers).

<sup>29</sup> THE REPORT, *supra* note 15 app. pt. I Comment Letters at 76, *Testimony of R. Frederick Woolworth in Opposition to H.R. 3221* (saying that only about 300 out of 200,000 artists have a secondary market for their works). See also THE REPORT, *supra* note 15, at 132-3 (relating thoughts on the effect of DdS on less-well-known creators).

While DdS is an incentive in form, it is entangled with being an equitable vehicle for creators.<sup>30</sup> An incentive is something “which urges to action, especially a promised reward for working harder.”<sup>31</sup> To urge to action, it must be forward-looking. In contrast, a right of equity in this context would be based upon rewarding past efforts and be something the creator would gain that does not result solely from the creator’s own choices.

Incentives are necessary to spawn a professional class of creators. The demand for a successful employee is stronger than for an average employee because of his scarcity, which causes his earnings to rise. Similarly, the creator of desirable works will see the price of his works go up<sup>32</sup> - the reward for his scarcity. Without the incentive of higher earnings for success, a creator is unlikely to be able to afford to pursue a career as a professional creator.

A caveat to the prior reward principle is that a successful employee’s past work is not necessarily rewarded to the extent of his success at that time. An employee is not paid based upon future value obtained by his employer from the employee’s work, all of which accrues to the employer. Instead, the employee is paid based on his proven ability to succeed and not for the specific gains he imparted to the employer when he was not yet proven to be successful. The amount an employer is willing to pay an employee is the value of the employee’s work at the time and not the potential future gains from that work.

In two ways the creator’s situation is analogous to that of an employee and in one way not. It is analogous in that the increase in value of a creator’s work accrues to the buyer of a work

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<sup>30</sup> Pfeffer, *supra* note 13, at 547 (“Most proponents of the *droit de suite* argue that it is an economic right, because it protects an economic interest. However, despite having some of the properties of economic rights, it has enough characteristics of a moral right to make it unfamiliar to common law copyright law.”).

<sup>31</sup> MACMILLAN DICTIONARY FOR STUDENTS 519 (Simon & Schuster Books For Young Readers) (1984).

<sup>32</sup> THE REPORT, *supra* note 15, at 131. (“Additionally, successful artists...secure ever increasing prices as their reputations grow and they sell successive works”).

and that a successful creator whose old works have increased in value will likely earn more for his new works than what he earned from the works he sold when he was unknown.<sup>33</sup> The non-analogous item is that the creator possesses his quiver of six rights with which to exploit his work, which allows the creator to earn more from his prior work should he choose to exploit these rights. Although the creator is mostly in the same position as an employee, he is positioned slightly better because he has the ability to exploit his prior work through his quiver of six rights.

DdS rewards creators from the future value gained and imbued into their VAs by buyers and differs from the other six rights because it rewards the creator not for his efforts but rather for the VA owner's decisions. It is effectively an unexploitable incentive because the creator cannot choose when to exploit it, if at all. Because the creator cannot freely exploit it, it becomes a right of equity instead of an urge to action to create. DdS is then a reward not for effort but for the mere fact that the owner decided to sell the VA.

Although DdS may not be an incentive per se and it may not be fully exploitable by the creator, it could still potentially act as an incentive in practice and this paper will examine it as such in Part II-B. In terms of DdS as an equitable right, Part III-B will examine whether demand and the concurrent market forces are a form of contribution to a VA's value by buyers.<sup>34</sup>

### 3. Some Creators Will Benefit More From DdS

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<sup>33</sup> *Id.* at 6. This can be inferred from the idea discussed therein that the rationale that a creator should benefit from increases in the work's value is because of his continued efforts to create. If the creator has worked and thereby increased his reputation and the value of his old works, then his new works will also increase in value from recognition.

<sup>34</sup> Patricia Cohen, *Artists File Lawsuits, Seeking Royalties*, N.Y. TIMES, Nov. 1, 2011, at C1, available at <http://www.nytimes.com/2011/11/02/arts/design/artists-file-suit-against-sothebys-christies-and-ebay.html?sq=copyright&st=cse&scp=4> (last visited Dec. 3, 2012). (“The increased price for Rauschenberg's “Thaw” at the Scull auction was due not only to the artist's continuing creative efforts, he said, but also to the dealers, collectors, auction houses and critics who took a risk in supporting and buying Rauschenberg's work before he was famous.”).

As with all incentives, the rewards of DdS will flow unevenly.<sup>35</sup> The creators who will gain most from DdS are the most successful to begin with because their VAs sell for more than less-successful creators' VAs and so they will receive more in royalties no matter when in life they become sought-out. The highest-valued creators will receive a disproportionate amount of total royalties because a few VAs sell for extremely high amounts and make up a large proportion of total sales while most VAs sell for much smaller sums.<sup>36</sup> These successful creators are also able to earn the most from selling new VAs, assuming they are still alive. Unknown and less-successful creators will largely gain nothing because most VAs never reach the floor-level value at which DdS kicks in.<sup>37</sup>

Although not likely, it is possible that DdS could have a negative impact on creators who do not receive it. This could occur by reducing the amount of money available to purchase lesser VAs because the money being paid as a royalty might otherwise be used to purchase these VAs. Fewer VAs may be sold as a result of VAs being more expensive to purchase, or prices for all VAs could simply decrease across the board to make up for it, hurting everyone. Overall, because most VAs do not sell for much, the theoretical negatives are unlikely to occur while the few who do receive the royalty will be earning something - much more than the nothing they currently receive from secondary sales.

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<sup>35</sup> The floor value of where DdS takes effect would exclude most works by the vast majority of creators from its scope. These creators will never see a dime from DdS. Consequently, while creators can strive to make works that reach the requisite values, most will never succeed in doing so.

<sup>36</sup> See CONTEMPORARY ART MARKET 2011/2012: THE ARTPRICE ANNUAL REPORT 16 (Artprice) (2012) (listing the highest auction prices in 2011 for VAs, with the artist Michael Basquiat dominating the list).

<sup>37</sup> Using 2011-12 statistics available for France, which has the most entrenched DdS law, works auctioned from €5000 (approximately \$6447 at the Oct. 28, 2012 exchange rate) and under made up 88% of the contemporary art auction market (these works cover a large portion of works DdS would cover overall), compared to an overall French art market of \$521 million. ART MARKET TRENDS 2011 6 (Artprice) (2012).

#### 4. Incentives Work When They Are Exploitable

What can be gleaned from foregoing three sections is that incentives work together with comparative advantage to reward successful creators the most because their VAs are desired, which allows them to afford to continue to create by exploiting the increasing value of their VAs through their quiver of rights. DdS, on the other hand, is not as exploitable by creators as the other six rights because it relies on the owner to sell the VA and thus it does not incentivize more creation. Finally, although DdS rewards the most successful creators more than others, the majority of creators are not likely to suffer harm from this unbalanced reward because it won't change how they are rewarded.

##### B. In What Way Do Incentives Impact New Creations?

The effectiveness of an incentive is the ultimate determinant of its social utility and therefore its value. This section helps to develop an understanding of DdS's effectiveness by (1) examining why different creators are motivated to create and (2) looking at the impact DdS may have on the types of VAs produced given those differing motivations. This section concludes that DdS fails as an incentive because it does not increase the quantity or quality of VAs produced.

##### 1. The Three Creators: How Incentives Affect Why They Create

Each creator differs in his goals from other creators<sup>38</sup> and as a result a given incentive affects each differently. Understanding why creators create is crucial to understanding how incentives affect them. Given creators' differing motivations and despite possible overlap at times, the classifications of creators into the three groups described earlier in this Part allows a general view with regard to how incentives may affect what each type of creator creates.

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<sup>38</sup> Jacey, *supra* note 23, at 1574 (laying out different motivations for creators.).

Starting with Career Creator, greater incentives may increase the number of creators in this group because they are driven by earning power, and thus more incentives can mean more creation if the incentive means more income. However, it is unclear how an increase in Career Creators will affect the market because if there are more creators and thus more supply then the value of each VA may decrease, countering the positive effect of potentially greater rewards. Thus, despite the possibility of greater income, an increase in incentives may result in no net gain of creators to Career Creator as a group.

Of the three groups, Hobbyist is least affected by incentives because they create without regard to incentives. Many Hobbyists may be prevented from marketing their VAs because of a limited skill set and are therefore unable to produce marketable VAs or are prevented from being a Career Creator because of the need to earn a higher or more predictable income in another profession. While Hobbyists need no incentives to create, increased incentives could allow some Hobbyists to make a career from doing something they enjoy doing for its own sake.

While not entirely distinct from the former two groups, Unique Creator is affected by incentives in ways distinct from the other two.<sup>39</sup> While fame and uniqueness drive Unique Creator more than money, among the three groups DdS would likely have the biggest impact on Unique Creator precisely because of their desire to be different.<sup>40</sup> Value accrues in VAs that gain recognition over time and if a Unique Creator succeeds then the value of his work will increase

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<sup>39</sup> Cowen & Tabarrok, *supra* note 16, at 247-8 (2000). (describing how avant garde artists are not likely to create popular art despite the incentives available for it).

<sup>40</sup> Jimmy A. Frazier, Comment, *On Moral Rights, Artist-Centered Legislation, and the Role of the State in Art Worlds: Notes On Building A Sociology of Copyright Law*, 70 Tul. L. Rev. 313, 325 (1995). (discussing “mavericks” in the art world who reject convention).

by magnitudes and thereby benefit Unique Creator in the long-run.<sup>41</sup> In most instances it is not the commercial art of Career Creator or Hobbyist that obtains the greatest acclaim and value, but rather the Unique Creator's. In terms of being an incentive, high market value is a sign of the recognition sought by Unique Creator but it is not the reason they create. Incentives certainly can push Unique Creator, but they are not crucial for the choice to create.

It is clear that the effect of incentives on Career Creator is high, on Hobbyist essentially non-existent, and for Unique Creator moderate.

## 2. DdS and Its Effects: What The Three Creators Create

With the understanding gained in Subsection 1 about how incentives affect the three types of creators, it is now time to analyze the impact DdS would have on why and what each of the three creators create. Copyright law provides incentives for creation in pursuit of an overall benefit to society while concurrently balancing those incentives against the public benefit obtained in return. If the balance is even or in benefit of society then an incentive should be considered for implementation.<sup>42</sup> Congruently, if the balance falls against society, then the incentive should not be used. This balance will be used to determine the beneficiality of DdS as an incentive within the framework of copyright law.

Evaluating the quality of VAs is difficult due to the subjective nature of taste and the unpredictability of the art world.<sup>43</sup> Some VAs once derided or deemed unworthy of attention are

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<sup>41</sup> The creators whose works gain the most value are the ones who were groundbreaking and original. Look at the works of Andy Warhol, Vincent Van Gogh, and Pablo Picasso for examples. They were all groundbreaking with no one like them before they came along and their works are immense sums today. Compare these artists' work to the works of a street-artist in Times Square. The street artist may have nice work, but it is not groundbreaking and thus will not be worth a lot.

<sup>42</sup> See *Twentieth Century Music Corp. v Aiken*, *supra* note 18.

<sup>43</sup> Frazier, *supra* note 38, at 326 (discussing how the greatness of an artist depends much on how society supports him and not necessarily the aesthetics).

considered groundbreaking today while other once-esteemed VAs are considered nothing of note today, assuming value and critical reception are proxies of quality.<sup>44</sup> Determining whether a period with a dearth or plethora of groundbreaking VAs results from normal flows of ideas and concepts trickling through from larger social dynamics or instead from an incentive is tough because there are many variables to isolate. Quality is even more difficult to assess when attempting to analyze the affect a proposed incentive may have on the creation of future VAs. Further, while the quantity of VAs is measurable the effect of an incentive on the amount created is not easily estimable for the same reasons. While quality is certainly in the eye of the beholder, the only possible determinant is the long-term general perception by the market and critics.

Subpart i examines the effect of DdS on the output of both Career Creator and Hobbyist while Subpart ii examines the effect of DdS on the output of Unique Creator.

i

Much the same as it is with incentives in general as discussed in Part II-1, the effect of DdS on Career Creator is the least certain amongst the three creators. DdS would seem to increase the quantity and quality of VAs by Career Creator. But DdS may decrease the output of Career Creator by pushing them to be more creative and thus towards becoming Unique Creators.<sup>45</sup> This may occur because greater potential profit is not now necessarily in creating VAs with a more immediate and predictable value but in VAs that are groundbreaking because those

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<sup>44</sup> Robin Pogrebin & Kevin Flynn, *Does Money Grow on Art Market Trees? Not for Everyone*, N.Y. TIMES, May 31, 2011, at C1, available at <http://www.nytimes.com/2011/05/31/arts/design/not-all-art-market-prices-are-soaring.html>. (last visited Dec. 3, 2012) (mentioning the changing market performances of various creators).

<sup>45</sup> While this paper is talking about the market size increasing, the creation of a DdS right for these artists is in effect an increase in market size because it increases the amount of money potentially available to them than otherwise may exist. See Cowen & Tabarrok, *supra* note 16, at 242.

VAs have the greatest potential value.<sup>46</sup> This factor can also uphold the status quo because of the speculativeness of the profit while Career Creator may need immediate income from producing his usual work-product if the need for immediate income made him a Career Creator to begin with.<sup>47</sup> These competing considerations make the effect of DdS unpredictable for Career Creator.

VAs created by Hobbyist are unlikely to change in quality or quantity as a result of DdS. Hobbyist generally does not sell his VAs and if he does they are not likely to be worth much, let alone meet the floor value for DdS. Neither the quality nor quantity of VAs created by Hobbyist will change because it is impossible to incentivize creation for something which has no market.

ii

The impact of DdS on Unique Creator potentially is the greatest of all three groups due to two primary factors. First is the potential influx of Career Creators, discussed in Subpart i, who may become Unique Creators if the long-term profit potential is substantial which could lead to more VAs produced by Unique Creators. The second is the potential for increased competition among Unique Creators seeking to be groundbreaking if being groundbreaking results not only in recognition but also greater financial rewards than successful creators currently derive from sales of new VAs.

The first factor requires a second look at the issue of work quality discussed in Part II-B-2. Here it is in relation to whether the VAs of a newly-Unique Creator would be high quality or merely poor attempts at being groundbreaking. Looking at it from a comparative advantage viewpoint, the issue is whether the skillset of newly-Unique Creators makes them better at

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<sup>46</sup> THE REPORT, *supra* note 15, at 140-1 (“Like participants in a lottery, some individuals are attracted to high-risk careers in the arts for the possibility of an eventual large payoff...”).

<sup>47</sup> Cowen & Tabarrok, *supra* note 16, at 237 (“An amateur artist who receives most of his income from labor in the manufacturing sector can afford to produce his own brand of art at little loss in income. A professional artist pays a high price for deviating from market taste.”).

producing their prior work-style or groundbreaking VAs. Concurrently, society is better off with the creation to which the creator's skillset is best suited and thus parallel with his comparative advantage. While it is impossible to objectively determine whether a given VA is high quality<sup>48</sup> because of the changing opinions of artwork over time,<sup>49</sup> it is possible for the market to objectively determine what work is demanded and therefore the comparative advantage of the creator should resolve whether a given creator should be a Unique or Career Creator.

Given that economics usually determines a person's choices, it is a fair assumption that in the aggregate creators' decisions are in the spaces where their comparative advantage lies and that it is the type of creation to which the creator is best suited.<sup>50</sup> Creators with an adaptable skillset will become and remain Unique Creators while those with fewer and less adaptable skills will never try or will switch back to being Career Creators if they attempt being Unique Creators and cannot earn enough to pursue a career as a Unique Creator.<sup>51</sup> Consequently, for creators who migrate from Career Creator to Unique Creator the overall quality of work will increase.<sup>52</sup> It is not easy to switch groups, but those that do switch and remain are the ones who will succeed.

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<sup>48</sup> This impossibility is compounded when attempting to compare the quality of a given creator's prior VAs as a Career Creator against his hypothetical VAs as a Unique Creator in order to determine whether the comparative advantage lies with being one or the other.

<sup>49</sup> While it is easier with traditional art to objectively perceive the skill of the creator, contemporary art makes it tougher because it is more abstract and difficult to compare the creativity of works.

<sup>50</sup> Cowen & Tabarrok, *supra* note 16, at 241 (explaining that artists gravitate towards the buyers from which they can receive the most remuneration for their type of work).

<sup>51</sup> In regard to the ability of creators to shift from one group to another, a limiting factor may be whether the skill or creativity of a creator can improve enough such that it results in a true increase in work quality if there are greater incentives to produce "better" quality works. Creators may fall into one of the three groups precisely because they cannot fit into the other two because of their skill set. No matter how many people may desire to be Unique Creators there may be a limit on what portion of overall creators will be recognized as such. Without this function, the values of works could become depressed overall.

<sup>52</sup> This relies on another assumption that creative new ideas are of higher quality than unoriginal works. Unoriginal here refers simply to not being groundbreaking or uniquely special in terms of artistic significance, and not to the meaning as used in copyright law.

Moving to the second factor, DdS may encourage the creation of experimental VAs that attempt to be groundbreaking. If a creator can gain from being not only groundbreaking at present but also in the future, there could be more experimental VAs created. But only if these VAs are valued in the future for their quality in greater proportion than past VAs were valued in their futures can the new VAs resulting from DdS be considered higher quality. Although an incentive may change the style of work created, increased incentives also sometimes reduce quality. Quality could even decrease on average from an influx of experimental VAs while increasing the absolute number of quality VAs that succeed in being groundbreaking.<sup>53</sup> An increase in experimental VAs would be positive if many turn out to be groundbreaking.

But Unique Creators' ability to increase their experimental output, and thus groundbreaking VAs, is limited by their inelastic supply curve.<sup>54</sup> While a fair assumption could be made that DdS will increase the quality of VAs created,<sup>55</sup> it fails upon closer inspection. It fails because Unique Creators are normally trying to be groundbreaking. Their supply curve is inelastic because no matter the increase in incentives they can't make their work any more unique than they currently try to do because their success is already dependent upon their uniqueness. Increased incentives will not change what Unique Creators create because they can't change their uniqueness beyond what it already is in their attempts to be groundbreaking.

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<sup>53</sup> Cowen & Tabarrok, *supra* note 16, at 248 (describing how pop artists and avant garde artists could both increase output but decrease avant garde art as a proportion of all works).

<sup>54</sup> In economics, inelastic supply refers to the situation in which the supply of a product will not change very much despite large changes in the incentives that would spur increased supply of goods that have elastic supply. This situation could arise for many reasons including a limited supply of raw materials, a limited speed of production, or a lack of workers available to increase production as necessary. See DAVE NEEDHAM ET AL., BUSINESS FOR HIGHER AWARDS 399 (Heinemann College) (2nd ed. 1999).

<sup>55</sup> Carson W. Bays, DOES A DROIT DE SUITE BENEFIT ARTISTS? THE CASE OF CALIFORNIA, 3 (2006), available at [http://www.fokus.or.at/fileadmin/fokus/user/downloads/acei\\_paper/Bays.doc](http://www.fokus.or.at/fileadmin/fokus/user/downloads/acei_paper/Bays.doc). (last visited Dec. 3, 2012) (describing the process by which DdS would create an interest for creators to maintain and improve work quality so that their oeuvre increases in value).

### 3. The Incentive Effect of DdS is Not So Strong

The effect of DdS on the quality and quantity of the output by the three creators is not very strong. The differing motivations of the three types of creators is what determines the effect of incentives in general, and DdS in particular. For the Hobbyist it will have no effect because the Hobbyist does not sell his work. For Career Creator, the effect is difficult to discern because some Career Creators may or may not be able to become Unique Creators; most will probably not be able to change groups. For Unique Creators, the effect will not be strong because they already try their best to make groundbreaking VAs, which blunts any potential positive impact resulting from greater incentives. The only way that DdS would affect Unique Creators is if it results in an influx of Career Creators into Unique Creators, and this is unlikely. On the whole, the incentive effect of DdS to increase quality and quantity is weak.

### III. Droit de Suite and the Market

The costs of DdS will be borne by market participants and there are several ways that market-participants may affect the market through their reaction to those costs. This section examines these effects in Subpart III-A by looking at how DdS impacts the risk-reward concept by shifting some gains and no risk to the creator after the creator has already sold the rights to those potential gains and concludes that this can have a strong effect on the market. Subpart III-B examines whether buyers may discount purchase prices to account for the possibility of paying DdS and concludes that this is unlikely to occur. Subpart III-C examines the potential for DdS to cause sales to move to jurisdictions lacking DdS and concludes that such a shift is not likely. Part III-D sums up these sections and shows overall that DdS may negatively impact the market.

Because this section focuses on buyers, the three types of buyers listed in Part I-A will now be described. The first type, Beauty, primarily purchases VAs for their aesthetic value. The second type, Investor, purchases VAs primarily for short- or long-term investment gain. The third type, Brag, buys either to have bragging rights or to show a sense of taste and culture through the VAs he purchases. These three groups will be used for the analysis throughout Section III.

#### A. To The Risk-Holder Goes The Spoils (And Losses)

The owner of an item owns not just the item itself but also the right to resell that item,<sup>56</sup> and with this right the owner also takes on the risk that the item will increase or decrease in value.<sup>57</sup> The bigger the risk, the greater the potential return.<sup>58</sup> A creator could hold his VA and sell in the future when its value has potentially increased, but creators rid themselves of market risk by selling. Despite creators holding no risk, DdS would give creators an interest in gains but not losses<sup>59</sup> and thus runs contrary to the principle of rewards flowing to risk-holders. In general, ownership conveys exclusively to the owner the rights to risk and reward.

Buyers of anything forgo alternative uses of their money<sup>60</sup> and take a financial risk by purchasing an item and the same holds true for VAs. No matter whether the buyer is Investor,

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<sup>56</sup> This comes from the FSD, which arises from 17 U.S.C.S. § 109 and states “the owner of a particular copy...lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy...”.

<sup>57</sup> *In the Matter of: Artists’ Resale Royalties*, 16 Colum.-VLA J.L. & Arts 185, 241 (1992) (statement of Stephen E. Weil, Deputy Director, Hirshhorn Museum) (“The risk of loss is and should be entirely on the collector. But if the collector bears the risk of loss, as he or she should, why should the collector not be entitled to the entire profit as a reward for his or her considerable risk.”).

<sup>58</sup> An example would be in the bond market where a low-quality bond that has a high probability of default pays the bondholder higher interest than a high-quality bond that has a low probability of default. The risk is greater and so the return is greater.

<sup>59</sup> Stephen E. Weil, *Resale Royalties: Nobody Benefits*, 77 Art News 58, 60 (1978) (discussing how DdS laws allow losses and fall entirely on sellers while giving a portion of gains to creators).

<sup>60</sup> Alternative investments encompass anything from buying stock in a company to buying antique cars to other VAs unaffected by the royalty. *See id.* at 60-1 (listing the possibilities for alternative investments).

Beauty, or Brag each could purchase VAs unaffected by DdS or other items altogether.<sup>61</sup> Similarly, rather than holding his VA, a selling creator exchanges his investment of holding the VA into an alternative investment in the form of obtaining money to use for other things. However, despite the creator having invested nothing in the VA after a sale,<sup>62</sup> under DdS a creator benefits from a buyer's risk-taking twofold with no congruent risk on the creator's part.<sup>63</sup> The availability of alternative uses are the hallmark of any type of investment opportunity and if the risk-reward ration is negatively affected, then buyers may turn to alternative uses.

A creator need not sell his VAs.<sup>64</sup> The creator who holds his own VAs is the risk-holder and thereby holds the potential upside rather than a buyer.<sup>65</sup> The creator's investment is not in money or time but in the income forgone from not selling that he could have put to other uses.<sup>66</sup> By holding a VA a creator is betting that a longer-term ownership of it will prove more valuable than the receipt of immediate payment.<sup>67</sup> Once sold, market risk shifts to the buyer.<sup>68</sup> Both parties get what they want, the buyer the VA itself and potential increases in its value, and the

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<sup>61</sup> However, there are arguments that VA buyers desire to purchase a specific work for its individual aesthetic value which cannot be had by buying any alternative work. *See* Goetzl & Sutton, *supra* note 13, at 49.

<sup>62</sup> A creator's post-initial-sale production of other new works could have an impact on the prices of prior works, but this is not an investment or risk taken in the work itself. Rather, it is an externality (which may be positive or negative on values) from the creator's continued production.

<sup>63</sup> The first instance is when the buyer purchases the VA from the creator and the second upon a secondary sale.

<sup>64</sup> If he desires to create interest in his works to increase their value and exposure he could exhibit them. If he needs to sell them to earn income that is the same fate that nearly everybody must do in order to survive, namely providing services and skills in return for income.

<sup>65</sup> THE REPORT, *supra* note 15, at 141 ("The artist is faced with a choice of whether to sell his work today, or to hold the art as an investment for a certain time period. A sale will take place if the artist has a greater present need for consumption than the buyer. And although both the artist and the buyer agree on the future price of a work, they differ in their preference for present relative to future consumption.").

<sup>66</sup> Cowen & Tabarrok, *supra* note 16, at 239 (describing the effects that nonwage income has on consumption).

<sup>67</sup> Joseph P. Bauer, *Addressing the Incoherency of the Pre-emption Provision of the Copyright Act of 1976*, 10 Vand. J. Ent. & Tech L. 1, 33 n.124 (2007) ("Other possible reasons for the appreciation in value are that the artist may originally have undervalued the work or may have lacked the financial wherewithal to bargain for its full value.").

<sup>68</sup> THE REPORT, *supra* note 15 at 136 (discussing the risk of decline in value after a purchase).

creator money for his time, effort, and ideas so that he can earn a living and continue his creative career.<sup>69</sup> Creators usually forgo holding the VA and sell sooner rather than later instead of gambling on a future valuation from which they would benefit anyways.<sup>70</sup> Holding a VA until it becomes valuable is an option for the creator as much as it is for a buyer.<sup>71</sup>

When a creator sells his VA he discharges the risk and reward that comes with owning the VA in return for the present value of the VA.<sup>72</sup> Yet DdS allows the creator to keep a hand in the cookie jar. DdS disrupts the allocation of risk and reward by giving the creator a contingent interest in the VA.<sup>73</sup> The creator has no investment in the VA but can benefit nonetheless. One conceptual way that creators maintain an interest is if buyers discount their purchase price as discussed in Subpart III-B. In that event, creators' interest in the VA is in the form of the those forgone earnings.<sup>74</sup> After a sale and without this conceptual interest, the creator has no real stake in the VA's risk.

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<sup>69</sup> *Id.* at 141 note 71 (“[A]n artist needs money for food and shelter, as well as the costs associated with the preparation of his work, and may not have any choice about selling his work for present consumption.”).

<sup>70</sup> *Id.* app. pt. I Comment Letters at 64, *Arguments Against the Resale Royalty* (“When an artist's work is resold at a high price, the works which the artist has retained and has not sold become more valuable.”).

<sup>71</sup> It is not certain they ever will become valuable, this is the same risk that a buyer maintains. *See id.* at app. pt. I Comment Letters at 64, *Arguments Against the Resale Royalty* (“More than 99% of all works of art created in a given year do not appreciate in value; they decline, if they can be sold at all.”).

<sup>72</sup> *Id.* at 130 note 25. (“[A]rtists get a lump sum that can be invested and receive interest.”).

<sup>73</sup> The interest is contingent because it will become due only if the buyer actually resells at auction the work during the period in which DdS is in effect.

<sup>74</sup> THE REPORT, *supra* note 15, at 72 (referring to the idea of the discounted sales price causing creators to earn less on a sale of their work if the buyer anticipates paying a royalty on a secondary sale).

An issue that may arise in terms of a creator's ability to gain more by holding his VAs is whether sales and a market for the VAs are a necessary driver of their value.<sup>75</sup> In other words, if the VAs are held by the creator and never sold but are known to potential buyers, will they be valued less, the same, or more than if the same VAs are freely available to be bought.<sup>76</sup> If the VAs are less valuable when owned only by the creator then sales are a necessary function for value. An existing market for them also allows for market-pricing mechanisms because without a pricing history it is much harder to make a valuation.<sup>77</sup> Increasing the value of an unsold cache of VAs is possible but without a market it is hard to determine the likelihood of increased value.

It does not necessarily follow that buyers are unfairly gaining something that can never accrue to the creator even if VAs are valued lower when held by the creator and sales do drive their value.<sup>78</sup> A buyer increases his risk precisely because potential buyers are a necessary component of value.<sup>79</sup> Buyers are the *raison d'être* for value because they compete to own a VA and this demand imbues value into the VA. Without competition amongst buyers, prices would

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<sup>75</sup> Works gain value partially because of the existence of a market for the works to begin with. It is somewhat of a chicken and egg problem: value is unknown if there are no works available to be bought or sold, so the artist may always be at a disadvantage no matter how long he waited until he initially sells his works even if he is an objectively good artist. *See id.* app. pt. I Comment Letters at 15, *Statement of Michael L. Ainslie President and Chief Executive Officer of Sotheyby's Holdings, Inc. before the Senate Judiciary Subcommittee on Patents, Copyrights and Trademarks, Hearings on S. 1619, December 3, 1987.*

<sup>76</sup> THE REPORT, *supra* note 15 app. pt. I Comment Letters at 76, *Testimony of R. Frederick Woolworth in Opposition to H.R. 3221.* Robert Rauschenberg's works immediately went up in value tremendously upon the sale of his work by Mr. Scull (the event that prompted California's DdS law), which is evidence that sales are necessary to create value but also that sales of resold works can immensely increase the value of unsold works, too, thus benefitting the creator without DdS.

<sup>77</sup> *Id.* at 136-7 (listing factors that can impact the price of a work).

<sup>78</sup> If greater value is only created when the creator sells and they are worth less when he holds them. This idea is premised more as a chicken and egg problem, meaning that buyers and people don't know about the works and may not want the works if they are unavailable to be bought if there is no prestige available in owning them because the artist is an obscure artist by dint of the works not being available to view or buy.

<sup>79</sup> THE REPORT, *supra* note 15, at xii ("Market forces, rather than any metaphysical concept, drive the price and terms of an exchange and determine value. In a free market, there is arguably no latent value of an object, rather it is only as valuable as the price a willing buyer will pay a willing seller at a given time.").

be lower and nearer to the creator's cost of making the VA. While buyers may be gaining something that cannot accrue to the creator, that gain does not derive directly from the creator's efforts because without buyers the VA does not have much independent monetary value.

If VAs are valued the same no matter whether held by the creator or owned by others, then both sides have equal risk profiles in either holding or buying the VA and the potential gains available to each are equal.

The buyer of a VA is effectively purchasing the risk of the VA market and not the risk of an individual VA. Most purchases are losing propositions and it is impossible to know which VA will become valuable. Unlike in the stock market, where a buyer has the ability to compare facts and numbers, a VA buyer has only intuition and taste to go on. Because of this lack of information, creators overall earn more than they otherwise would if it were known which specific creators' VAs would increase in value. As a result, while the tiny number of creators who do become successful earn less than they would otherwise if it were known at the outset that they will become successful, many more creators come out ahead due to the unpredictability of success even though an individual creator may not be successful. As a result, buyers overall pay more than they would if the market was efficient. This is why an individual VA purchase is risky.

The allocation of the rewards and losses that flow from risk is a fundamental aspect of a market. Although creators do not play an active role in the creation of the value imbued into the VA, which arises from the market itself, DdS gives creators an interest in gains with no concurrent risk after a creator has freely sold his VAs and chosen not to partake in that risk.

#### B. Discounts Are Great! (If You Can Calculate Them)

DdS may impact both initial prices and later secondary prices of VAs because buyers may discount the royalty rate to its future expected value in the calculation of their maximum present buying price.<sup>80</sup> The higher the sales value, the larger the discount. The biggest issue with making a discounted-price buying decision is that the future value of the VA from which you would be making the discount assumption is unknowable, although possibly estimable in absolute terms.<sup>81</sup> Because of this, paying a royalty-adjusted discounted purchase price is not likely.

A buyer can only speculate about whether a VA will be worth much in the future and hence be able to make a speculative assumption about how much of a discount to take.<sup>82</sup> Taking a discount from an initial sales price would concern creators because it would reduce their present income with no guarantee of future royalties to make up for this reduction.<sup>83</sup> But the value of the VA in an initial sale is likely inconsequential compared to what it may go for in the future and thus its purchase is a small investment.<sup>84</sup> The buyer of a high-priced VA who has a

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<sup>80</sup> Leonard D. DuBoff, et al., *Artists Rights: The Kennedy Proposal to Amend the Copyright Law*, 7 *Cardozo Arts & Ent. J.* 227, 258 (1989) (“These investment-minded collectors would attempt to discount the price quoted in order to compensate for the amount potentially owed under the resale -royalty provision.”) (internal quotes omitted) .

<sup>81</sup> *Id.* at 258 note 207 (explaining the many variables necessary to make such a calculation).

<sup>82</sup> Perlmutter, *supra* note 13, at 409 (criticizing opponents of DdS who claim it will have a big impact while at the same time saying it will not be worth much to creators).

<sup>83</sup> The discount would reduce creators’ income in two ways. First, at the time of the initial sale the discount reduces the amount paid to the creator. Second, discounts by secondary buyers in the amount of what they must pay as a royalty will concomitantly reduce the royalty. For example, assume a 5% royalty on what would normally sell for \$100, with \$100 being the buyer’s ceiling, the creator does not receive \$5, which would make the total cost \$105, but would instead receive \$4.76 (5% of \$95.24, or put otherwise, 105% of 95.24 equals \$100).

There are also two ways DdS could work invidiously against creators as compared to the status quo. In the first case, if an initial buyer takes a discount with the assumption that he will sell it sometime within the DdS period but does not, then the creator will make less money than he would have otherwise. In the second case, if the future value of the money received by the creator is taken into account and the initial discount is large enough the creator could lose out if subsequent sales do not reach the expected valuation on which the discount was taken. This creates a situation where the future value of the money the creator received plus the royalty income turns out to be less than what the money would have been worth if the creator had received the an non-discounted sales price to start with.

<sup>84</sup> See *supra* note 23 for one example. In a more contemporary example of secondary sales, works by Michael Basquiat struggled to break €25,000 in the mid 1980s while today some of his works are sold for millions of dollars. For the purposes of this paper it will be assumed that this is adjusted to current exchange rates since the Euro did not exist then. CONTEMPORARY ART MARKET 2011/2012: THE ARTPRICE ANNUAL REPORT, *supra* note 33, at 27.

large investment will most likely to take the discount into consideration<sup>85</sup> because he is tying up large amounts of capital that could go towards other uses, as discussed in Subpart III-A. Not all buyers will take this route, especially Brag, but Investor and Beauty might. It is possible that buyers could take a discount but the likelihood of doing so is scant in light of the difficulty of making an informed decision based upon speculation about how much the VA will be worth and therefore the size of the discount to take.

### C. Royalty...What Royalty? Let's Sell It Across The Border!

If DdS becomes law in the United States, there is a possibility that VA owners may move their sales to countries without DdS.<sup>86</sup> If this occurs, these countries could see an increase in their use as venues and creators would lose out from DdS's benefits. While sellers would move to avoid paying DdS, the likelihood of this occurring is not high because the benefits of selling in the American market are great and many buyers are not willing or able to buy VAs abroad.

Markets act in mostly-predictable ways when taxes are imposed and since DdS can be viewed as a sales tax on covered VAs, market participants may respond by moving sales to jurisdictions without DdS.<sup>87</sup> People and organizations affected by higher taxes often relocate to places with lower taxes so long as they can have better returns and efficiency in the new locale. While it takes longer and is more expensive to move when things like factories are involved, the

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<sup>85</sup> Assuming a 5% royalty rate, a \$50 discount off a \$1000 work is much less likely to be worth consideration than a \$50,000 discount off a \$1 million work simply because the amount is so much larger no matter whether the buyer is extremely wealthy. See e.g. Jesse Drucker, *How to Pay No Taxes: 10 Strategies Used By The Rich*, BLOOMBERG BUSINESSWEEK, April 17, 2012, <http://www.businessweek.com/articles/2012-04-17/how-to-pay-no-taxes-10-strategies-used-by-the-rich#p1> (last visited Dec. 6, 2012) (saying that the 400 highest-income Americans paid a lower effective tax rate than the next 1.4 million highest-income Americans).

<sup>86</sup> See Goetzl & Sutton, *supra* note 13, at 48-49 (explaining how the French DdS system may cause sales that would normally have taken place in France to shift to other countries).

<sup>87</sup> THE REPORT, *supra* note 15, at 99 (“A vocal minority, however, including some artists, representatives of museums, art galleries, auction houses, and legal experts argued against a resale royalty, calling it a tax...”).

location of a sales transaction is much simpler and cheaper to relocate. A DdS law based upon location of sale would be easy to avoid by selling a VA in a country without DdS.<sup>88</sup>

The United States is a very large market and not every locale is suited or desirable to sell in, which dampens the likelihood of sales moving out of the United States.<sup>89</sup> Sellers will only move their sales if the benefits of a move outweigh the costs<sup>90</sup> and it is feasible that this will be true for some sellers. Despite the possible benefits from a move, a mass movement of sales out of the United States is unlikely because the United States market is simply too big and the benefits obtained from selling abroad are not great enough to counteract the negatives of selling abroad.

#### D. What Does This All Mean for the Market?

Given all of these considerations, the effect that DdS may have on the VA market is strong. The potential effect on the market from buyers paying a discounted purchase price is low because it is too difficult to determine how much of a discount to make in addition to the fact that the overwhelming majority of VAs will decline in value and thus negate the necessity for the discount. Secondary sales are highly unlikely to move out of the United States simply because the American market is wealthy and makes up a large portion of the world art market and the benefit of moving away to avoid DdS would most likely be outweighed by fewer sales with lower prices. The negative impact from these two issues is weak, which makes them fall in favor of DdS.

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<sup>88</sup> *In the Matter of: Artists' Resale Royalties*, *supra* note 56, at 262 (statement of Mitchell Zuckerman, President, Sotheby's Financial Services Incorporated) ("If you layer additional transactional costs on top of [taxes and dealer payments], it is absolutely certain that you will deflect some portion of business elsewhere into jurisdictions with lower transaction costs.").

<sup>89</sup> Important considerations are availability of storage for VAs, level of taxes, ease of access and transport, buyer and seller nearness, and other factors.

<sup>90</sup> These costs can include moving away from a large pool of buyers or transacting in a less-favored currency,

On the other hand, the shift of who gains from risk will strongly affect the market. While a small royalty amount would not seem to have a great impact, a lower reward for a big risk in the aggregate can have a big impact. Because most VAs decrease in value, buyers take a big risk when purchasing most VAs. The creator eliminated his risk when he could have kept the VA and DdS tries to piggy-back on the risk taken by the buyer and share only gains. The result of a change in who gains from risk can adversely affect the market for all VAs because buyers will have less money with which to purchase other VAs and they will take fewer risks because they will not be rewarded as much for taking that risk. The negative affect from the shift in risk outweighs the small potential impact that would result from discounted purchase prices and sellers moving to different markets.

#### IV. Conclusion

##### A. DdS Is Too Uncertain and Speculative To Be A Useful Incentive

The incentive created by DdS would certainly benefit some artists at some point but it is too speculative to be a motivating incentive for creators to make more and higher quality VAs. DdS fails as incentive for the three creators because given their motivations to create it is unable to effect a change in the quality or quantity of their output. For Unique Creator, which is the only group it would have the real potential to benefit, it cannot improve or raise their output. It would simply reward them more in return for nothing extra gained by society from them. It is possible that Career Creator and Hobbyist may increase their output because people tend to see rich rewards as more likely to accrue than is probable, but given their time and skills it is improbable that it would actually benefit them in the long term even if their output increases because their

ability to create desirable, highly-valued works is limited. The effect on any of the three types of creators is simply not strong enough to improve their output so that it enriches society to a greater extent than it costs society.

### B. Giving Rewards Without Risk Distorts Market Processes

It is all too easy to decry a buyer who has purchased a VA for what seems a pittance and later turns around to sell it for a princely sum. Left out of this equation are the innumerable VAs bought that decline in value or are valued barely more than the pittance for which they were bought. Owning VAs is not a gold mine. It is a risky purchase that rarely pays financial dividends. Buyers purchase VAs for various reasons and help the creators to earn a living when they do so. Initial purchase prices are what they are because it is impossible to predict which creator will hit it big.

The frenzy of buyers seeking to own a specific VA is what creates a VA's value. The aesthetics of the VA itself certainly create the object of desire, but what creates the value is competition among buyers. No one can say that a painting is intrinsically worth millions of dollars. Desire to own creates that price. In a normal market, the price of an object is somewhere just above its cost to produce and for luxury objects a bit higher. But an item that is sold for thousands of times its cost to produce derives its value not from its cost but from demand. The same is true with VAs.

Buyers take a risk in purchasing a VA with the hope that other buyers in the future will continue to desire it so that its value increases. The creator gains only from the value of his VAs at the time he sells them because that is what they are worth when he chooses to forgo holding any more risk in the VA. Further, because a buyer is buying the market risk and not the risk of an

individual VA, in the few times that a buyer does guess successfully on what is a risky and uncertain purchase, his risk-taking must be rewarded because creators overall have benefitted from the risks taken by buyers even if the creator of a specific highly-valued VA does not necessarily gain more than other creators.

The argument for DdS as an equitable right is hampered by the creator's sale of a VA because the risk of decreased value is solely on the owner. The owner who holds the risk in a VA is the one who should gain. The creator forsook any risk in the VA when he sold it and he did not have to do so - he chose to do so. The creator can still gain from any increases in his prior VAs' value by selling new VAs that will hopefully be as highly valued. Further, if the VA's value decreases the creator is not obligated to pay the owner anything for the decline. As such it is imprudent for the creator to gain from the VA's increase.

Even with DdS, while the creator and owner share the risk that gains will not be as large, the creator still does not have any real risk in the VA because he does not share decreases in value, which is the only real risk of ownership. A lesser gain is not a risk. The only way that the creator does share the risk in the VA is if buyers discount their purchase prices to make up for the expectation that they will pay a royalty. This reduced payment creates an interest in the VA by way of the forgone payment portion. Nonetheless, this discount was determined to be unfeasible and so it will rarely be a realistic consideration. Consequently, even with DdS the creator still does not share the risk of ownership.

### C. It Ain't So Sweet

For all the foregoing reasons, DdS should not be implemented in the United States.