

Opinions

Declaration on a Balanced Interpretation of the "Three-Step Test" in Copyright Law

Introductory Remarks

There are increasing concerns about the impact of the so-called "three-step test" on the law of copyright and related rights. From its relatively modest origin as a confirmation that countries of the Berne Union are entitled to permit the reproduction of copyright works "in certain special cases, provided that such reproduction does not conflict with a normal exploitation of the work and does not unreasonably prejudice the legitimate interests of the author",¹ the scope of this legal instrument has been steadily extended. Under the TRIPS Agreement² and the WIPO Treaties,³ it has been applied to the full range of authors' and related rights and has also increasingly been enshrined explicitly in national legislation. Today, the test affects all debates concerning the future of exceptions and limitations to copyright.

At the same time, the prevalent understanding of the impact of the "three-step test" has become more restrictive. The WTO Panel's interpretation of the test in its decision on Sec. 110(5) of the United States' Copyright Act 1976 was self-avowedly economic in focus and appears to leave limited scope for states to balance the interests of rightholders with countervailing interests of fundamental importance.⁴ Domestic courts have sometimes misunderstood the requirements of the test and, as a result, have applied it in a profoundly unbalanced manner.

Against this background, in a joint project of the Max Planck Institute for Intellectual Property and the School of Law at Queen Mary, University of London, a group of experts has collaborated on a declaration that aims to confirm the legitimacy of a balanced interpretation of the "three-step test" in copyright law. The Declaration that has resulted from this collaboration is set out below. It is open for signature on the websites of the Max Planck Institute (www.ip.mpg.de) and the School of Law at Queen Mary, University of London (www.law.qmul.ac.uk).

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1 Berne Convention for the Protection of Literary and Artistic Works, Art. 9(2).

2 TRIPS Agreement, Art. 13.

3 WIPO Copyright Treaty, Art. 10; WIPO Performances and Phonograms Treaty, Art. 16(2).

4 Report of the WTO Panel dated 15 June 2000, WT/DS160/R.

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Wording of the Declaration

Preface

The ever-increasing pace of technological development has prompted a fundamental change in the function and effectiveness of copyright law. The evolution of new business models has led to a dramatic shift in priorities. Unprecedented and unfamiliar threats have developed – threats for both the copyright holder and the copyright user. As far as possible, potentially conflicting interests should be reconciled.

In the context of global copyright regulation, harmonisation has focussed on securing rightholders' ability to benefit from new modes of exploitation and business models. While international harmonisation primarily serves the interests of copyright-exporting countries in a secure and predictable trading environment, historic evidence, economic theory and the principle of self-determination suggest that individual states should have sufficient flexibility to shape copyright law to their own cultural, social and economic development needs. Copyright exceptions and limitations tailored to domestic needs provide the most important legal mechanism for the achievement of an appropriate, self-determined balance of interests at national level.

The Three-Step Test has already established an effective means of preventing the excessive application of limitations and exceptions. However, there is no complementary mechanism prohibiting an unduly narrow or restrictive approach. For this reason, the Three-Step Test should be interpreted so as to ensure a proper and balanced application of limitations and exceptions. This is essential if an effective balance of interests is to be achieved.

Considerations

– Copyright law aims to benefit the public interest. It produces important incentives for the creation and dissemination of new works of authorship to the general public. These works serve to satisfy common needs; either in their own right or as a basis for the creation of further works. However, the public interest is only truly served if copyright law provides appropriate incentives for all parties involved. Consequently, copyright law must accommodate the interests of original rightholders (such as creators) as well as the interests of those who acquire rights as a consequence of the marketing or commercial exploitation of a work (in the following: subsequent rightholders).

Creators and subsequent rightholders often have concurrent interests, for example, in the prevention of unauthorised uses of works. However, the respective interests of creators and subsequent rightholders may also come into occasional conflict. For example, limitations and exceptions almost

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always clash with subsequent rightholders' primary goal of generating the maximum possible profit from their investment. By contrast, limitations and exceptions can, in certain circumstances, *favour* the interests of creators. This is particularly true within legal systems in which the application of limitations and exceptions is contingent upon the payment of adequate compensation in which the creator has a mandatory participation. The Three-Step Test should not be interpreted in a manner that jeopardises an adequate solution for this multi-level conflict of interests.

– The public interest is not well served if copyright law neglects the more general interests of individuals and groups in society when establishing incentives for rightholders. Where friction arises between the interests of rightholders and the general public, an effort must be made to bring them into equilibrium. This balancing of interests is a general objective of intellectual property regulation as embodied in Art. 7 TRIPS and the WIPO Copyright Treaty, the preamble to which emphasises "the need to maintain a balance between the rights of authors and the larger public interest, particularly education, research and access to information".

Limitations and exceptions are the most important legal instrument for reconciling copyright with the individual and collective interests of the general public. In determining the scope of application of limitations and exceptions, the Three-Step Test should not take into account only the interests of rightholders. The need to give equal consideration to third party interests is confirmed explicitly in the Three-Step Test as applied in industrial property law (Art. 17, Art. 26(2) and Art. 30 TRIPS). The fact that third party interests are not explicitly mentioned in the Three-Step Test as applied in copyright law does not detract from the necessity of taking such interests into account. Rather, it indicates an omission that must be addressed by the judiciary.

– When correctly applied, the Three-Step Test requires a comprehensive overall assessment, rather than the step-by-step application that its usual, but misleading, description implies. No single step is to be prioritised. As a result, the Test does not undermine the necessary balancing of interests between different classes of rightholders or between rightholders and the larger general public. Any contradictory results arising from the application of the individual steps of the test in a particular case must be accommodated within this comprehensive, overall assessment. The present formulation of the Three-Step Test does not preclude this understanding. However, this approach has often been overlooked in decided cases.⁵

⁵ See for instance the decision of the French Supreme Court, 28 February 2006, 37 IIC 760 (2006). The same attitude is revealed in the WTO Panel report WT/DS114/R of 17 March 2000 (*Canada – Patents*), where it is held that failure to meet the requirements of one of the three steps will necessarily result in a violation of Art. 30 TRIPS. Though not expressly endorsing the same attitude, the subsequent Panel report WT/DS160/R, 15 June 2000 (*USA – Copyright*), has not distanced itself from *Canada – Patents* in a manner that would help to rule out further misunderstandings.

– The public interest is particularly clear in the case of those values that underpin fundamental rights. These values must be given special consideration when applying the Three-Step Test. In addition, the public interest is served when the inevitable tendency of copyright law to restrict competition through the grant of exclusive rights is no greater than necessary.

Limitations and exceptions provide a mechanism for the elimination of anti-competitive exclusive market positions. In this respect, limitations and exceptions have an advantage over the remedies provided within competition law as they establish a general basis for remedies (as opposed to the case-by-case approach of competition law). Thus, they ensure legal certainty and predictability and reduce transaction costs. Decisions concerning the introduction and scope of limitations and exceptions promoting competition should be left to the discretion of the relevant legislature. The Three-Step Test should not be applied in a manner that safeguards anti-competitive practices or impedes the establishment of a harmonious balance between the legitimate interests of rightholders, on the one hand, and competition (especially competition in secondary markets) on the other.

– One of the key incentives that copyright law offers to original and subsequent rightholders is compensation at market rate. In fact, higher prices must be accepted as long as they result from market-based competition. However, it is not the case that *only* market-based pricing can be “adequate” and commensurate with the interests of right holders. Compensation developed under anti-competitive conditions is unjustifiable.

Consequently, where third party interests justify the introduction of limitations and exceptions to exclusive rights, the Three-Step Test should not preclude the payment of compensation below the market rate. Compensation is inherently adequate as long as there are sufficient incentives for the continued creation and dissemination of works. Compensation can also be sufficient where the difference between actual below-market compensation and theoretical compensation at market rate is justified by third party interests.

Aims

The Three-Step Test performs distinct functions at different regulatory levels and within different legal systems. Internationally, it controls state autonomy in drafting domestic exceptions and limitations. At the domestic level, the Test may be incorporated directly or it may function exclusively as an aid to the interpretation of domestic legislation.

This Declaration does not seek to eliminate such differences. Furthermore, it does not aim to constrain the freedom or discretion of regional and domestic legislators to permit or prohibit particular limitations and exceptions. Neither shall it undermine the internal European allocation of competencies with respect to legislating on limitations and exceptions.

International economic regulation allows for a balance of economic and social interests. International intellectual property law also stresses the need for balance. In the field of copyright law, this Declaration proposes an appropriately balanced interpretation of the Three-Step Test under which existing exceptions and limitations within domestic law are not unduly restricted and the introduction of appropriately balanced exceptions and limitations is not precluded.

Declaration

The Signatories,

- Recognising the increasing reliance on the Three-Step Test in international, regional and national copyright laws,
- Considering certain interpretations of the Three-Step Test at international level to be undesirable,
- Perceiving that, in applying the Three-Step Test, national courts and legislatures have been wrongly influenced by restrictive interpretations of that Test,
- Considering it desirable to set the interpretation of the Three-Step Test on a balanced basis,

Declare as follows:

1. The Three-Step Test constitutes an indivisible entirety.
2. The three steps are to be considered together and as a whole in a comprehensive overall assessment.
The Three-Step Test does not require limitations and exceptions to be interpreted narrowly. They are to be interpreted according to their objectives and purposes.
3. The Three-Step Test's restriction of limitations and exceptions to exclusive rights to certain special cases does not prevent
 - (a) legislatures from introducing open-ended limitations and exceptions, so long as the scope of such limitations and exceptions is reasonably foreseeable; or
 - (b) courts from
 - applying existing statutory limitations and exceptions to similar factual circumstances *mutatis mutandis*; or
 - creating further limitations or exceptions, where possible within the legal systems of which they form a part.
4. Limitations and exceptions do not conflict with a normal exploitation of protected subject matter, if they
 - are based on important competing considerations or
 - have the effect of countering unreasonable restraints on competition, notably on secondary markets, particularly where adequate compensation is ensured, whether or not by contractual means.

5. In applying the Three-Step Test, account should be taken of the interests of original rightholders, as well as of those of subsequent rightholders.
6. The Three-Step Test should be interpreted in a manner that respects the legitimate interests of third parties, including
 - interests deriving from human rights and fundamental freedoms;
 - interests in competition, notably on secondary markets; and
 - other public interests, notably in scientific progress and cultural, social, or economic development.

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