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THE POTENTIAL DEMISE OF ANOTHER NATURAL MONOPOLY: NEW TECHNOLOGIES AND THE FUTURE ADMINISTRATION OF COPYRIGHT

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The Potential Demise of another Natural Monopoly: New Technologies and the Future of Collective Administration of Copyrights

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ABSTRACT

A quarter century ago, in its landmark decision in *BMI v. CBS*, the US Supreme Court decided that the practice of collective administration of performing rights by Performing Rights Organizations (PROs) and the issuance of blanket licenses by them are not *per se* illegal price fixing. The decision has since been an example of good economics and good law, for a triumph of rulemaking based on economic realities rather than on wooden judicial doctrine. Although technically, all that the Court ruled was that the practices in question were not *per se* illegal the opinion of the majority, which highlights the benefits of the blanket license issued by PROs, is read as an endorsement of the idea of collective administration of copyrights, and the case is often cited when an example for a pro-competitive welfare enhancing arrangement is needed.

PROs and blanket licenses exist in most countries. Moreover, collective administration is not limited to performing rights and is often advocated as a solution to many copyright licensing and enforcement problems. The intuition behind the proliferation of collective administration is that some aspects of copyright administrations are natural monopolies. It is often argued that individual administration is impracticable or at least non-economical. Collective administration is therefore promoted as the most efficient method for licensing, monitoring and enforcing those rights. In addition, since the market is a natural monopoly, regulation, rather than an attempt to create competition, is thought to be the optimal regulatory response.

This paper critically analyzes this natural monopoly argument. I argue that the case for PROs is not as straightforward as it is assumed to be. I show that many of the underlying cost efficiencies that are attributed to PROs are usually simply assumed, and in many cases could be equally achieved under less restrictive arrangements. I further argue that even if the natural monopoly framework has been correctly applied in the past, technological changes that can facilitate the online licensing of music undermine the natural monopoly framework even further. I show that the Internet and Digital Rights Management technologies (DRM), which enable the online distribution of protected

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copyrighted material, can effectively facilitate the formation of a competitive marketplace for performing rights. Due to some economical, legal and political barriers however, the availability of the technology will probably not suffice to make the transition from monopoly to competition a spontaneous process.

JEL Classification: L12, L41, L43, O33, Z1

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I. Introduction

Almost a quarter century ago, the US Supreme Court gave one of its seminal decisions for the modern analysis of antitrust, intellectual property and the relationships between the two areas of law. The decision in *Broadcast Music, Inc. v. Columbia Broadcasting Systems, Inc.*² has since been an example of good economics and good law, for a triumph of rulemaking based on economic realities rather than on wooden judicial doctrine. The parties in *BMI v. CBS* were the American Society of Composers, Authors and Publishers (ASCAP) and Broadcast Music, Inc. on the one hand, and Columbia Broadcasting System, Inc. (CBS) on the other, and the question was “whether the issuance by ASCAP and BMI to CBS of blanket licenses to copyrighted musical compositions at fees negotiated by them is price fixing *per se* unlawful under the antitrust laws.”³ The Court’s answer to this question was negative. It acknowledged the existence of considerable efficiencies in the operation of ASCAP and BMI and in the issuance of blanket licenses by them and ruled that consideration under the rule of reason would be more appropriate. The case was remanded accordingly. Technically,

² 441 U.S. 1 (1979).

³ *Id.* at 4.

all that the Court ruled was that the practices in question were not *per se* illegal – it did not rule that they were legal – yet the opinion of the majority which highlights the benefits of the blanket license issued by ASCAP and BMI is generally read as an endorsement of the idea of collective administration of copyrights and more generally, the case is often cited as an example of a pro-competitive welfare enhancing arrangement.⁴

The idea of collective administration of performing rights by Performing Rights Organizations (PROs) such as ASCAP and BMI is far from unique to the US and in fact is the copyright holders' preferred method of licensing worldwide. According to the copyright society folklore the origins of collective administration date back to 1847 when Ernest Bourget, a French composer's visit to the Café Ambassadeurs – where his music was being played without his permission – led to the formation of the first PRO, Agence Centrale, which later, in 1851, became the first modern PRO, Société des Auteurs et Compositeurs et Editeurs de Musique (SACEM).⁵ There are currently 201 PROs in 108 countries organized under the International Confederation of Societies of Authors and Composers, CISAC.⁶

Moreover, collective administration of copyrights is not limited to performing rights and is often advocated as a solution to many copyright licensing and enforcement problems. In Canada, for example, the government has viewed collective administration a desirable practice for a variety of copyrights⁷ and a series of amendments to Canada's Copyright Act has led to the formation of a world record 36 collective organizations representing a variety of copyright holders and administering a variety of rights.⁸

⁴ See e.g., *National Collegiate Athletic Ass'n v. Board of Regents of University of Oklahoma*, 468 U.S. 85 (1984) at 103 (“Broadcast Music squarely holds that a joint selling arrangement may be so efficient that it will increase sellers' aggregate output and thus be procompetitive”); HERBERT HOVENKAMP, *FEDERAL ANTITRUST POLICY*, 210-12 (2nd ed. 1999) (noting that the blanket license issued by BMI is “a dramatic example of a market facilitating agreement”); RICHARD A. POSNER, *ANTITRUST LAW* 30 (2nd ed. 2001) (PROs are an example of a few cases of “benign cartels”).

⁵ Martin Kretschmer, *The Failure of Property Rules in Collective Administration: Rethinking Copyright Societies as Regulatory Instruments*, 24 E. I. P. R. 126 (2002).

⁶ See *What is CISAC?* at

<http://www.cisac.org/web/content.nsf/Builder?ReadForm&Page=Article&Lang=EN&Alias=A-US-CISAC> (last visited November 5, 2003).

⁷ See e.g., *Government of Canada, Supporting Culture and Innovation: Report on the Provisions and Operation of the Copyright Act 30-31 (2002)*, available at

<http://strategis.ic.gc.ca/epic/internet/incrp-prda.nsf/vwGeneratedInterE/rp00863e.html>

⁸ See Daniel J. Gervais & Alana Maurushat, *Fragmented Copyright, Fragmented Management: Proposals to Defrag Copyright Management*, 2 CAN. J. L. & TECH. 15 (2003).

The general idea behind the proliferation of collective administration of copyrights is that because individual administration is often impracticable, or at least uneconomical, collective administration is the most efficient method for licensing, monitoring and enforcing copyrights and therefore, when this is the case, society is better served by a single seller. Although not generally articulated in these words, the argument behind collective administration of copyrights in general, and performing rights in particular, is that the market for the licensing of certain rights is a natural monopoly and when this is the case, regulation,⁹ rather than an attempt to create competition, is the optimal regulatory response.¹⁰

The purpose of this paper is to analyze critically this natural monopoly argument. I will argue that the case for PROs is not as straightforward as it is assumed to be. I will show that many of the underlying cost efficiencies that are attributed to PROs are usually simply assumed, and in many cases could be equally achieved under less restrictive arrangements. I will further argue that even if the natural monopoly framework has been correctly applied in the past, technological changes that can facilitate the online licensing of music undermine the natural monopoly framework even further. I will argue that the Internet and Digital Rights Management technologies (DRM), which enable the online distribution of protected copyrighted material, can effectively facilitate the formation of a competitive marketplace for performing rights. Due to some economical, legal and political barriers however, the availability of the technology will probably not suffice to make the transition from monopoly to competition a spontaneous process.

II. Public Performance of Music – General Economic and Legal Background

The copyright laws in most jurisdictions provide that copyrighted music cannot be publicly performed without the prior approval of the copyright holders,¹¹ and

⁹ Regulation in this connection includes not only regulation by a specific regulatory body but also intervention in the operations of PROs under antitrust law, as is the case in the US and some other countries.

¹⁰ The term Natural Monopoly will be defined and explained in Part III.3 *infra*.

¹¹ See 17 U.S.C. § 106; in Canada see Copyright Act (R.S. 1985, c. C-42 s. 3); and see Article 11(1) of the Berne Convention for the Protection of Literary and Artistic Works: “Authors of dramatic, dramatico-musical and musical works shall enjoy the exclusive right of authorizing: (i) the public performance of their work, including such public performance by any means or process; (ii) any communication to the public of the performance of their work.”

it is expected that such approval will be granted in return for the payment of royalties. In the case of public performance or broadcast of sound recordings, in addition to securing a license from the author of the lyrics and the composer, the public performer might be required to secure authorization from (or sometimes only to pay royalties) the producer of the sound recording and the performer(s).¹²

A simple reading of the relevant legislation regarding public performance might convey the impression that public performers reach agreements and obtain licenses from individual copyright holders. In practice however, agreements between performers and individual copyright holders are rare. In most cases performers negotiate, obtain licenses and pay royalties to Performing Rights Organizations (PROs) that operate on behalf of numerous copyright holders, typically all (or an overwhelming) majority of the copyright holders within a jurisdiction.¹³ In addition, PROs do not usually grant licenses to every song sought to be performed but rather issue a blanket license that allows the licensee to publicly perform any of the titles in the repertoire of the collective, usually without limitations with respect to the number of performances, their timing, etc.

The existence of PROs and their practice of granting only blanket licenses have created a special challenge to competition law enforcers and other policymakers in various jurisdictions. On the one hand, as a result of the existence of PROs,¹⁴ price competition between copyright holders is virtually eliminated and a single monopolistic entity becomes the sole seller in the market. Such monopolies can exploit their market power vis-à-vis music users and set their prices in order to maximize their revenue without any competitive restraints. In addition, PROs can exploit their power against their individual members by imposing

¹² In the US, subject to a new limited performing right in online transmission of music (this limited right will be discussed in Part V.A.1 *infra*), there is no performing right in the sound recording, only in the underlying lyrics and composition. In Canada, as in many industrialized countries, there exists a separate performing right in the sound recording, *see Copyright Act*, s. 19. This is, however, only a right for equitable remuneration to be paid by the performer to the producer and performer of the sound recording.

¹³ A notable exception is the US, where two major PROs, ASCAP and BMI and a smaller one, SESAC, Inc. coexist. In the majority of cases a composition can be part of the repertoire of only one PRO. The exception are cases known as “cross-registration” which may occur when a writer affiliated with one PRO writes in collaboration with a writer affiliated with another, *see AL KOHN & BOB KOHN, KOHN ON MUSIC LICENSING* 914, 3rd. ed. (2002).

¹⁴ For the sake of convenience, unless otherwise indicated, I will use the term PRO to describe both collective administration and blanket licensing of performing rights although both practices are not inherently connected. In theory PROs can issue many types of licenses other than blanket- (*e.g.*, per-song license) just as individual copyright holders can issue blanket licenses that cover their entire individual repertoire.

burdensome conditions upon them¹⁵ or by discriminating against some members. On the other hand, there exist substantial economies of scale in the administration, licensing and enforcement and as a result PROs are often regarded as an indispensable mechanism for the licensing, administration and enforcement of the public performance right. According to a document published by the World Intellectual Property Organization (WIPO), for example, an average of 60,000 musical works are broadcast on television every year, so thousands of owners of rights would have to be approached for authorization;¹⁶ The number of works broadcast on radio is probably even larger. Even if not completely impractical, the costs seem to be enormous relative to the value of an individual work, so the cost savings from collective licensing are substantial. Additionally, because in many cases copyrights in one work are shared by several different copyright holders, collective licensing overcomes potential problems of hold-up by an individual copyright holder. Those conflicting considerations have often led to the endorsement of the collective model of licensing by PROs, although such endorsement is usually coupled with some sort of regulation, either by specific provisions of countries' copyright legislation, by application of competition laws or both. In the US, antitrust has been the dominant vehicle for regulatory oversight of PROs, and the operations of the two major PROs, ASCAP and BMI are governed by consent decrees entered into following antitrust complaints filed by the Antitrust Division of the Department of Justice.¹⁷ The operations of ASCAP and BMI were also challenged in private antitrust suits. The most famous of these *BMI v. CBS*,¹⁸ which refused to attribute

¹⁵ See e.g., a decision of the European Court of Justice in Case 127/73 *Belgische Radio en Televisie v. Societe Belge des Auteurs, Compositeurs et Editeurs (S.A.B.A.M.)*, [1974] 2 C.M.L.R. 238 (E.C.J.) (holding that a national PRO may be abusing its dominant position when it "imposes on its members obligations which are not absolutely necessary for the attainment of its object and which thus encroach unfairly upon a member's freedom to exercise his copyright.")

¹⁶ See WIPO, *Collective management of copyright and related rights*, at http://www.wipo.org/about-ip/en/about_collective_mngt.html (last visited November 14, 2003).

¹⁷ The government first brought a criminal antitrust suit against ASCAP in 1934 but then the Government was granted a mid-trial continuance and never returned to the courtroom. It then brought a civil action in 1941 which led to the first consent decree (*U.S. v. ASCAP*, 1941-1943 Trade Cas. (CCH) ¶ 56, 104 (S.D.N.Y. 1941); it was then modified in 1950 (*U.S. v. ASCAP*, 1950-1951 Trade Cas. (CCH) ¶ 62, 595 (S.D.N.Y. 1950), again in 1960 (*U.S. v. ASCAP*, 1960 Trade Cas. (CCH) ¶ 69, 612 (S.D.N.Y. 1960), and most recently in 2001, see *U.S. v. ASCAP*, 2001 WL 1589999 (S.D.N.Y.)). The first consent order with BMI was entered in 1941 (*U.S. v. BMI*, 1940-1943 Trade Cas. (CCH) ¶ 56, 096 (E.D. Wisc. 1941), and was modified twice: in 1966 (*U.S. v. BMI*, 1966 Trade Cas. (CCH) ¶ 71, 941 (S.D.N.Y. 1966) and 1994 (*U.S. v. BMI*, 1996-1 Trade Cas. (CCH) ¶ 71, 378 (S.D.N.Y. 1994)).

¹⁸ *Supra*, note 1.

per-se illegality to the issuance of blanket licenses by ASCAP and BMI, is often cited as an example of sound application of economic analysis in law-making in general and in the area of the intersection between competition laws and intellectual property laws in particular.¹⁹ In Canada, the Copyright Act provides the main avenue for the regulation of PROs (as well as other forms of collective management of copyright).²⁰ With respect to PROs, Section 67 of the Copyright Act empowers the Copyright Board to oversee the terms and fees of PROs and determine the tariffs in individual cases when parties fail to reach an agreement. As will be discussed later in Part V.B, the regulation of PROs is probably outside the ambit of Canadian competition law, at least in the majority of cases. Competition law plays a part in the oversight of PROs in several additional jurisdictions. In the EU, the European Court of Justice has ruled that PROs are subject to the competition laws of the European Communities and in particular to the prohibition against abuse of dominant positions under Article 82 of the EC Treaty.²¹ Nevertheless, none of those rulings seem to have significant influence on the operations of PROs.²² In the UK, the Mergers and Monopolies Commission has held inquiries into the operation of PROs and issued two reports with recommendations for legislative reform.²³ In Ireland, the Competition Authority has overseen and approved the operation of several PROs and their agreements with some users.²⁴ In Australia, the Competition

¹⁹See *e.g.*, WILLIAM M. LANDES & RICHARD A. POSNER, THE ECONOMIC STRUCTURE OF INTELLECTUAL PROPERTY LAW 386 (2003); Willard K. Tom & Joshua A. Newberg, *Antitrust and Intellectual Property: From Separate Spheres to Unified Field*, 66 ANTITRUST L. J. 167 (1997); William M. Landes, *Harm to Competition: Cartels, Mergers and Joint Ventures*, 52 ANTITRUST L. J. 625 (1983).

²⁰ For a comprehensive view of collective management of copyright in Canada see Daniel J. Gervais, *Collective Management of Copyright and Neighboring Rights in Canada: An International Perspective*, Report prepared for The Department of Canadian Heritage (2001), available at http://www.pch.gc.ca/progs/ac-ca/progs/pda-cpb/pubs/collective/index_e.cfm.

²¹ See *e.g.*, Case 395/87 *Ministere Public v. Jean Louis Tournier*, [1991] 4 C.M.L.R. 248 (1989)

²² See Gervais, *supra* note 18, at 52.

²³ Monopolies and Mergers Commission, *Collective Licensing: A Report on Certain Practices in the Collective Licensing of Public Performance and Broadcasting Rights in Sound Recordings*, 1988, Cm. 530; Monopolies and Mergers Commission, *Performing Rights: A Report on the Supply in the UK of the Services of Administering Performing Rights and Film Synchronisation Rights*, 1996, Cm. 3147 (hereinafter – MMC Performing Rights).

²⁴ See *e.g.*, Competition Authority Decision of 21 December 1995 relating to a proceeding under Section 4 of the Competition Act, 1991, Notification No. CA/3/91E - Irish Music Rights Organisation Ltd/Public Performance Users. Decision No. 457, 1995); Competition Authority Decision of relating to a proceeding under Section 4 of the Competition Act, 1991, Notification No CA 1048-1050/92E, CA/26/96 - Phonographic Performance (Ireland) Ltd. / Various Agreements, Decision No. 580, 2000).

Tribunal has recently forced some changes in the operations of the Australasian Performing Rights Associations.²⁵ In Israel, the Restrictive Trade Practices Tribunal issued in 2000 an interim decision approving changes in the operations of the Israeli branch of the International Federation of the Phonographic Industry (IFPI Israel). The changes were required by the Israeli Antitrust Authority following an inquiry into the practices of the IFPI.²⁶ A similar inquiry into the operations of ACUM, the PRO representing composers, authors and publishers in Israel is currently underway.

III. The Antitrust Dilemma

PROs can run afoul of antitrust principles in two related ways. A PRO can be viewed as a typical cartel. It is a horizontal joint venture of copyright holders who create a common sales agency - “one of the hallmarks of a successful cartel”²⁷ - and then pools revenues and distribute them among members, thus eliminating competition between the member copyright holders.²⁸ Additionally, PROs, especially when the repertoire that they hold is significant (as is usually the case), presumably have significant market power which they might wish to exploit in the form of supra-normal licensing fees.

1. PROs, Deadweight Loss and Price Discrimination

The traditional economic concern with monopolies is the creation of deadweight loss that results when the prices set by the monopolist are above the competitive level. When the monopoly limits its output and sells its product at a price above

²⁵ Re Australasian Performing Right Association Ltd [1999] ACompT 3 (interim decision); Re Applications by Australasian Performing Right Association Ltd [2000] ACompT 2, 20 July 2000, 2001 WL 762285.

²⁶ See H.I. 3574/00 IFPI Israel v. The Commissioner for Restrictive Trade Practices, July 18, 2000, available at <http://80.70.129.21/vol001/503/005/503005844.pdf> (Hebrew).

²⁷ See Landes, *supra* note 17, at 632.

²⁸ The horizontal-agreement description applies to the majority of PROs which are organizations that private entities held and managed by member copyright holder. The description is less applicable to organizations such as SESAC in the US, which is a privately-owned for-profit company which represents (but not owned) its affiliate publishers and writers. SESAC differs from the other US PRO, BMI and ASCAP in that it allocates negotiated shares to its publisher and writer affiliates, after first deducting overhead costs, with SESAC retaining the balance as its profits, see M. WILLIAM KRASILOWSKY & SIDNEY SHEMEL, *THIS BUSINESS OF MUSIC: THE DEFINITIVE GUIDE TO THE MUSIC INDUSTRY* 155 (8th ed. 2000). The cartel description is probably also less applicable, at least from a legal standpoint, in countries where the existence of PROs is mandated or at least approved by legislation. This will be discussed later in the context of Canada in Part V.B.3 *infra*.

its marginal cost, consumers that are willing to pay a price which is higher than cost but lower than the monopoly price are forced out of the market. Because such transactions do not materialize although they have a positive social value, such monopoly pricing creates a deadweight loss.

In addition, monopoly pricing involves wealth transfer from the buying consumers (who would have paid less under conditions of competition) to the monopoly. However, it is an unsettled dispute in antitrust whether the law should be concerned only with inefficiencies created by monopoly (the deadweight loss) or whether it should be concerned with wealth transfers as well.²⁹

This description applies when a monopoly charges a uniform price. When the monopoly can charge different prices to different consumers according to their tastes and willingness to pay, the effects of such pricing on efficiency are more ambiguous. When a monopolist can engage in such differentiated pricing - a practice that is often called "price discrimination" - it can charge more to consumers who value the product highly and less to consumers who value it less. In some cases the monopolist can charge less to consumers who were excluded from the market under uniform pricing, thereby creating a smaller deadweight loss. Ideally, if the monopolist could set the price for each consumer according to her valuation it could maximize its profit by selling the same quantity that would have been sold in a perfectly competitive market without creating any deadweight loss. Nevertheless price discrimination might implicate a greater wealth transfer from consumers to the monopoly. PROs are monopolists of the second type, because they often charge different fees to different customers, and the differences basically reflect different valuations of music. A TV network, for example, pays more than a small café. However, since the PRO cannot effectively gauge the exact preferences of each user, PROs often employ third-degree price discrimination, *i.e.*, they set different prices to different *classes* of users. The welfare effects of this type of price discrimination are less obvious.³⁰

The legal treatment of price discrimination in the case of PROs reflects the ambiguous nature of price discrimination and the resulting ambiguous regulatory response to it. In the US, ASCAP and BMI cannot unreasonably refuse to grant a license to a user who seeks one and is willing to pay reasonable

²⁹ See HOVENKAMP, *supra* note 4, at §14.5a.

³⁰ See *e.g.*, Jeffrey Church & Roger Ware, *Industrial Organization: A Strategic Approach* 165-66 (2000).

fees. In addition they are required to set different fees to different classes of users. These requirements are probably aimed at eliminating the deadweight loss that would have occurred if PROs charged uniform prices. At the same time, PROs are usually prohibited from discriminating within the same class of users, which means that within each class of users they cannot charge more to users who value music more than others. This requirement is probably aimed at limiting the wealth transfer from those users to the PRO. But at the same time such anti-discrimination rule prevents the PROs from charging less to users who value music less than the others in the same class, thereby potentially excluding some of them from the market and creating a deadweight loss that might have been avoided without the intra-class anti-discrimination rule.³¹

However, despite the fact that PROs, because they are price discriminating monopolists, do not necessarily create significant deadweight loss, this alone should not make them immune from antitrust scrutiny because if the same level of output can be achieved under competition or by a price-discriminating monopolist, the first option would be preferred by many because it involves no wealth transfer from consumers to sellers.³² Copyright holders, of course, would have the opposite preference.

2. Performing Rights and Price Discrimination

A source of further complication for the antitrust treatment of price discrimination in the case of performing rights is the fact that the public performance right itself is a legal mechanism that encourages and facilitates more effective price discrimination. Under copyright law it is not enough for a user to purchase a copy of the protected work in order to perform it; she must obtain a separate license from the copyright holder. The right, thus, allows copyright owners to distinguish between high-valuation commercial users who engage in public performance and low-valuation 'home' users who perform the music

³¹ Similar ambiguity exists in Canada. PROs should operate a licensing scheme with classes of users to which the PRO agrees to license. They must submit their proposed fees to the Copyright Tribunal for approval and cannot refuse to grant a license to a user who offers to pay the fees approved by the Tribunal. The effect is similar to that of the US. The Tribunal might reduce the fees proposed by the PRO thereby allowing users who value music more than the approved rate to retain a greater portion of the value of music whereas users whose valuation of music is below the approved fees will be excluded from the market.

³² In both Canada and the US certain forms of price discrimination are outlawed when the result of the practice is injury to competition. The practice *per se*, however, is not illegal even if as a result some consumers pay higher prices.

privately.^{33,34} Moreover, the need to obtain a performing license compels the user to approach the copyright holder thus making it easier for the copyright holder to identify the characteristics of every user and price the license accordingly, or at least implement a fine-grained method of discriminating according to observable characteristics common to groups of users.³⁵

Additionally, in order to effectively price discriminate the copyright holder must be able to prevent arbitrage; she must be able to prevent low-valuation users from buying at low price and then reselling the product to the users with high valuations. In the case of sale of copies of protected works, the copyright holders cannot effectively prevent arbitrage because they usually do not wholly control the distribution chain, but more importantly their attempts to prevent resale of copies are likely to be frustrated by the first-sale doctrine.³⁶ The first-sale doctrine, however, applies only to the physical copies of the protected work; it does not apply the public performance rights and to licenses granted thereto.³⁷ Therefore, if copyright holders specify in the license that it is not transferable (as they often do) as well as the type of premises or services that the license applies to they can effectively prevent arbitrage. Thus a small bar, for example, cannot 'resell' its low-priced license to a national TV station.³⁸

³³ Michael J. Meurer, *Copyright Law and Price Discrimination*, 23 CARDOZO L. REV. 55, 110 (2001).

³⁴ The traditional definition of price discrimination is charging different prices for the same product when the difference in price does not reflect a difference in costs. Formally, a bundle that includes the performing right is not the same product as the copy of the work alone, so there is no price discrimination. This is misleading. In both cases the copyright holder sells a copy, and the user must physically have a copy in order to perform it whether the work is played privately or publicly. The legal right for public performance thus adds nothing physically and no user would have paid for it unless to law required so.

³⁵ Meurer, *id.*

³⁶ The first sale doctrine provides that a copyright owner's right to distribute copies of his protected work by way of sale or other transfer of ownership, or by rental, lease, or lending, is limited to the first sale of the copy, whereas the subsequent holder of the copy can freely sell or otherwise dispose of the possession of it without the authorization of the copyright holder. In the US the first sale doctrine was first endorsed by the US Supreme Court in *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339, 28 S.Ct. 722, 52 L.Ed. 1086 (1908) and was later codified in 17 U.S.C. § 109(a), see *Quality King v. L'anza*, 523 U.S. 135, 118 S.Ct. 1125 (1998). Similarly in Canada, once the first copies of a work have been put on the market the copyright owner cannot control later distribution of copies of the work, whoever puts them on the market, see DAVID VAVER, *COPYRIGHT LAW* (2000), at ch. 5(A)(1).

³⁷ *Red Baron-Franklin Park, Inc. v. Taito Corp.*, 883 F.2d 275 (4th Cir. 1989).

³⁸ See e.g., ASCAP Experimental License Agreement for Interactive Sites & Services - Release 1.0 available at <http://www.ascap.com/weblicense/ascapinteractive.pdf>; See also ASCAP Concerts and

Nevertheless, although the public performance right builds price discrimination into copyright law, a PROs ability to price discriminate is greater than that of an individual copyright holder. When copyright holders compete among themselves their ability to price discriminate and extract greater portions of the consumers' surplus is restricted. Every song is unique and its copyright holder faces a downward sloping demand curve, and in this sense competition between songs does not result in their prices converging to marginal cost. Competition between songs, however, prevents their copyright holders from attempting to extract the whole surplus from consumers because such an attempt might cause the user to choose another song (perhaps of another artist in the same genre), whose copyright holder is willing to charge a slightly lower price. The individual copyright holder under competitive licensing can only charge the marginal value of his song to the user, but no more.³⁹ This is an example of a case of competition between differentiated products where prices in equilibrium are expected to be higher than the competitive price, but lower than the monopoly price.⁴⁰

However, when all sellers of the differentiated products collude or merge, they can collectively set the price of their products at the monopoly level. This is what PROs do. Because the PRO sets the price of licenses, it can set the price at the optimal monopoly price rather than the level at which the individual copyright holders would have set it. Because the PRO usually grants only blanket licenses, this 'all-or-nothing' bargain forces most users to buy more units than they wish at a price that is higher than they otherwise wish to pay and enables the PRO to extract the higher value of the license.⁴¹

3. PROs as Natural Monopolies

Despite the monopolistic aspects of PROs, it is generally accepted that collective administration of performing rights by PROs yields some efficiencies and benefits which are generally believed to outweigh the cost associated with their monopolistic nature. It is also widely assumed that competition between copyright holders in the licensing of performing rights will not achieve socially

Recitals Blanket License Agreement and ASCAP Colleges and Universities License Agreement in M. W. KRASILOWSKY & SIDNEY SHEMEL, MORE ABOUT THIS BUSINESS OF MUSIC 228 (5th ed. 1994).

³⁹ Stanley M. Besen et al., *An Economic Analysis of Copyright Collectives*, 78 VA. L. REV. 383 (1992).

⁴⁰ See generally CHURCH & WARE, *supra* note 30, at 258-62.

⁴¹ Besen et. al., *supra* note 39, at 393; John Cirace, *CBS v. ASCAP: An Economic-Analysis of a Political Problem*, 47 FORDHAM L. REV. 277 (1978).

superior outcomes.⁴² The case of PRO thus fits into the paradigm of a natural monopoly.⁴³

The term “Natural Monopoly” is usually associated with utilities such as electricity, water supply or some aspects of telecommunication,⁴⁴ yet a natural monopoly exists whenever the costs of production are such that it is less expensive for market demand to be met by one firm than by more than one. In this situation it is optimal, from a cost perspective, to have only one firm.⁴⁵ When a natural monopoly exists, a common policy response is to subject it to some form of regulation, in order to ensure socially desirable outcomes when competition cannot be relied upon to achieve them.⁴⁶ Although the term Natural Monopoly is only rarely used in the context of PROs,⁴⁷ PROs fit into the natural monopoly paradigm because it is widely accepted that collective administration is the most efficient form for administering performing rights and because it is also believed that regulation is necessary to assure that the benefits of the natural monopoly will not be replaced by monopolistic abuses.

⁴² See e.g., POSNER, *supra* note 4, at 30-31 (“The effect [of collective administration] is to eliminate price competition among the members of each association but at the same time to eliminate the prohibitive costs to the performing entities of dealing separately with each composer. So high are those costs that it is nearly certain that the output of the song industry is greater than it would be if the BMI and ASCAP cartels were outlawed. [...] But probably the [blanket license] fee is lower than the cost of equivalent rights if licensees had to negotiate with composers separately, since the cost of those negotiations would be part of overall cost of acquiring the rights. It is an example of the case given earlier where the monopoly price is probably lower than the competitive price”).

⁴³ The term Natural Monopoly does not refer to the actual number of sellers in a market but to the relationship between demand and the technology of supply. If the entire demand within a relevant market can be satisfied at lowest cost by one firm rather than by two or more, the market is a natural monopoly, whatever the actual number of firms in it, Richard A. Posner, *Natural Monopoly and Its Regulation*, 21 STAN. L. REV. 548 (1969). Therefore, the observed fact that in the US there are three PROs is not necessarily inconsistent with the natural monopoly argument, although it is a troubling fact that adherents of the natural monopoly argument often fail to confront.

⁴⁴ What these industries have in common is a very high fixed cost and a very low marginal cost of production, so that average costs are declining throughout the relevant production range, which implies that average cost is minimized when there exists a single seller.

⁴⁵ Kenneth E. Train, *Optimal Regulation: The Economic Theory of Natural Monopoly* 1 (1991).

⁴⁶ TRAIN, *id.*

⁴⁷ Occasionally, however, the term is used. See e.g., William R. Johnson, *Commentary on “An Economic Analysis of Copyright Collectives”*, 78 VA. L. REV. 417 (1992); Cirace, *supra* note 41, at 302. The term was also used by the Australian Competition Tribunal in its APRA decision, *supra* note 23.

Nevertheless, the regulated natural monopoly paradigm has been subject to serious reappraisal in the last two or three decades. In some markets, such as electricity and telephony, technical change has led to a reduction in the traditional natural-monopoly basis for regulation and to the acknowledgement that natural monopoly may be limited to certain segments of the industry whereas others can operate competitively.⁴⁸ In other markets, such as airlines, the reappraisal has been inspired by a reconsideration of whether these industries ever fit the natural monopoly framework.⁴⁹

In the remainder of the paper I wish to follow a similar path. I will first critically survey the efficiencies and benefits that are usually associated with collective administration of performing rights. I will try to identify which of the claimed efficiencies, if any, are such that they can only be achieved under monopoly. I will then turn to explore the implications of technological change, namely the development of the Internet, Digital Rights Management technologies, and advancements in monitoring technologies for the existence of a natural monopoly in performing rights.

B. The Supply Side Advantages of Collective Administration

1. Economies of Scale and Scope in the Administration, Licensing and Enforcement of Performing Rights

"[A]uthors are not supposed to spend their time going after their rights. They create!"⁵⁰

⁴⁸ In telephony, the rise of microwave and satellite communication enabled competition in the long-distance part of the telephone network, *see* HOVENKAMP *supra* note 3, at 701. In electricity, the development of combined cycle gas turbines and other changes have enabled efficient generation on lower scales and created opportunities for competition even if the transmission segment of electricity remained a natural monopoly, *see* Michael J. Trebilcock & Michal S. Gal, *Market Power in Electricity Industry Restructuring*, 22 *WORLD COMPETITION* 119, 125 (1999).

⁴⁹ Edward Iacobucci et. al., *Economic Deregulation of Network Industries: Managing the Transition to Sustainable Competition*, at the Competition, Pricing and Natural Monopoly: Taking Stock of Network Industries conference held at the Faculty of Law, University of Toronto, May 23, 2003, *available at*

http://innovationlaw.org/pages/DEREGULATION_MAY%2015%202003.doc

⁵⁰ Online publication of the International Confederation of Societies of Authors and Composers (CISAC), at

<http://www.cisac.org/web/content.nsf/Builder?ReadForm&Page=Article&Lang=EN&Alias=MAN-AR-07> (last visited July 18, 2003).

It is usually argued that there are economies of scale and scope in the management, licensing and enforcement of performing rights, which make the management of an aggregate of rights more efficient than the management of a single or few rights. It is further argued that the use of a blanket license creates some additional efficiencies. These arguments make sense. For example, it is costly for an individual writer to locate potential users and infringers, negotiate with them *ex ante* or enforce her copyright *ex post*. In addition, the administration of copyrights requires professional skills, knowledge of the industry and its legal environment. But once a potential user (or infringer) has been identified the cost of licensing (or enforcing) does not change dramatically whether a license is being issued for a single copyrighted work, a blanket license for all the works of a single copyright holder or a blanket license for all the works of thousands of copyright holders. PROs therefore, by operating on behalf of numerous copyright holders and by using blanket licenses, reduce the average cost of administration per work, and this average cost continues to decrease as the size of the repertoire of the PRO increases.⁵¹

Although theoretically compelling, there are several problems with this argument when used to support an argument that PROs are natural monopolies. While it is probably true that there are some fixed costs in the administration of copyright which create economies of scale and scope when multiple, rather than single, songs are administered, it only follows that administration by the individual *writers* is highly inefficient; it does not follow that those economies of scale and scope can be realized fully only when a single firm administers the entire worldwide copyrighted repertoire. Such economies of scale and scope can explain the existence of music publishers who act as intermediaries between writers and users. They can explain the common practice in the industry that songwriters grant publishers full ownership in the copyright in their musical compositions in exchange for the publisher's service and payment of the writer's share of the royalties collected by the publisher.⁵² Moreover, the existence of multiple publishers of varying sizes suggests that the minimum efficient scale of

⁵¹ The history of ASCAP demonstrates the high fixed costs of the administration of performing rights. In its early days, despite significant legal victories and low overhead costs (its officers and lawyer were volunteers) its expenses exceeded its earnings, *see* Lionel S. Sobel, *The Music Business and the Sherman Act: An Analysis of the "Economic Realities" of Blanket Licensing*, 3 LOY. L. A. ENT. L. J. 1 (1983). Only with the advent of commercial radio broadcasting (and later TV) could ASCAP turn to a profit, *see* Ruth Charles, *ASCAP - A Half Century of Progress*, 11 BULL. COPYRIGHT SOC'Y U. S. A. 133 (1964); Robert P. Merges, *Contracting into liability rules: Intellectual property rights and collective rights organizations*, 84 CAL. L. R. 1293 (1996).

⁵² KOHN & KOHN *supra* note 13, at 108.

copyright administration (at least when rights other than performing rights are concerned) can probably be achieved at scales that fall well short of monopoly.⁵³ And similarly, the existence of three PROs in the US, and especially SESAC (whose repertoire comprises less than 5 percent of the music performed in most venues)⁵⁴ indicate that the minimum efficient scale for the administration of performing rights can be achieved at much lower scales than monopoly. Therefore a theory of natural monopoly in the area of performing rights cannot simply rely on the true assumption that the licensing of those rights by *individual songwriters* is highly inefficient. It should explain what makes the use of a single intermediary (a PRO) more efficient than the use of several licensing intermediaries (music publishers, record companies, etc.).

The argument that the licensing of performing rights can only be done efficiently by PROs is troubling in another respect. The argument assumes that there are serious impediments for individual transactions between copyright holders and users which make this possibility completely impractical.⁵⁵ This argument, which is often repeated in one form or another, is usually simply assumed, not empirically proved,⁵⁶ and ignores a basic, yet highly important, fact: that such individual transactions exist all the time. Despite the intangible nature of music compositions, every establishment that publicly performs music must, by definition, obtain a tangible copy of the song: a record or a CD in the case of prerecorded music, and sheet music in the case of a live performance. And unless the copy is an illegal one (and this is not argued to be the general case),

⁵³ Although it could be argued that these varying sizes conditional on the existence of the PROs, who handle (some of) the administration and monitoring tasks.

⁵⁴ Memorandum of the United States in Support of the Joint Motion to Enter Second Amended Final Judgment, *United States v. ASCAP*, No. 41-1395, (S.D.N.Y. 2000), *available at* <http://www.usdoj.gov/atr/cases/f6300/6395.pdf> [hereinafter – AFJ2 Memorandum] at 7.

⁵⁵ See e.g., WIPO, *supra* note 14.

⁵⁶ See e.g., *BMI v. CBS*, *supra* note 1, at 20. See also WORLD INTELLECTUAL PROPERTY ORGANIZATION, COLLECTIVE ADMINISTRATION OF COPYRIGHT AND NEIGHBORING RIGHTS 64-65 (1990): “In the case of “performing rights,” reprographic reproduction rights and the rights concerned by simultaneous and unchanged retransmission of broadcast programs, collective administration is an indispensable means of the exercise of the exclusive rights to authorize the uses concerned, and, in a way, collective administration is the condition for maintaining those rights as exclusive rights, as the only workable alternative to non-voluntary [*i.e.*, compulsory – AK] licenses. The number and circumstances of uses and the number and variety of works used make it, practically, impossible for the users to identify the right owners in due time, ask for their authorization, negotiate their remuneration and other conditions of the use and to pay the fees, on an individual basis. It is also, from a practical point of view, impossible for right owners to monitor all such uses.”

the user must obtain it (directly or indirectly) from a seller who had been authorized by the copyright holders to sell that copy. A direct transaction between the user and a seller authorized by the copyright holders of every song thus precedes every performance of every song. Theoretically, therefore, a radio station or a discotheque could purchase the right to perform the music recorded on a CD at the same time they purchase the CD itself.

The problem with the argument that the licensing of performing rights can only be done efficiently by PROs can be further demonstrated through the following thought experiment that shows that a similar licensing costs rationale can be used to justify collective administration of many other copyrights which are easily administered individually and competitively. Imagine a world without publishers, record companies and record stores. A TV station broadcasts an average of 60,000 musical works annually,⁵⁷ so it needs to purchase thousands of records that contain the works of thousands of songwriters. All of those songwriters need to be located and the terms of the transaction need to be negotiated; how could that be done efficiently? A joint selling agency of all copyright holders might undoubtedly solve the problem. Would the existence of such joint agency benefit songwriters? Probably yes. Is it the only solution? Certainly not. Are there better solutions in terms of consumer welfare? Probably yes, and the market seems to have worked out one such solution. Songwriters (who are the initial copyright holders) assign their rights to music publishers who grant record companies the right to make records, copy them and distribute them to record stores and other outlets. The only thing that the TV station needs to do is to contact the record store and purchase a copy; it does not need to contact each songwriter. Why cannot this solution, which works so nicely for the sale of copies, be used for the sale of performing rights? The answer is that it probably can. There is no practical reason why the sale of a CD could not include the right to publicly perform that CD. This, of course, will be less profitable for the copyright holders because they will be forced to compete and their ability to price discriminate among different users will be diminished. Although the copyright holders in a CD could require that an additional payment would be charged if the sold CD is going to be publicly performed they will only be able to distinguish between private (home) performers and public ones, but not between different kinds of public performers. The copyright holders could improve her ability to price discriminate by using record stores for selling CDs only to home users (*i.e.*, without the public performance right, just as they do today) and licensing the performing rights (with or without the

⁵⁷ WIPO, *supra* note 16.

CD) directly to users by the record company or through specialized stores or agents. Of course, there would still remain the problem of enforcement – how to assure that users who purchased only a ‘home version’ of a CD would not publicly perform – but this problem is separate from the problem of licensing. If copies of CDs (or music sheets) are sold individually (although with the aid of intermediaries) the right to perform them can be licensed individually as well. Therefore the existence of economies of scale and scope in the licensing of performing rights is sufficient to explain the existence of intermediaries; it is insufficient to support a conclusion that licensing of performing rights is a natural monopoly.

Other supply side economies of scale and scope exist in the area of enforcement that may better support a theory of natural monopoly. The per-work cost of monitoring infringement and enforcing the rights seems to fall as the number of the works increases.⁵⁸ In the extreme (yet highly frequent) case, when all the performing rights in a given territory are administered by a single PRO, monitoring and proving an infringement is done at the lowest cost. All that the PRO needs to know (and later prove in court) is that a user has performed music publicly,⁵⁹ and that that user has not obtained a license.⁶⁰ When these conditions are fulfilled the user’s liability is easily established. Compare this to a situation where all that a single copyright holder knows is that a user plays music in his business. In order to know whether that music is his he needs to constantly monitor the user’s location in order listen, record and later prove in court which song was played, when, and that he, the plaintiff, is the copyright holder.⁶¹ Similarly, it is probably as costly to litigate a suit brought by an individual

⁵⁸ *Cirace, supra* note 38, at 302.

⁵⁹ In theory, knowledge that the user has played music generally is insufficient because only copyrighted music requires a license. If the user plays only music that is public domain he does not need any license. In practice, however, given the present length of the period copyright protection lasts and the relatively much shorter period that music is popular, very few users would be able to persuasively argue that they play only music that is public domain in order to avoid liability.

⁶⁰ *Besen et. el., supra* note 36, at 409 n97.

⁶¹ *Cf. BMI v. CBS, supra* note 16, 19 note32 (“Because a musical composition can be “consumed” by many different people at the same time and without the creator’s knowledge, the “owner” has no real way to demand reimbursement for the use of his property except through the copyright laws *and* an effective way to enforce those legal rights.... It takes an organization of rather large size to monitor most or all uses and to deal with users on behalf of the composers. Moreover, it is inefficient to have too many such organizations duplicating each other’s monitoring of use”).

copyright holder as it is to litigate the same suit by a PRO.⁶² Yet if the individual plaintiff seeks an injunctive relief against unauthorized performance of her copyrighted works (in addition to backwards-looking remedies such as statutory damages), the remedy can only prevent future infringement of *her* works, not of other copyright holders. When this is the case the user can fully abide by the court's order and yet continue to perform, without authorization, any other copyrighted song. In contrast, when suits are brought by a PRO the injunction that is often sought and granted is against the future unauthorized performance of any of the works in the PRO's repertoire.⁶³ This remedy, naturally, is much more effective in securing the payment of royalties to all copyright holders.⁶⁴ Because copyright law envisages the payment of royalties to all copyright holders whose works had been performed, a mechanism that facilitates such an outcome can be considered socially beneficial.⁶⁵

While theoretically appealing, this natural monopoly argument needs to be reconciled with some potential factual inconsistencies. As Posner explains, "If the entire demand within a relevant market can be satisfied at lowest cost by one firm rather than by two or more, the market is a natural monopoly, whatever the actual number of firms in it. If such a market contains more than one firm, either

⁶² For the moment I ignore the possibility that a PRO may be more skilful in handling such a litigation and that in a litigation in which a PRO is the plaintiff some disputes regarding whether the plaintiff is the real owner of the work or not will not exist since the court might be more readily assume that the PRO is the right plaintiff because it represents all copyright holders.

⁶³ Melville B. Nimmer & David Nimmer, *Nimmer on Copyrights*, vol. 2, §8.19[B] (Release 60 Apr. 2003).

⁶⁴ In a sense, this can be viewed as a type of a "group boycott" ("if you infringe one seller's rights you won't be able to do business with any seller") to which competition laws are often hostile. However, if the prevention of copyright infringement is a desirable social end, and to the extent that copyright holders would be less reluctant to license their rights if they can obtain an effective remedy against infringement, such a boycott is an efficient mechanism and should not be illegal. See *Merges*, *supra* note 51, at 1324-27.

⁶⁵ *BMI v. CBS*, at 19: "Although the copyright laws confer no rights on copyright owners to fix prices among themselves or otherwise to violate the antitrust laws, we would not expect that any market arrangements reasonably necessary to effectuate the rights that are granted would be deemed a *per se* violation of the Sherman Act. Otherwise, the commerce anticipated by the Copyright Act and protected against restraint by the Sherman Act would not exist at all or would exist only as a pale reminder of what Congress envisioned." Note, however, that the desirability of this arrangement is economically beneficial only under the assumption that without an ability to collect royalties from the performance of music, creators would not have enough incentives to create. This assumption is implicit in copyright law but is not necessarily correct. If that assumption is incorrect the optimal price of performing rights is zero, *i.e.*, society is better off without a mechanism for the collection of performance royalties.

the firms will quickly shake down to one through mergers or failures, or production will continue to consume more resources than necessary.”⁶⁶ In most countries there are single national PROs. However, in some countries more than one PRO co-exists. The US, of course, is a well known example, where SESAC has coexisted with ASCAP since 1931 and BMI has co-existed with both since 1941. Since none of these PROs seems to be failing, either the market is not a natural monopoly or it is working inefficiently. It is possible of course, that a merger between the three PROs would be highly efficient but antitrust concerns prevent such an otherwise efficient move, but there is a difficulty with such an explanation. When there are two major players in a market and a third minor one, it is obvious that antitrust laws could potentially (though perhaps erroneously) be used to block a merger between the PROs. Yet, copyright holders are free to choose which PRO to join and are likely to choose the PRO they believe would generate the highest royalty income for them. If size really matters for efficient enforcement it could be expected that overtime copyright holders would gravitate towards the most efficient PRO; SESAC, which is significantly smaller than the other, must have had a significant comparative disadvantage and should have lost copyright holders, a process which antitrust laws would be ineffective in preventing. In contrast, despite the large differences in size, none of the PRO seems to have a salient advantage over the others.⁶⁷ Advocates of the natural monopoly explanation for collective administration need therefore to provide an explanation for this factual inconsistency.

Even if monitoring and enforcement tend to exhibit characteristics of a natural monopoly, the case for collective licensing of music is much weaker. This may lead to the conclusion that an optimal solution would be to separate monitoring and enforcement from licensing. The first function would be carried out by PROs while the latter by the copyright holders or their agents. Such an arrangement has been proposed by Besen, Kirby and Salop, who suggested that the PRO would also serve as collector of the individually negotiated fees.⁶⁸ The separation of monitoring and enforcement from licensing, however, would increase the cost of monitoring because users will be able to cheat by getting

⁶⁶ Posner, *supra* note 45.

⁶⁷ See KOHN & KOHN, *supra* note 13. The authors note that it was once believe that a copyright holder’s decision which PRO to join depended on the type of music in question because each PRO specialized in different genres and worked primarily with different kinds of radio stations. In this sense each PRO could have been considered as operating in a different relevant market. These distinctions, however, no longer apply, and the authors urge copyright holders to shop between the different PROs and choose the best deal.

⁶⁸ Besen et. al., *supra* note 36.

licenses to only part of the music that they intend to perform.⁶⁹ In such cases (in contrast to the case of a blanket license that covers all the members' music) it would not be possible to determine whether a user infringes the PRO members' copyrights unless more extensive (and costly) monitoring is done.⁷⁰ It is therefore difficult to determine the merit of this proposal without further investigation into the benefits of competition vs. the increased cost of monitoring and enforcement. However, the fact that some copyright holders find attractive a PRO as small as SESAC suggests that the claimed efficiencies of monopoly in monitoring and enforcement might be overestimated.

2. PROs and Anticommons

Another set of efficiencies that PROs seem to create emanates from a phenomenon that has recently been coined in the law and economics literature as "The Tragedy of the Anticommons".⁷¹ Anticommons are "a property regime in which multiple owners hold effective rights of exclusion in a scarce resource",⁷² and their tragedy is that when this is the case the multiple exclusion rights lead to suboptimal use of the resource. The tragedy happens because the use of the resource requires the authorization of each exclusion-right holder, but each of them, in an effort to maximize his rents from the use of the resource, sets the price regardless of the fact that the price that he sets has an external effect on the demand for the other exclusion-right holders' authorization. As noted by Buchanan and Yoon, in the limiting case, in which all persons in a large group are assigned rights of exclusion such that each proposed user must secure the permission of all persons, the resource may not be used at all, despite its potential value.⁷³

The possibility that PROs possibly solve problems of anticommons that may exist in performing rights has been suggested recently by Parisi and Depoorter.⁷⁴ They point out that the public performance of music might be an anticommons if the

⁶⁹ For example, to get licenses only for the songs that they publicly perform most or for those songs whose right-holders are known to be more vigilant enforcers.

⁷⁰ *Id.* at 409, n97. For additional criticism of this proposal see Paul Goldstein, *A Commentary on "An Economic Analysis of Copyright Collectives"*, 78 VA. L. REV. 413 (1992).

⁷¹ See Michael A. Heller, *The Tragedy of the Anticommons: Property in the Transition from Marx to Markets*, 111 HARV. L. REV. 621 (1998).

⁷² *Id.*, at 660.

⁷³ James M. Buchanan & Yong J. Yoon, *Symmetric Tragedies: Commons and Anticommons*, 43 J. L. & ECON. 1, 4 (2000).

⁷⁴ Francesco Parisi & Ben Depoorter, *The Market for Intellectual Property: The Case of Complementary Oligopoly*, in *THE ECONOMICS OF COPYRIGHT 26* (Wendy J. Gordon & Richard Watt eds. 2003).

performing rights for the individual compositions are complementary inputs for users. If that is the case, the collective administration by monopolistic PROs may indeed result in lower prices and greater output than under competition.⁷⁵

The anticommons framework enables us to identify three potential problems of fragmented rights that PROs seem to solve. If PROs are indeed the optimal solution to these problems, anticommons theory can support the natural monopoly argument because competitive administration would lead to less efficient results. However, as will be discussed below, in each of these instances the solution of collective administration might be excessive compared to the extent of the problem or to alternative - and arguably more competitive - solutions.

a) Individual Songs as Anticommons

It is not uncommon that the copyrights in a single song are held by more than one copyright holder. A single song essentially comprises two separate protected works, its composition and its lyrics. When the lyricist and composer are separate people - and that case is not unusual - the public performance of that song requires licenses from both.⁷⁶ Moreover, oftentimes there exists joint ownership in the copyright, such as in the case of co-authors (*e.g.*, Lennon & McCartney), or in the case of several heirs of a deceased author or when an original author and a publisher agree to be co-owners. While generally a joint owner of a copyright is free to license the use of the work without the knowledge or consent of the other co-owners, such freedom is subject to some limitations or contractual arrangements between the co-owners, which can complicate the licensing process.⁷⁷ Because the public performance of such songs requires the authorization of both the lyricist and the composer, and each of them, by withholding his consent can effectively veto the performance of the song, the public performance of the song is under an anticommons regime. If there are additional claimants, the problem becomes more severe.

Collective administration is often proposed as a solution to this problem.⁷⁸ By pooling their rights into a single entity, such as a PRO, copyright holders set a

⁷⁵ *Id.*, at 33-36.

⁷⁶ Unless, of course, due to subsequent arrangements (such as license or assignment between the parties or to a third party) a single person is authorized to grant performing licenses for both works.

⁷⁷ See KRASILOWSKY & SHEMEL, *supra* note 26, 208-12.

⁷⁸ See *e.g.*, by Merges, *supra* note 51. Although Merges does not use the term “anticommons”, his discussion of fragmented copyrights describes the same problem.

standard price for their rights thus eliminating the incentive to behave opportunistically and avoiding this anticommons problem. The result is that more transactions, relative to individual licensing, are enabled.

Although PROs indeed solve this problem this solution might be excessive.⁷⁹ In the case of individual songs the potential tragedy of the anticommons is a result of fragmented ownership that occurs at the level of the individual song. There are two implications of this observation. One is that because the number of separate right holders in an individual song is usually low – the extent of underuse that results from fragmentation is narrow.⁸⁰ The second implication is that even in those cases when the rights are more highly fragmented, all right holders can anticipate *ex ante* (or experience *ex post*) that if they hold each other up their song will be less marketable than other songs and their revenues lower compared to other writers. They can therefore act to increase their revenue by transforming their song into a marketable cleared-parcel of rights by authorizing each other, only one of them, or a third party to grant licenses for the parcel as a whole.

It is true that once property rights have been fragmented the cost of rebundling them could be a costly enterprise (and sometimes too costly),⁸¹ but the market might provide writers with the proper incentive to avoid fragmentation in the first place. This might happen because in a competitive marketplace users will be interested in being able to use ‘cleared-parcels’ of music, *i.e.*, songs which upon payment become free of any additional claims. Songs in such form would be more marketable and gain a competitive advantage over songs whose separate rights are not bundled in a single parcel; it is not unimaginable that only such songs will be marketable at all.

⁷⁹ When it comes to the Internet the problem of fragmentation becomes more complicated because a single online transmission of a work may involve different overlapping copyrights (such as reproduction, performance, distribution, etc.). Because each of these rights may be held by a different person (and by different people in different territories) the problem is exacerbated. In this case even traditional PROs cannot really solve the problem because the user would still need to obtain licenses from the owners of the other rights, which may or may not be administered collectively. One solution to this problem is the creation of a right to online transmission that will replace all the other rights, *see* Mark A. Lemley, *Dealing with Overlapping Copyrights on the Internet*, 22 U. DAYTON L. REV. 547 (1997). Another solution is the creation of ‘mega-collectives’ that will function as one-stop-shop vis-à-vis the user and distribute the royalties that they collect among the relevant copyright collectives, *see* Gervais & Maurushat *supra* note 7.

⁸⁰ Buchanan & Yoon, *supra* note 73, at 5.

⁸¹ *See generally* Heller, *supra* note 71.

There are three additional factors that strengthen the proposition that the market may effectively overcome the tragedy of the anticommons in the case of individual songs. One is that in many cases the creation of songs is team effort by authors and composers who are players in a repeated game and therefore are less susceptible to opportunistic behavior by one towards the other. The second factor is that whenever the public performance is of pre-recorded music, the recording of the song had already required authorization by the relevant copyright holders so that they have already had ample opportunity to make the necessary contractual arrangements that will maximize the potential for commercial viability of their works.

The third factor is that the problem of fragmentation is not limited to performing rights but exists in other aspects of copyright that are not administered collectively. Although the problem has been described by some veterans of the music industry as an impediment to efficient licensing and a real managerial problem, it seems to have been solved by market mechanisms other than collective administration.⁸² The testimony of Al Kohn, a longtime retired Vice President, Licensing for Warner/Chappell Music, Inc., a copyright behemoth, is illustrative. Kohn explains:

“As a result of the Split Copyright Syndrome [*i.e.*, fragmented copyrights] ... producers have been finding it increasingly difficult to clear licenses for songs they desired to use. Often, the catalog of Warner/Chappell contained close substitutes for the songs requested and the advantage to the producer of using one of these substitutes is that they could quickly get a license from a single source, without having to track down and negotiate with the multiple owners of songs tainted by the split copyright problem. One day, it occurred to me that if I could compile and publish a list of standard songs in the Warner/Chappell catalog which we could offer quickly and easily (*i.e.*, with no need to get permissions from co-publishers or consent of the songwriters), producers would more likely turn to the songs on such a list than to songs in the catalog of other publishers. This is, in fact, what I did: I made up just a list and organized the songs by genre, such

⁸² KOHN & KOHN *supra* note 13, Ch. 6.

as the Roaring 20's, Country & Western, 50's Rock & Roll, and chronologically by year of publication."⁸³

The conclusion therefore is, that in order to overcome the problem of fragmentation at the level of the individual song it is enough to rebundle the different rights in each *song*, there is no need to bundle the entire worldwide repertoire of songs,⁸⁴ and it seems that markets are entirely capable of doing so. Therefore, while PROs solve the problem they nevertheless perpetuate it because when PROs exist copyright holders face lower incentive to create cleared-parcels.⁸⁵

In order to justify monopolistic collective administration on the basis of the fragmentation argument it needs to be explained what makes performing rights different from other rights in the musical bundle and why solutions that work for other strands of the copyright bundle are inefficient when it comes to public performance. It needs to be explained why cleared-parcels would not be formed or at least why they are an inferior solution. Fragmentation at the level of individual songs alone cannot support the case for monopoly.

b) Playlists as Anticommons

Even if all songwriters made their songs available in the form of cleared-parcels, the tragedy of the anticommons might still occur if different songs (rather than the different rights within a song) are complements in the production of some subsequent product of service (a radio program for example). If for some

⁸³ *Id.*, at 95-96. There are sings that such online licensing of cleared-parcels of music is beginning to develop as well. Warner-Chappell Music has created a designated website OneStopTrax.com in which it offers online licensing of a selected repertoire of pre-cleared songs, for a limited list of uses (such as motion pictures, TV programs, multimedia products and more). Public performance is not currently offered through the website, probably because those rights are administered collectively.

⁸⁴ Consider the following analogy. Suppose that a certain piece of land is subject to a restrictive covenant such that several people have rights to use that land and rights to exclude others from it and as a result further development of this land is prevented or delayed. Normally in such a case we would look for ways to rebundle the rights in that particular piece of land, and would not opt for creating a monopoly that will be the sole owner of all the land in the country (and serve as agent for similar monopolies in foreign countries) although such a monopoly might definitely solve the problem of underuse.

⁸⁵ The existence of a PRO *pro se* cannot explain why its members fail to form cleared-parcels, because if the PRO acts as a cartel its members face an incentive to cheat on it and destabilize it. In Part III.D *infra* I explain why the stability of PROs could be maintained despite the incentives to cheat on it.

reason a user is required to play very specific songs in some fixed proportion, those songs become complementary inputs in the production of this program. If, in addition, the right to perform each song is administered by a separate right holder, the program will be governed by an anticommons regime, since each right holder will be able veto the production of that program. The result in this case, according to the anticommons theory, will be higher overall price for the set of rights which might lead, in the extreme case, to non-production of that program; a tragic outcome that could have been avoided had all the rights been administered by a PRO.

The problem, however, with the application of this anticommons theory to the case of PROs is that anticommons exist (and their tragedy is therefore avoided by PROs) only if we assume that there is some reason as a result of which the user is required to play very specific songs and in some fixed proportion. The question therefore is whether such an assumption is realistic. There are reasons to believe that it is not.

In order for the theory to apply individual songs must be complements. It is true that a radio station cannot probably play the same song over and over again without alienating its audience; it needs to play a variety of songs. However, the need to play different songs and the limitation on the number of repetitions – while implying that songs are not perfect substitutes for each other - does not necessarily make the songs complements in the economic sense. In order for two products to be complements, an increase in the price of one of them, A, should lead to a decrease in the demand for the second, B. If an increase in the price of A leads to an increase in the demand for B, however, the products are substitutes. Therefore when it comes to the choice of songs by a radio station, songs A and B will be complements only if an increase in the price of A will negatively affect the demand for B. This scenario does not seem to be very likely. We may assume that generally radio stations (and other users) have greater flexibility in the choice of the songs that they play. Therefore, if the copyright holder of A attempts to raise its price the station might play song B additional times or substitute C, D, or F for A;⁸⁶ in either case the demand for B will not be negatively affected. It is true that in some cases the combinations of songs B:C, B:D, or B:F might be less attractive than the combination B:A and in such a case substituting C, D or F for A will negatively affect the demand for B, but even in such a case in order to act strategically, the copyright holder of A must know the exact preferences of the radio station; otherwise, acknowledging the existence of

⁸⁶ C for this matter can be any type of content, not only songs.

C, D and F, she should be more concerned about the possibility that the result of an increase in the price of A would lead to its substitution and not to increased income.

In any event, before we conclude that PROs are the solution, we should be convinced that there is a problem, and that this is a general problem, rather than one that exists in very narrow circumstances.⁸⁷ It seems that a better understanding of the production function of radio stations (and other users) is required, before such a conclusion could be reached.

The foregoing discussion assumed that without PROs performing rights for songs would be purchased as individual units. It might be possible, however, that as a consequence of some of the economies of scale and scope discussed earlier, music publishers would license their respective repertoires on a blanket basis even under competition. Under such circumstances, the determinative factor is not the number of substitute songs but rather the number of publishers from which blanket licenses could be obtained. Given the high level of concentration in the music industry, it might be possible that a radio station cannot compete effectively without having obtained a blanket licenses from each of the major publishers. This may lead to the hypothesis that a separate license from each of the major publishers is indeed a complementary input in the programming function of radio stations, and that therefore absent PROs a tragedy of the anticommons might occur. Again, a better understanding of the production function of users is required in order for such a hypothesis to be substantiated.

c) Anticommons in Pre-produced Programs and Source-Licensing

One occasion in which anticommons seem to exist is the case of users that do not have any control over the selection of the songs that they publicly perform. This is the case, for example, of establishments who publicly perform music by

⁸⁷ Suppose, for example, that a radio station wishes to broadcast on August 2004 a special program to celebrate the 35th anniversary of the 1969 Woodstock Festival. Presumably, it would have to acquire licenses to play the songs of some of the prominent artists that participated in the festival, such as Crosby, Still & Nash, The Band, Janis Joplin, Joe Cocker, Joan Baez, Jefferson Airplane, Santana and other. The rights to play those songs may seem like complementary inputs. However, even in such a case the tragedy of the anticommons would occur only if two conditions are met: one, that the station must broadcast such a program (*i.e.*, it cannot choose to broadcast anything else without being punished severely by its audience), and second, that it must play all the songs of any of those artists, without, in response to an attempt by one rights-holder to behave opportunistically, being able to substitute one artist for the or other or change the length or format of the program. It seems that such conditions are unrealistic.

delivering radio or television broadcasts to customers (*e.g.*, bars, hotels, etc.), or theatre owners who perform the music synchronized into the soundtrack of a film. In their case, once the user decides to perform a particular radio or television program or exhibit a film, all the underlying copyrighted works are indeed complements; each right-holder in each underlying copyright can effectively veto the performance of the film or the program, and no substitute is available. If the number of copyright holders is big enough, a tragedy of the anticommons could easily occur. In this case a blanket license issued by a PRO is clearly preferable to protracted individual negotiations. Yet even in such cases, or at least in some of them, there could be alternative and more competitive licensing options. Therefore, the alleged superiority of collective administration represents a misguided assumption that the only alternative to collective administration is highly inefficient direct transactions between the individual right holders and users.

One such alternative is source-licensing. Source-licensing can occur when the publicly performed music is pre-recorded: in a sound recording or in an audio-visual work. In source-licensing, in addition to the right to produce a sound recording or an audio-visual work, the copyright holder grants the producer a right to publicly perform the composition and authorize others to do so. Because nowadays most users perform pre-recorded music (on a CD, music from the radio or music in the soundtrack of some audio-visual work) and because they must obtain a legitimate copy of that pre-recorded music, source-licensing can function as a realistic alternative to collective licensing. Source-licensing solves the anticommons problem because generally, pre-production most compositions could be substituted by other and consequently the right to publicly perform them would be negotiated and granted in a competitive environment; the ability of each right-holder to veto the use of the resource is avoided in advance.

Furthermore, source-licensing even solves the problem of monitoring and enforcement vis-à-vis users, because when music is source licensed all the subsequent performances of the licensed work are pre-authorized and the copyright holder should only be concerned with the producer's compliance with the terms of the agreement (*e.g.*, that the producer would indeed pay the royalties, or the lump-sum that were agreed on) – not with the end users' authorization to perform (or lack thereof). Presumably, this could be done without extra cost because if a license to synchronize a song into a motion picture, for example, already contains a provision about the payment of royalties for the synchronization right based on the motion picture's income, the cost of monitoring and enforcing this agreement would not change if a right to publicly

perform the music and authorize others to do so were also granted in the same license as well.

Nevertheless, source-licensing is seldom used by copyright holders. This, however, is not surprising, as there are several reasons for copyright holders' reluctance to enter into source licensing agreements. First, as Kohn warns rights-holders: "in considering the terms upon which to enter into a source or direct license, a music copyright owner should consider that, while a single lump sum payment may be attractive in the short-term, accepting such terms will mean foregoing any compensation from the performance rights society based upon the type and number of performances of the work [that] are rendered over time."⁸⁸ Kohn recommends that in any event such licensing should be structured on some royalty basis.⁸⁹ More generally, source-licensing may require more costly *ex ante* contracting in order to envisage all of the potential types of future uses of the work. Second, even if the copyright holder can structure source licenses on an effective royalty basis, the expected royalties that a copyright holder can collect when negotiating with the producer pre-production are probably considerably lower than the royalties that the copyright holder – through her PRO – is able to collect from the user post-production, because pre-production the producer bargains with the copyright holder in a competitive environment whereas post-production the user bargains with a monopoly, that can hold the user up. Third, the producer who re-licenses the work may not be in a position to effectively price discriminate because she may not have sufficient information about the preferences of the end-user or may be incapable of preventing arbitrage, and such inabilities would decrease the collected royalties.⁹⁰ In contrast, when the performing right is licensed separately, the two conditions for effective price discrimination: information about the preferences of users and an ability to prevent arbitrage are fulfilled. The end-user who needs a performing license must approach the copyright holder (the PRO for that matter) and reveal his preferences, and the resulting license would often be non-transferable. Finally,

⁸⁸ KOHN, *supra* note 13, at 921.

⁸⁹ *Id.*

⁹⁰ For example, a songwriter may source-license the performing right to a record company who sells copies and the record company may attempt to price discriminate between a hair-dresser, a discotheque and radio station. However, an owner of a discotheque disguised as a hairdresser could buy a cheap copy and even resell it to the radio station. The record company could try various ways to prevent this, for example, by selling through specialized stores, but these attempts may or may not be successful in preventing arbitrage.

because with source-licensing the producer acts as an agent of the songwriter their interests may not be aligned, giving rise to some agency problems.⁹¹

While copyright holders' reluctance to enter into source licensing agreements may be understandable from their profit-maximizing perspective, source-licensing does present an alternative to collective licensing that may be preferable to consumers.⁹² Such alternative, however, is generally overlooked by policymakers. The history of the motion picture industry in the US is an example of an exception to that general neglect. Following two 1948 court decisions that found the licensing practices of ASCAP in the case of movie theaters illegal under the antitrust laws,⁹³ copyright holders were compelled to abandon collective licensing to movie theaters and start source licensing their rights to film producers instead. Those decisions were subsequently incorporated into the 1950 consent decree. Similar efforts to compel source-licensing in the cable TV industry resulted in inconsistent decisions.⁹⁴

In practice, source-licensing remains the exclusive province of the US motion picture industry. A typical US motion picture synchronization license agreement contains not only the right to record the musical composition into the soundtrack of a motion picture and to make copies of it, but also to publicly perform the composition in movie theaters and other public venues in the US. However, the typical license agreement explicitly excludes television performance in the US and all other forms of public performance outside the US. The license provides that the producer can only authorize US television performances by entities

⁹¹ For example, if the royalty is based on a percentage from the revenue of a motion picture, a producer that is vertically integrated with movie theaters may lower the price of tickets and increase the price of popcorn in order to minimize the income that is subject to a payment of royalties. It should be noted, however, that the licensing through PROs may create its own set of agency problems.

⁹² This discussion describes the disincentives for copyright holders to supply source-licenses. In Part III.E *infra* I will explain why PROs create disincentives for users to seek source licensing, *i.e.*, how PROs affect the demand for source-licensing.

⁹³ *Alden-Rochelle, Inc., v. American Soc. of Composers, Authors and Publishers*, 888 F. Supp. 80 (S.D.N.Y. 1948); *M. Witmark & Sons v. Jensen*, 843 F. Supp. 80 (D. Minn. 1948) *appeal dismissed*, 177 F.2d 515 (8th Cir. 1949).

⁹⁴ In *Buffalo Broadcasting Co., Inc. v. ASCAP*, 744 F.2d 917, 928-32 (2nd. Cir. 1984) the court ruled that cable stations did not prove that they could not require source licensing and therefore failed to prove the requisite anticompetitive effect of the blanket license. In *Broadcast Music, Inc., v. Hearst/ABC Viacom Entertainment Services*, 746 F.Supp. 320 (S.D.N.Y. 1990) the district court emphasized that the decision in *Buffalo Broadcasting* resulted from the specific facts of the case and suggested that if the blanket license created disincentive for copyright holders to source-license their performing rights it might be anticompetitive.

having separate performance licenses from ASCAP, BMI or the relevant publisher, and, in the case of public performance outside the US, that such performances shall be subject to clearance by foreign PROs.^{95,96} A typical television synchronization license agreement grants television producers only the right to synchronize a composition and explicitly stipulates that the performance of the composition requires a separate performing license.⁹⁷ It seems that the only difference between theatrical performance in the US (the right for which is source licensed) and other forms of performances (where source licensing does not exist) stems from the provisions of the consent decree, which are confined to US theatrical performance. This exceptional case of the US motion picture industry cannot be attributed to its unique economics but rather to the fact that a consent decree reflects a regulatory compromise, not necessarily an optimal policy.⁹⁸

Nevertheless, the case of the US motion picture industry demonstrates that source-licensing can function as a competitive alternative to collective licensing not only in theory but also in practice. But there is another, deeper lesson: if there are no significant differences in the economics of music licensing between US and non-US theatrical performances or between the production of motion pictures and television programs, then the natural monopoly theory of PROs should have equally applied to all cases. In such an event the ban on collective licensing imposed on theatrical performance by the consent decrees more than fifty years ago should have created an extremely inefficient licensing market, and it could have been expected that such inefficiencies would somehow be apparent and subject to criticism. Yet none of the strong advocates of collective licensing seems to suggest that the provisions of the consent decree dealing with motion pictures are wrong and should be modified; the subject is usually just ignored. But if there is no natural monopoly in the case of licensing music to motion

⁹⁵ See Synchronization License for Motion Picture Theatrical and Television Exhibition Only at KOHN, *supra* note 13, at 791.

⁹⁶ Source-licensing should be distinguished from music that has been composed specifically for the film or program. In this case, being a Work Made for Hire, the producer is the considered the author, *see e.g.*, 17 U.S.C. §101, §201.

⁹⁷ See Television Synchronization License at KOHN, *id.*, at 800.

⁹⁸ By definition, a consent decree can only be entered into after the defendant has agreed to its provisions and this compromise will often reflect the relative bargaining power of the parties. Because ASCAP had lost the cases in *Alden Rochelle* and *Witmark* it probably could not oppose incorporating their practical consequences into the consent decree, but the US Department of Justice probably could not force ASCAP and its members to agree to wider exceptions to their collective practices.

pictures, and the regulatory ban on collective licensing in this area is justified, a similar rule should apply to all other industries that exhibit similar economies.

* * *

The tragedy of the anticommons framework seems to offer a potentially persuasive foundation for a justification of collective administration of performing rights. However, closer examination reveals that while in theory fragmented copyrights may lead to inefficiencies and result in underuse, on many occasions the market can overcome these problems or could have overcome them if PROs did not exist. While it is not impossible that in some cases collective administration would be the optimal solution, it seems that further investigation should be done in order to determine whether such cases are a general phenomenon so that collective administration should be the general rule, or whether the case for collective administration exists only in some special and narrow circumstances.

3. Additional Possible Benefits

Landes and Posner offer two additional benefits for the PROs' blanket license besides economizing on transaction costs. One is that the blanket license avoids "the misallocation of resources that would occur if some musical compositions, being unique and protected from competition by copyright, were priced far above marginal cost,"⁹⁹ thereby leading some users to choose second best substitutes. Because under the blanket license the user can use any song as much as she wants, she can use the optimal level of her first best choice. The argument assumes a seller that sells two or more products. The seller is a monopolist with regard to (at least) one of the products and has two options to exercise his market power: he can either sell the products by the unit and charge the monopoly price for each unit of the monopoly product and a competitive price for the rest, or sell the songs as a bundle and set a monopoly price for the whole bundle. Landes and Posner argue is that the second option avoids the misallocation of resources in the choice of songs. This is probably not objectionable.

However, Landes and Posner do not distinguish between a situation in which an *individual* copyright holder sells bundles on a blanket basis and a situation in which *all* copyright holders pool their rights and sell a single bundle. In the first case, although the uniqueness of the seller's song makes it possible to charge a price far above marginal cost, this price may still be pushed back towards

⁹⁹ Landes & Posner, *supra* note 19, at 386

marginal cost as a result of competition from other right-holders offering other unique songs, whereas in the second case, which is the case of PROs, no such restraint exists. In other words, in the first case there is competition between bundles, leading to more bundles sold at lower prices, whereas in the second less bundles at higher prices are offered. Thus the argument can hold only under two alternative conditions: One is that the administration of performing rights is indeed a natural monopoly and the only reasonable choice therefore is between a PRO issuing per song licenses or a PRO issuing blanket licenses. Alternatively, the argument holds if we assume that there are a few songs of such high quality, the price of which is not materially affected by competition from other good-quality songs, offered by other actual or potential copyright holders. That is, that some songs are real monopolies, not merely differentiated products. Only if we assume that such monopolistic songs exist on a regular basis, we can consider whether the social cost that might result from the choice of second-best alternatives in an unbundled offer exceeds the social cost from having monopoly over all songs.

The last point reflects a second problem with the argument: that it proves too much. If the logic of the argument leads to a conclusion that the pooling all performing rights and licensing them on a blanket basis is preferable to competition between them, the conclusion should not necessarily be limited to performing rights, but equally apply to other intellectual property rights. The patent system, for example, could be accordingly replaced by some “mega pool” of all patents available to all under a compulsory blanket license, thus allowing every manufacturer that uses patented technologies to choose her first best technologies. This may or may not be a good idea; perhaps such a system is indeed preferable to our current intellectual property system and perhaps it is not, but at the moment it seems that we need to know more about the costs and benefits of such a system or any specific arrangement, before it is endorsed.

The other potential rationale identified by Landes and Posner relates to the economics of “block booking”. The term refers to the movie studios’ practice of charging distributors a price for a bundle of movies rather than pricing them separately.¹⁰⁰ One of the rationales for the practice is that it is a form of low cost price discrimination.¹⁰¹ The blanket license offered by PRO is similar to block

¹⁰⁰ *Id.* at 387-88.

¹⁰¹ Landes and Posner use the following example, originally offered in George J. Stigler, *United States v. Loew’s Inc - A Note on Block-Booking*, 1963 SUPREME COURT REVIEW 152 (1963): A movie studio sells two films X and Y that are worth different amounts to different viewers and hence to distributors. There are two distributors, A and B. A is willing to pay \$8000 for X and \$2500 for Y,

booking as it allows the PRO to sell a bundle of songs at a uniform price to a class of users whose valuation of specific songs might differ.¹⁰² Landes and Posner's point is that since the welfare effects of price discrimination are ambiguous, and therefore we cannot have a general rule against it, and since we can expect that firms will choose this form of price discrimination when it is the most cost effective method of price discrimination, prohibiting the practice does not make a lot of sense because prohibition might lead merely to an increase in the cost of discrimination. A prohibition makes sense only if we know in a particular case that price discrimination imposes social cost rather than gain and that prohibiting the practice will lead to a reduction in discrimination.¹⁰³ Since we do not know what the welfare effects of the blanket license and what would happen without it, there is little point in prohibiting it.

The problem with this argument is similar to the problem with the former. Again, while not objectionable *per se*, it does not distinguish between an individual copyright holder selling a bundle of his own rights yet competing with other right holders, and a case in which all copyright holders sell a single bundle, the price of which is not subject to competitive restraints. While there is no point in prohibiting individual copyright holders from selling bundles of their own works in competition with other right holders selling other bundles, the argument cannot be used to justify collusion between all copyright holders. The argument can only be used if one accepts the existence of PROs and then considers whether or not they should be allowed to offer a blanket license. Sure enough, Landes and Posner's point is based on their view that the fact the US PROs hold only nonexclusive rights prevents them from setting a monopoly price for their bundles, but as we shall see below in Part III.D, this approach might be highly optimistic.

while B is willing to pay \$7000 for X and \$3000 for Y. The seller does not know the exact preferences of each distributor so he cannot tailor individual price per movie for each of them. Therefore, if the movies are sold separately the seller will charge \$7000 for X and \$2500 for Y and make a total revenue of \$19,000. Instead, he can sell a bundle of X and Y and sell it for \$10,000, making a total of \$20,000. By charging a bundle at a uniform price to different customers with different valuations, the seller can price discriminate at low cost.

¹⁰² Note that PROs are usually *required* to set a uniform price to each class of users and are not allowed to discriminate among users within a same class. The economics of block-booking show that this regulatory requirement is not burdensome on PROs; it probably only codifies the practice that they would adopt anyway. If the PRO can identify a class of users which, on average, place similar valuations for music generally, the use of the blanket license allows the PRO to price discriminate regardless of its inability to gauge the individual valuations for the specific songs.

¹⁰³ Landes & Posner, *id.* at 388.

In sum, if the debate is whether PROs should be illegal *per se*, as was the question in *BMI v. CBS* then those potential benefits provide good reasons for escaping *per se* condemnation. However, they are insufficient for reaching a conclusion about the overall merit of collective administration.

C. The Demand Side Advantages of Collective Licensing

[U]sers of creative works would find it as impossible to address the proper right holder every time they use one ... Just as authors, broadcasters ... have better things to do.”¹⁰⁴

1. Reducing Search and Negotiations Costs

Businesses that publicly perform music are generally interested in performing multiple and different songs, which means that they must obtain prior licenses from many different copyright holders. The WIPO document mentioned earlier¹⁰⁵ suggests that an average of 60,000 musical works are broadcast on television every year (and the number of musical works broadcast on radio is presumably even larger), so with individual licensing thousands of owners of rights would have to be approached for authorization and thousands of negotiations and contracts would have to be concluded. A similar rationale was provided by the US Supreme Court in *BMI*:

“ASCAP and the blanket license developed together out of the practical situation in the marketplace: thousands of users, thousands of copyright owners, and millions of compositions. Most users want unplanned, rapid, and indemnified access to any and all of the repertory of compositions and the owners want a reliable method of collecting for the use of their copyrights. Individual sales transactions in this industry are quite expensive, as would be individual monitoring and enforcement, especially in light of the resources of single composers.”¹⁰⁶

PROs thus reduce those costs by creating a one-stop shop; the blanket license reduces costs even further by providing unlimited access to the entire repertoire

¹⁰⁴ CISAC, *Supra* note 50.

¹⁰⁵ WIPO, *supra* note 16.

¹⁰⁶ *BMI v. CBS*, *supra* note 2, at 20.

through a single transaction. However, there is a chicken-and-egg question here: Do most users really require rapid and unplanned access so that PROs issuing blanket licenses are just a response to this demand, or is it that because only blanket licenses are offered users enjoy the freedom that blanket licenses provide and the spontaneity that they enable, but they would not necessarily elect to purchase blanket licenses if they had available licensing alternatives? To illustrate, the radio station or dance hall that plays songs immediately in response to requests from listeners or patrons¹⁰⁷ surely could not legally respond to such requests without the blanket license, but it is not obvious that the ability to respond to such requests is essential to their business model. In the case of broadcasters, most programs are pre-recorded, and even on live programs music is usually determined in advance. In the case of the dance hall, it is not inconceivable that the operator would respond “sorry, I cannot play this song” if she is not licensed to play it. In any event, the freedom that the blanket license offers is certainly a benefit; whether this benefit is worth the cost is a different question.

Another problem with the argument about the benefit to users from increased search and negotiations costs is that it is based on an implied assumption that because there are thousands of songwriters and millions of compositions there are thousands of copyright holders to negotiate with. The truth is that this picture of a highly dispersed industry is quite misleading. It is true that there are thousands of writers, but it does not follow that most users need to negotiate with such a large number of them.

Consider my late grandmother for example. Esther Isaacson was a poet. Although her aspirations in the area of poetry were modest she did publish some of her works¹⁰⁸ and joined ACUM - the Israeli authors’ and composers’ PRO¹⁰⁹ - and assigned it the performing rights in her works. The repertoire of ACUM, through cross-licensing agreements between most PROs across the world, is available to most of them. So when it is said that PROs like ASCAP, BMI in the US or SOCAN in Canada have thousands of members and millions of works in their repertoires it counts my grandmother along with John Lennon, Paul McCartney, Madonna or Michael Jackson. Regrettably, however, my

¹⁰⁷ The example of the radio station and the dance hall is from Herbert Hovenkamp et al., *IP and Antitrust: An Analysis of Antitrust Principles Applied to Intellectual Property Law*, §22.5c (2002).

¹⁰⁸ Esther Isaacson, *Biyemei Enut: Shirim [In Times of Misery: Poems]* (Tel Aviv, Sefer Press: 1945) (Hebrew).

¹⁰⁹ The PRO’s official name is *Société des Auteurs, Compositeurs et Editeurs de Musique en Israël*, ACUM is the Hebrew abbreviation.

grandmother and her poems are so rarely performed that they should not be counted in any serious analysis of the structure of the market. The relevant facts are not the nominal number of members and works in the repertoires of a PRO, not even how many of them get performance-based royalties in a given period of time. What is more relevant for an understanding of the market is the form of distribution of royalties among those copyright holders whose music is performed and receive royalties as a consequence. A closer look at the distribution of royalties reveals that only a small minority of receive most of the royalties. The district court in *Buffalo Broadcasting v. ASCAP*¹¹⁰ found that in 1979, only 13% of all ASCAP and BMI publishers received any television distributions and less than 0.8% received more than 75% of all ASCAP and BMI television performance royalties.¹¹¹ An inquiry made in the UK by the Monopolies and Mergers Commissions found that in 1993 the highest-earning 1.3 per cent of the Performing Rights Society (PRS) writer members received nearly 41 per cent of the royalty distributions, and the highest-earning 19.5 per cent accounted for some 92 per cent. A similar picture is revealed in respect of PRS publisher members. The skewness of the distribution would appear even greater if set in the context of the entire PRS membership as there are a further 7,900 PRS writer members who had no works performed in the UK that gave rise to distributions during the period analyzed.¹¹²

This highly skewed distribution of royalties may only represent the “superstar phenomenon” that exists in many intellectual property markets. The “superstar phenomenon” occurs in markets where there is little or no additional cost attached to using the best product, even if that product is only slightly preferable to the next best product, which could be a very close substitute.¹¹³ One of the factors that affect the creation of superstars is the ability to create a large market for the individual product, a characteristic of many intellectual products such as songs, which the marginal cost of disseminating is very low. As a result, a slightly better song can gain a huge market share and become a hit receiving substantial royalties, while a very close substitute may get none.

¹¹⁰ *Buffalo Broadcasting Co., Inc. v. ASCAP*, 546 F.Supp. 274 (D.C.N.Y. 1982), *rev'd* 744 F.2d 917 (2d Cir. 1984), *cert. denied*, 469 U.S. 1211 (1985).

¹¹¹ *Id.*, at 284 .

¹¹² MMC Performing Rights, *supra* note 23, at 65.

¹¹³ See LANDES AND POSNER, *supra* note 19 at 49; Mitu Gulati & Veronica Sanchez, *Giants in a World of Pygmies? Testing the Superstar Hypothesis with Judicial Opinions in Casebooks*, 87 Iowa L. Rev. 1141, 1144-45 (2002). The primary economic exposition of the phenomenon is Sherwin Rosen, *The Economics of Superstars*, 71 AM. ECON. REV. 845 (1981).

The superstar phenomenon (which the blanket license, under which all songs have identical price, might accelerate, but not necessarily create)¹¹⁴ only implies that at any given period there exist only few hits and few right holders receiving disproportionate share of the total royalties. However, the user cannot tell in advance which songs are going to be hits and which are not, and therefore, although there are only few right holders to contract with in any given period, she cannot tell in advance who they are. The short life-cycle of most musical hits aggravates this problem.¹¹⁵ Therefore, the skewed distribution itself does not disprove the utility of the blanket license which allows the user to get timely licenses from every superstar. The last point holds unless despite the high turnover in hits (and presumably songs writers who write them), the number of actual copyright holders which end up receiving the royalties from their public performance remains small. In the latter case, if most songs are tunneled to the market via a small number of publishers, the blanket license might be unnecessary. There is some evidence that this might be true.

In fact, the music industry is much more concentrated than it appears in the ordinary discourse about PROs. While talent and creativity are indeed dispersed, the commercialization of the fruits of this talent is usually undertaken by professional publishers and record companies. The common practice in the industry is that a songwriter signs an agreement with a music publisher, in which she grants to the publisher full ownership in the copyright in her musical compositions in exchange for the publisher's service and payment of the writer's share.¹¹⁶ Under a standard music publishing agreement the publisher and writer split most of the publishing income on a 50-50 basis and with one exception, the writer's share is paid to the writer by the music publisher. The one exception is performance royalties which are paid directly to the writer by her PRO.¹¹⁷

Music publishers can be classified into three main categories: (1) the major multinational publishers ("the Majors"); (2) independent publishers and (3) self-publishing songwriters. The larger publishers in the first category include

¹¹⁴ The phenomenon exists in many fields of arts, sports, literature and professional services that are not sold under blanket licenses. It is therefore unlikely that the blanket license is the sole cause of the phenomenon.

¹¹⁵ Gregory J. Sidak & David E. Kronemyer, The "New Payola" and the American Record Industry: Transaction Costs and Precautionary Ignorance in Contracts for Illicit Services, 10 HARV. J. L. & PUB. POL'Y 521, 527 (1987) (noting that most records effectively stop selling within three months after their release).

¹¹⁶ KOHN & KOHN *supra* note 13, at 91.

¹¹⁷ *Id.*

Warner/Chappell and EMI Music, with a catalog in excess of 700,000¹¹⁸ and 500,000 songs respectively.¹¹⁹ Others include MCA Music (owned by Universal), Sony, and BMG (owned by Bertelsmann Music Group).¹²⁰ Also included are Polygram Music, Virgin Music and Chrysalis Music who are affiliated with major record companies.

The second category of independent publishers is the largest in number but most of them contract with one of the Majors for most of their rights administration functions.¹²¹ The third group, the songwriter-publishers, such as Bob Dylan, Bruce Springsteen and Neil Diamond try to get the best administration at the lowest possible price, and to that end enter into administration deals directly with the Majors and overseas publishers.¹²² Because the Majors administer other publishers' rights the industry might be even more concentrated than the picture that appears from the report of the MMC.¹²³ It therefore seems plausible that for

¹¹⁸ David Sinacore-Guinn, *Collective Administration of Copyrights and Neighboring Rights: International Practices, Procedures, and Organizations* 198 (1993).

¹¹⁹ KOHN, at 68 (estimating that each of the two has a catalog in excess of 500,000 songs). Warner's significant market share dates back to the 1930s when its publishing subsidiaries' music catalogues were estimated at 15%-40% of the ASCAP material that was broadcast then, *see* KERRY SEGRAVE, *PAYOLA IN THE MUSIC INDUSTRY: A HISTORY, 1880-1991*, 52 (1993).

¹²⁰ On its website, for example, Sony/ATV Music Publishing (owned by Sony and Michael Jackson), states that it "owns or administers copyrights and catalogues by such artists as Babyface, The Beatles, and Felice and Boudleaux Bryant, Leonard Cohen, Miles Davis, Bob Dylan, The Everly Brothers, Jimi Hendrix, Graham Nash, Roy Orbison, Pearl Jam, Sarah McLachlan, Roger Miller, Joni Mitchell, Graham Nash, Willie Nelson, Stephen Stills, Hank Williams, and Brooks & Dunn, among others," *see* <http://www.sonymusic.com/sony/corpcomm2.html> (last visited Feb. 21, 2003).

¹²¹ KOHN, at 87

¹²² *Id.*

¹²³ This description of the music publishing industry is consistent with the high concentration that characterized other segments of the music industry. The five major music groups collectively control, through their affiliated record companies, at least 80% of the market for prerecorded music. *See* Statement of Chairman Robert Pitofsky and Commissioners Sheila F. Anthony, Mozelle W. Thompson, Orson Swindle, and Thomas B. Leary, *In re Sony Music Entertainment, Inc.*, File No. 971-0070, Sept. 6, 2000, *available at* <http://www.ftc.gov/os/2000/09/musicstatement.htm> (last visited Aug. 4, 2003); *see also* *U.S. v. Time Warner, Inc.*, 1997 WL 118413, (D.D.C., 1997). This situation is not unique to the US, *see* *Australian Competition & Consumer Commission v Universal Music Australia Pty Limited* [2001] FCA 1800 (14 December 2001), section 14 (the five majors have a collectively market share of about 85% in Australia). While this data usually refers to the sale of records, not necessarily to the public performance of music, there is direct relationship between what is being performed publicly and what is being sold, *see* Part III.E *infra*, so an assumption that the majors have control over the same percentage of publicly performed music seems reasonable. *See also*, Roger Wallis et

the majority of users, and for the majority of songs, direct transactions with the copyright holders are entirely practicable. The argument for natural monopoly thus seems even weaker.

2. Blanket License as a Risk Management Tool

In the legal parlance users must purchase licenses before they can legally perform music. That description is a legal construction that does not adequately reflect the true nature of the transaction. Copyrighted music has traditionally been distributed without any protecting technology. Therefore, once a user gains access to the work by obtaining a copy of it, he can *technically* perform it without obtaining any license. If he does so, however, and is caught, he may be liable for infringement. By obtaining a license, though, the user gets the copyright holder's right of action waived. Current technology enables users, once they obtain a CD, to have rapid and unplanned access to music and an unimpaired ability to perform it. But at the same time, because the purchase of a CD does not entitle the user to perform it publicly users are exposed to the risk of liability. A blanket license that authorizes unrestricted access to the licensor's repertoire reduces the risk of being held liable for infringement, at least with respect to the works in the licensor's repertoire. Since PROs' repertoire, usually through a cross-licensing agreement with other foreign PROs, covers the entire worldwide repertoire,¹²⁴ a blanket license granted by a PRO is a practical tool that reduces the risk of being liable for infringement, especially if the license contains an indemnification clause against suits by third parties.¹²⁵ Therefore, the periodic payment that a

al., *Contested Collective Administration of Intellectual Property Rights in Music*, 14 EUR. J. COMM. 5, 17-19 (1999) (describing the global concentrated nature of the music industry, including data from several industrialized countries, the integration between record companies and publishers within each of the five multinational major groups, and quoting (without referenced) estimates that some 80% of cash flowing through collecting societies comes [perhaps in the form of mechanical royalties – AK], and goes to the five majors). Moreover, concentration is not a new characteristic of the industry. It was estimated that at the end of the 1920s about 80% of the really popular hits had been written by a group no more than fifteen writers. This feature of a closed system that characterized ASCAP would later be one of the reasons for the later formation of BMI. ASCAP was slow in accepting genres such as rock, country and black music, which found their home in BMI, see SEGRAVE, *supra* note 119, at 22-23.

¹²⁴ The US is a notable exception in this regard, because no single PRO covers the entire repertoire.

¹²⁵ See *Columbia Broadcasting System, Inc. v. American Soc. of Composers*, 562 F.2d 130, 140 (2nd Cir. 1977) ("There is not enough evidence in the present record to compel a finding that the blanket license does not serve a market need for those who wish full protection against

user makes to a PRO is similar to periodic payments for insurance premiums or a healthcare plan.¹²⁶ Some jurisdictions provide different judicial and legislative mechanisms that are aimed at providing users the “peace of mind” of being able to use any work without having to check in advance whether an individual work is indeed part of the licensed repertoire. Among such mechanisms are judicially constructed notions of implied license or implied indemnity, a construction of a presumption that the PRO has the questionable rights, legislative limitations on the rights of non-represented copyright holders, a mandated extension of the rights of PROs to cover an entire class of works or uses, or even mandatory collective management.¹²⁷

It is obvious that only a blanket license offered by a seller with a significant repertoire can effectively reduce the risk of infringement and that the resulting peace of mind is a virtue. Yet it is less clear whether this virtue is essential (so that no reasonable user will perform music unless he is covered), or is it just a by-product of collective administration.¹²⁸ Careful management of users’ play lists and the setting up of performance schedules in advance can be equally effective in minimizing the risk of infringement. If accidental unlicensed performance was a cause of serious risk the insurance market could supply coverage for such accidents, but unlike PROs, the insurance market could offer such coverage under competitive terms. Such solutions will not enable users spontaneous access to every song, however, but as I have noted earlier the practical importance of such spontaneous access is doubtful.¹²⁹

Another variation of this risk-minimization theme is that even a properly licensed performer of music can be placed at risk if the song that he performs infringes another copyright holder’s rights and the ‘true’ copyright holder is not

infringement suits or who, for some other business reason, deem the blanket license desirable. The blanket license includes a practical covenant not to sue for infringement of any ASCAP copyright as well as an indemnification against suits by others.”)

¹²⁶ HOVENKAMP ET AL., *supra* note 77, at §22.5c. The insurance analogy is not perfect because insurance typically refers to risks that are outside the control of the insured. This is not the case in performing rights, unless the insurance is sought by the managers against the risk of performing unlicensed music by their employees, or against the risk is of accidentally performing an unlicensed song.

¹²⁷ *Gervais, supra* note 20, 33-43.

¹²⁸ The answer may change from user to user and also depends on the degree of risk in the case of infringement. If, for example, the law provided strict liability and imposed life imprisonment on officials of a radio station in any case of unauthorized performance (a suggestion that some members of the music industry would gladly support) than a blanket license covering each and every work would be indispensable.

¹²⁹ *See supra* Part III.C.1.

a party to the license agreement. When a blanket license is used the chances are that it covers the 'true' copyright holder as well are great.¹³⁰ This consideration, however, cannot seriously justify collective licensing. Whenever an intellectual property right is licensed the licensee may ultimately find himself infringing some unknown third party's right, as is the case in many ordinary sales transactions whereby the buyer might be exposed to claims from third parties. Obviously, pooling the entire assets in a market in the hands of a single sales or licensing agency would eliminate this risk, but absent persuasive evidence that the risk is serious and can only be handled by such pooling, it does not seem to be a significant justification for the practice. Contractual tools (such as indemnification clauses) and legal instruments (such as estoppel), or rules that otherwise protect buyers acting in good faith work well in other areas of law and can work equally well in this case too. Moreover, the case of public performance even seems to be one in which such a risk is not serious at all, because if the performance of the pre-recorded song is infringing the rights of a 'true' owner, the making of the record and the reproduction of it are likely infringing too. In such a case the producers of the record are probably a better target for an infringement suit than an establishment that performed it publicly once or even several times.

D. Are PROs Contested Monopolies

The argument that PROs are natural monopolies usually assumes that as a result of the (presumed) economies of scale and scope in the administration of performing rights, collective licensing by a single PRO is the most efficient mode of administration, but because there is only one PRO who exercises control over all compositions, the prices that it charges are necessarily monopolistic because there is no competition to restrain them.

This, however, need not necessarily be true. As Harold Demsetz explained, scale economies in the production do not tell us anything about the price that the product will be sold at, because if large enough number of non-colluding firms can bid to offer the product, then the bidder with the lowest bid price for the entire demand will be awarded the contract.¹³¹ Therefore, even in a market with a natural monopoly prices can be set at the competitive level. Demsetz's argument has developed into the theory of contestable markets. According to

¹³⁰ This point was made by Judge Winter, in his concurring opinion in *Buffalo Broadcasting Co., Inc. v. American Soc. of Composers, Authors and Publishers*, 744 F.2d 917, 934 (2nd Cir. 1984) cert. denied 469 U.S. 1211 (1985).

¹³¹ Harold Demsetz, *Why Regulate Utilities?*, 11 J. L. & ECON. 55 (1968).

this theory “potential entry or competition for the market disciplines behavior almost as effectively as would actual competition within the market. Thus, even if operated by a single firm, a market that can be readily contested performs in a competitive fashion.”¹³² It is often said that in such situations the competitive outcome results not from competition within the market but rather from competition for the market.

Although the consent decrees were entered before the formulation of this theory, the idea of contested monopolies is crucial to the US treatment of its PROs. The provisions of the consent decrees that mandate the ability of ASCAP and BMI’s members to issue licenses individually were designed to make the practices of the PRO contestable by their individual members. The idea is explained by Professor Landes as follows:

“Nonexclusivity means that ASCAP competes against its own members who have the option to license their compositions directly to a music user... Because it would be infeasible for the thousands of ASCAP members to agree not to license except through ASCAP, the blanket license survives because it offers users a lower-cost method of acquiring performing rights. ASCAP beats the competition (its members) by saving users so much that they prefer to deal with ASCAP rather than individual members. The possibility of licensing, however, sets a ceiling on the price ASCAP can charge for the blanket license. The actual price will be somewhere between the ceiling and the lower costs associated with negotiating the blanket license.”¹³³

The existence of an option for individual licensing was fundamental to the Supreme Court’s decision in *BMI v. CBS* and in all other post-consent-decree decisions. In *Buffalo Broadcasting* the mere theoretical existence of program, direct- and source-licensing was sufficient for the Court to rule that the blanket licenses issued by the PRO were not a restraint at all, not only an unreasonable one.¹³⁴ Another theoretical source of potential competition is the ability of new songwriters to form new PROs if the incumbent PRO sets its prices too high. This, in fact, was the motivation for the formation of BMI.¹³⁵

¹³² Elizabeth E. Bailey, *Contestability and the Design of Regulatory and Antitrust Policy*, 71 AM. ECON. REV. 178 (1981).

¹³³ Landes, *supra* note 19, at 634.

¹³⁴ *Buffalo Broadcasting Co., Inc., v. ASCAP*, *supra* note 94, at 933.

¹³⁵ See Andrew N. Kleit, *Creating a Public Good to Fight Monopolization: The Formation of Broadcast Music, Inc.*, 19 REV. INDUS. ORG. 243 (2001), Besen et al., *supra* note 36, at 401-02.

Although the non-exclusivity provisions of the consent decrees and the lack of legal restriction on entry into the licensing market make collective administration in the US more contestable when compared to PROs who hold exclusive rights (such as SOCAN in Canada), or to PROs who enjoy a *de jure* monopoly (such as PROs in Italy, the Netherlands and Spain)¹³⁶ the idea that this potential competition is effective in disciplining any monopolistic practice by ASCAP and BMI seems improbable because serious limitations restrain the ability of individual licensing and new entry to discipline current PROs.

One limitation is the blanket license itself. Since songs are not homogenous, a user's demand is not simply for songs, but rather for different songs and for a variety of songs. That means that even if a new entrant or an existing member of a PRO seek to present an alternative to the PRO by offering songs at a lower fee than the PRO charges, the user – a radio station for example - cannot easily accept that offer, unless this competitor has a large enough repertoire that the station can substitute for the license issued by the PRO, or alternatively, if sufficiently large number of copyright holders make similar offers. The result is that even if the user is interested in acquiring performing rights from other non-PRO sources she might still need a license from the PRO to cover all the remainder of the works that she is unable to license from the alternative sources. However, as long as the PRO offers only blanket licenses which are offered on an 'all-or-nothing' basis, users cannot realize any cost savings from licensing works included in the PRO's repertoire from other sources. Of course, the PRO could adjust its fees in such cases to reflect only the residual nature of the blanket license, but although this could be an ideal arrangement for users, the PRO has no incentive to make such adjustments.

This implies that PROs could be truly contestable only if existing members or new entrants could offer the *same* repertoire that incumbent PROs offer, or at least a repertoire large enough that it could be a reasonable substitute.¹³⁷ The fact

¹³⁶ Gervais, *supra* note 18, at 25.

¹³⁷ In order for the market dominated by the PRO to be fully contestable, an option to offer the same repertoire is essential to the theory of contestable market, since the theory requires that the inputs required to enter production must be available to all potential entrants, *see* Demsetz, *supra* note 106, at 58. Put differently, a perfectly contestable market requires that entry is absolutely free (and exit is absolutely costless), and free entry for this purpose means that the entrant suffers no cost discrimination compared to the incumbent, *see* William J. Baumol, *Contestable Markets - An Uprising in the Theory of Industry Structure*, 72 AM. ECON. REV. 1 (1982). Since in the case of PROs the important economies are economies of scope – the ability to license and enforce sufficiently large repertoire – the condition of free entry requires that the entrant can offer either

that most US radio stations obtain licenses from both ASCAP and BMI,¹³⁸ despite their respective huge repertoires, suggests that the second option, the possibility that individual copyright holders would have large enough repertoires is not very likely.¹³⁹ The first option, offering the *same* repertoire as the PRO does, faces even more serious obstacles. While some of the inputs required for setting up a licensing business such as managerial staff, legal services, computing, accounting, etc. are probably easily available, the most important inputs – songs – are, as direct result of copyright law, highly unavailable. An entrant (or an existing member of the PRO) seeking to enter the performing rights market on a full scale cannot simply offer the same repertoire at a lower price. He can only offer the limited repertoire of his own songs or obtain concurrent rights from the other copyright holders. This, however, might not have been possible so far in the US, and is impossible in virtually any other jurisdiction. Under the old consent decrees copyright holders were free to license their rights individually, but it was unclear whether they could do so by third parties. If copyright holders are not allowed to offer their songs through third parties, no entrant can offer a license comparable to the one offered by the PRO. This might change under the new consent decree, the AFJ2, which makes it clear that copyright holders are free to license through agents, implying that ASCAP relied on the ambiguity of the provisions of the former consent decree and opposed this possibility.¹⁴⁰ Because important economies in that market are economies of scope, *i.e.*, the ability to offer a wide repertoire, individual copyright holders' ability to offer their songs individually, but the inability of third parties to aggregate a sufficiently large number of songs, made the option of individual licensing only a remote source for potential competition. Thus Landes's contention that "nonexclusivity means that ASCAP competes against its own members"¹⁴¹ seems simplistically optimistic.

the same or sufficiently other large repertoire in order not to suffer from cost discrimination compared to the incumbent PRO.

¹³⁸ Michael A. Einhorn, *Intellectual Property and Antitrust: Music Performing Rights in Broadcasting*, 24 COLUM.-VLA J.L. & ARTS 349, 362 (2001).

¹³⁹ In fact, the US Supreme Court's contention that the blanket license is not a naked restraint of trade, *see BMI v. CBS*, *supra* note 1, at 20, but rather a different product of which the individual compositions are raw material and is greater than the sum of its parts, *id.*, at 21-22, is inconsistent with the assumption that the individual parts – the raw materials – are good substitutes, which can effectively discipline the market power of the PRO. Raw materials will be good substitutes to the final product only if there are no substantial cost savings from buying the final product but this is not the case if the final product is truly "greater than the sum of its parts".

¹⁴⁰ AFJ2 Memorandum, at 19.

¹⁴¹ Landes, *supra* note 19, at 634.

Another attempt to increase the contestability of ASCAP's blanket license was made in the 1950 consent decree, when ASCAP was required to offer broadcasters per-program licenses in addition to the blanket license. Per-program licenses make the full catalog available for an individual program, and the consent decrees required that they be a "genuine choice" to the blanket license. The idea was that the availability of per-program licenses would enable broadcasters to bunch songs from alternative sources for specific programs and use the per-program license as a residual and presumably cheaper device, thus creating a competitive alternative to the blanket license. Past experience has shown, however, that ASCAP did whatever it could to avoid making per-program licenses a "genuine choice": it made their price significantly higher than the price of the blanket license and refused to offer them to users other than those which the consent decrees expressly required.¹⁴² The new consent decree (AFJ2), seeks to reinforce ASCAP's obligations to make per-program (as well as the newly defined per-segment) licenses a truly genuine choice available to many other users as well.¹⁴³ It is yet to be seen whether the new terms will succeed where the old ones failed.

Lande's contestability argument has a second prong. It is the premise that "it would be infeasible for the thousands of ASCAP members to agree not to license except through ASCAP." Recall, however, that the atomistic picture of ASCAP's (and other PROs') membership is an illusion and that the vast majority of compositions are owned, or at least administered by the five Majors.^{144,145} So whereas collusion between the thousands of ASCAP's members might not be possible, collusion between the Majors might not be impossible.¹⁴⁶ It is not inconceivable that they might effectively agree not to license except through the PROs. Alternatively, given the oligopolistic structure of the publishing market it is also possible that the major publishers could reach the same result without collusion, but simply by each Major's individual recognition of the long term benefits from maintaining collective licensing. In either case, the hypothesis of contested markets might prove wrong. Of course, the fact there are only a few players that control the vast majority of present copyrighted music might be a

¹⁴² AFJ2 Memorandum, at 24-25.

¹⁴³ AFJ2 Memorandum, at 23-33.

¹⁴⁴ See Part III.C.1 *supra*.

¹⁴⁵ In the US, many of the major publishers form three publishing subsidiaries, each joining a different PRO, see AFJ2 Memorandum, at 7 n8, so it is possible that the majors essentially dominate the entire repertoires of ASCAP, BMI and SESAC.

¹⁴⁶ But see Wallis et al., *supra* note 123, at 19-23 (predicting a threat to the system of collective administration from a potential withdrawal of the Majors from the system).

necessary condition to sustain a collusive arrangement but not sufficient. The barriers to entry into the business of songwriting are probably very low, and the life cycle of songs is usually very short,¹⁴⁷ so in theory supra-competitive profits that result from collusion among the majors should induce entry by non-affiliated songwriters and publishers. In practice, however, despite the seemingly low barriers for songwriting the concentration in the music industry and the integration between various aspects of it (*e.g.*, music publishing and record production) imply that there probably are some synergies and economies of scale and scope that preclude the possibility of hit-and-run entry by songwriters generally, and hit-and-run entry into the limited area of performing rights particularly.¹⁴⁸ In other words, there probably are barriers to entry that guarantee that the major music companies would have control over new music, not only over existing works until, at least, technological change alters the economics of the music business.

E. PROs and the Lessons from Payola

1. The Dual Value of Public Performance

So far it has been assumed that public performance of music is financially beneficial to those who publicly perform it. This is quite obvious; otherwise they would not be willing to pay for it. The benefit is straightforward in the case of users whose business is based on music (some TV and radio stations, discotheques, etc.) and is indirect in the case of users for whom music increases the attractiveness of their main non-music business (*e.g.*, bars, restaurants, retail stores, etc.).¹⁴⁹

This description, however, covers only one aspect of the economic value of the public performance of music. The public performance of music is not only something that users are willing to pay for, it is also a service – advertising – supplied to record companies and other copyright holders by those who perform music. Yet public performance is more than a mere method to advertise music; it is a way to overcome an inherent problem in the sale of music. Music is an experience good. Experience goods are goods for which the buyer cannot

¹⁴⁷ Sidak & Kronemyer, *supra* note 115.

¹⁴⁸ It seems unlikely that a songwriter or a small publisher who depend on the services of large publishers in administering their bundle of rights would find it economical and contractually possible to set up a licensing business for performing rights alone.

¹⁴⁹ See *Herbert v. Shanley* 242 U.S. 591, 594 (1917) (holding that this indirect benefit makes public performance by a restaurant ‘for profit’).

discern the true quality until after purchase. When this is the case buyers will be reluctant to purchase before they know what they are getting.¹⁵⁰ One important tool to overcome this problem is to let customers sample the good before they make their purchasing decisions. The public performance of music on the radio in order to increase the sales of records is an example of the kind of strategies that producers devise to overcome the problem of experience goods.¹⁵¹

The importance of radio airplay for the sale of music cannot be understated. Radio airplay is generally believed to be the greatest stimulant to sales of a particular pop album;¹⁵² without airplay the expected level of CD sales diminishes greatly.¹⁵³ Record companies are well aware of this and are willing to pay significant amounts to promote the airplay of their music on the radio. It is estimated that US record companies spend more than \$100 million on radio promotion each year,¹⁵⁴ with a typical per-song spending of \$200,000 to \$300,000, and occasionally more than \$1 million.¹⁵⁵

The practice of payments by the record companies to broadcasters - often termed 'payola' - has acquired a bad reputation as a corrupt and immoral business practice. Payola has been a subject of public controversies in the US, which subsequently led to an official ban on it in 1960.¹⁵⁶ Surprisingly, although payola seems to benefit the music industry, the regulatory ban was not imposed on it; it was rather sought by it. But despite the ban, the practice has never really ceased, nor have the efforts of the music industry to curb it. In the following

¹⁵⁰ CHURCH & WARE SUPRA note 30, at 190.

¹⁵¹ Carl Shapiro & Hal R. Varian, *Information Rules: A Strategic Guide to the Network Economy* (1999).

¹⁵² Sidak & Kronemyer, *supra* note 115, at 526.

¹⁵³ Eric Boehlert, *Fighting pay-for-play*, SALON.COM (2001) at

<http://dir.salon.com/ent/music/feature/2001/04/03/payola2/index.html>

¹⁵⁴ Eric Boehlert, *Record companies: Save us from ourselves!*, SALON.COM (2002) at

http://www.salon.com/ent/feature/2002/03/13/indie_promotion/index.html.

¹⁵⁵ Anna W. Mathews & Jeniffer Ordonez, *Music Labels Say It Costs Too Much to Get Songs on Radio*, WALL ST.J., June 10, 2002, at B1.

¹⁵⁶ The public interest justification for anti-payola rules is rooted in the argument that payola misleads listeners because music that they believe to be chosen according to its merit is actually performed because it had been paid for. Therefore the FCC Act forbids only undisclosed payments, *see generally* Ronald H. Coase, *Payola in Radio and Television Broadcasting*, 22 J.L. & ECON. 269 (1979). The expectation – as long as there is one – that the choice of music is based only on its merit – is reasonable only when the prices of all songs are identical. If different songs have different prices very few listeners would find offensive a radio station's decision to include price in its decision about the choice of music, just as very few viewers would find it immoral for a TV station to choose its programs not only according to their 'merit' but also according to their price.

paragraph I will describe briefly the history of payola and argue that payola, the efforts to eliminate it and the collective administration of performing rights are actually all sides of the same coin. The fees collected by PROs reflect only the value of performance to users, not the value of performance to the copyright holders, and as such do not reflect the true economic value of public performance. Because this cannot be an equilibrium, a reverse flow of payments, in the form of payola, increases (or begins). But this reverse flow decreases the profits of the music industry, hence the collective attempts to curb it. The persistence of payola is strong evidence that when coordination between copyright holders is absent, the net performing-based income is substantially lower than the fees collected by the industry's PROs and that if left unchecked, competition may even reverse this flow. This may suggest that under competition, the true economic value of the right for public performance is rather low. In order to profit from it a dual system is required, collective licensing on the one hand, and anti-payola rules on the other. Had competition for performing rights existed, payola would have disappeared.

2. The History of Payola

The history of payola is probably as old as the history of commercial music. Equally old are the music industry's failed efforts to curb it. Long before the commercial development of radio, a system of payments for the inclusion of songs in live performances by popular singers and musicians was commonplace in the US as well as in England. In those days, music publishers, who sought to increase the sales of their (copyrighted) sheet music, paid singers and musicians in exchange for their agreement to perform the publishers' music. At least since the 1890s, though, those music publishers have tried collectively to stop such payments in an effort to reduce their advertising costs.¹⁵⁷ Since payola was an effective means of introducing new songs and new musical styles, banning payola was also an attempt to restrict the opportunities for new entrants.¹⁵⁸ Those efforts persistently failed, because despite the agreements to eliminate promotional payments, individual publishers realized their individual benefit in pursuing them. Publishers thus found themselves in a typical prisoners' dilemma, and the incentives to cheat on what had been agreed on were too high. The failure to eliminate those payments by agreement led to creation of the Music Publishers' Protective Association (MPAA) in 1917, which, according to its founders "the primary and main object of [was] to promote and foster clean and

¹⁵⁷ SEGRAVE, *supra* note 119, at 4; Coase, at 273.

¹⁵⁸ *See* Coase, at 315.

free competition among music publishers by eradicating the evil custom of paying tribute or gratuities to singers or musicians employed in theaters, cabarets and other places to induce them to sing or render music.”¹⁵⁹ Although such concerted attempts to reduce promotional expenditure would probably violate the antitrust laws (which were already in place), it does not seem that these laws were a major concern for the publishers at that time, not even to the US antitrust agencies. As we shall see below, at some stage the Federal Trade Commission even considered endorsing such initiatives to eliminate such promotional expenditures.

Payola included not only direct payments and benefits to singers and musicians, but also indirect and disguised forms, designed to bypass the formal ban on the practice, such as the practice of “cutting-in” (adding performers as co-writers to enable them to receive part of the songwriters’ royalties).¹⁶⁰

By the beginning of the 1930s the focus of payola had shifted to radio, and the main recipients of payola were the radio bandleaders.¹⁶¹ In 1931 ASCAP took its own anti-payola initiative. It unanimously passed a resolution to “curb the evils of cut-ins”.¹⁶² Any publisher found guilty of splitting royalties with orchestra leaders - or other entertainers - or engaging in any other payola practices would be placed in ASCAP’s nonparticipating class for six months. This meant that the publisher would receive no dividends from ASCAP for that time. The period towards the entry into force of this anti-payola rule on April 20, 1931 was a period of rampant cutting-in activity, when publishers and musicians tried to take advantage of the non-retroactive nature of the new ban. This new ban also did not succeed in curbing payola, like all previous attempts.¹⁶³

Frustrated by their inability to eliminate payola, publishers then sought to impose a regulatory ban. The method was to draw up an industry code prohibiting what was then called “the payment system” that would be approved by a governmental agency, the National Recovery Administration (NRA)

¹⁵⁹ VARIETY, May 4, 1917, at 4, *cited in* Coase, *id.*, at 276. In 1966 the MPAA changed its name to the National Music Publishers’ Association (NMPA), *see* National Music Publishers’ Association, Eleventh Annual International Survey of Music Publishing Revenues (2002), *available at* <http://www.nmpa.org/nmpa/survey11/NMPA2002Survey11thEdition.pdf>. According to Segrave, this was the sole reason for the formation of the MPAA, which at that time had no other mandate in any other aspect of the business of the music publishers, *see* SEGRAVE *supra* note 119, at 16.

¹⁶⁰ *Id.* at 21.

¹⁶¹ SEGRAVE, at 30-32; Coase, at 274

¹⁶² SEGRAVE, at 38.

¹⁶³ *Id.* at 39-40.

(established in 1933), and would thereby bind the industry. Such a code, proposed by the MPAA, was approved and became effective on March 1935. However, on May 1935 the US Supreme Court declared the act establishing the NRA unconstitutional¹⁶⁴ and this attempt to ban payola failed.¹⁶⁵ Another attempt was an approach to the Federal Trade Commission (FTC), proposing rules of fair trade practice that would become binding once approved by the FTC. Ultimately, the FTC rejected the proposed trade practice rules after its chief counsel noted the pending antitrust suit against ASCAP, of which the members of the MPAA were also members.¹⁶⁶

By the 1950s, when records rather than music sheets became the industry's most important source of income, the predominant form of payola became payment by record companies – rather than their music publishing divisions - to disc jockeys on radio stations.¹⁶⁷ The attempts to legally ban payola were eventually successful by 1960, when the making of such payments became a crime as a result of amendments to the Communication Act in 1960 and by further regulations of the Federal Communications Commission (FCC). ASCAP was a key actor in lobbying for the ban, largely as a result of the rivalry between it and BMI.¹⁶⁸

The legal ban on payola has not eliminated the phenomenon; it only changed its form. The legal ban contributed to the emergence of independent music promoters who indirectly transfer payments from record companies to radio stations' employees in a manner that enables the record companies to circumvent the legal prohibition.¹⁶⁹ In a ritual manner, however, the music industry tries to overcome its players' prisoners' dilemma by supporting tighter regulatory bans on promotional payments from record companies to broadcasters, especially when the industry faces periods of low sales and its managers face a need to cut expenses. Sidak & Kronemyer describe such an initiative in 1986, which resulted in a (temporary) break in commercial relations between the major record labels and independent promoters.¹⁷⁰ This initiative, however, was short-lived, and

¹⁶⁴ A.L.A. Schechter Poultry Corp. v. U.S., 295 U.S. 495 (1935) (ruling that Congress cannot constitutionally delegate its legislative authority to trade or industrial associations or groups).

¹⁶⁵ Coase, *supra* note 156, at 279-81.

¹⁶⁶ *Id.* at 281-85.

¹⁶⁷ *Id.* at 286.

¹⁶⁸ In the 1950s ASCAP music lost its dominance to new genres such as rock and roll and rhythm and blues that were generally part of repertoire of the emerging BMI. ASCAP blamed payola by BMI and its members as the main cause for the change in musical taste, *see* Coase, *id.*, at 287-88.

¹⁶⁹ Sidak & Kronemyer *supra* note 115.

¹⁷⁰ *Id.* at 556-60.

payola still exists. Similar calls for regulatory intervention to eliminate payola were made as recently as 2002 implying that payola is alive and well.¹⁷¹

3. The Payola Conundrum

The prevalence of payola demonstrates what might be seen as an anomaly that exists in the music industry. Instead of one single pricing system that reflects the value of the public performance for both rights holders and broadcasters there seem to be two *separate and unrelated* pricing systems for what essentially is a single thing: the public performance of music.¹⁷² One system exists between copyright holders (through their PROs) and broadcasters, in which copyright holders are the payees; another exists between individual copyright holders and the broadcast personnel, in which the copyright holders are the payors.¹⁷³

That anomaly is not really surprising, however. Indeed it may be simply a typical consequence of the lack of competition that results from collective administration of performing rights. In a non-cooperative setting (*i.e.*, without a PRO), a copyright holder acting individually, would factor the promotional

¹⁷¹ Boehlert, *supra* note 129; Anna W. Mathews, *Promotional Payments Hit A Sour Chord*, WALL ST.J., May 24, 2002, at B3.

¹⁷² There are other industries in which distributors receive goods from a manufacturer and pay for them and then get promotional payments or rebates from the distributor. The difference is that in such cases those bi-directional payments are closely related because, unlike in the case of payola, both elements of the deal are negotiated, often simultaneously, by the manufacturer and the distributor.

¹⁷³ The fact that currently the principal payors of payola are record companies (and not the authors and publishers) and that the recipients of payola are radio personnel (rather than the radio stations themselves) should not obscure this anomaly for several reasons. First, the promotional function of public performance of music benefits record companies who sell records, just as it benefits holders of copyright in the underlying compositions and lyrics. If more records are sold, copyright holders receive more payments in the form of royalties for the underlying compositions and improve their market positioning towards future deals; it is not surprising that when the major labels (temporarily) suspended their relations with independent music promoters in 1986, demand for independent promotion shifted partly to the recording artists themselves and to music publishers, who previously benefited from the record companies' promotion expenditure, *see* Sidak & Kornemyer, *supra* note 115, at 558. Second, as the history of payola clearly demonstrates the fact the main payors today are the record companies merely reflects the shift of focus from sales of sheet music to records, but types of sales benefit authors. Moreover, in many cases the record companies and the publishing houses belong to the same economic entities, and finally, ASCAP's own anti-payola rules demonstrate that the writers' and publishers' interests were similar to the record companies'. On the receiving side of payola, although broadcasters do not benefit directly from payola they benefit indirectly, because the ability of their employees' to accept benefits from the record companies allows them to pay them lower salaries, *see* Sidak & Kronemyer, *id.*, at 532.

value of the public performance of his music when she negotiates and determines the price that she asks for a license to perform her music. Recall that whereas a PRO can attempt to capture the whole value of music (P_m), the maximum price that a radio station will pay for a song under competition equals the marginal advertising revenue that it could earn by broadcasting the particular song (P_c).¹⁷⁴ This leads to a lower maximum per-song price under competition ($P_c < P_m$).¹⁷⁵ Moreover, because the copyright holder receives a benefit from additional airplay of her music (B) she would lower the price of her songs (P^*) even further in order to increase their airplay ($P^* = P_c - B < P_c < P_m$). If B is large enough, the value of P^* can be even negative, meaning a complete reversal of the flow of payments.

Therefore, the pooling of rights in the hands of a PRO (which issues only blanket licenses) and the attempts to ban payola can be seen as two complementary elements in a scheme to set the price of public performance at a level that corresponds only to the value of music to broadcasters (P_m) without the offsetting effect of the benefit from performance to the copyright holders (B). This can be achieved, at least partially, because the decision-making authority with regard to P_m is the PRO, whose mandate is to maximize revenue from performing rights, not from the sales of records (or music sheets), and is therefore less inclined to factor B into P_m . Furthermore, because the PRO does not function as a mere agent of the individual copyright holders it is immune from attempts by individual copyright holders to lower P_m in order to promote sales: the PRO issues only blanket licenses and charges a flat fee. It does not accept pricing directions with regard to individual works and copyright holders have no incentive to influence the PRO to reduce P_m in order to increase the airplay of music. There are two reasons for that. First, the fee for the blanket license does not change according to the time music is played; therefore a decrease in the price of the blanket license does not necessarily or directly lead to more airplay.

¹⁷⁴ I use marginal revenue from advertising for the sake of simplicity. The argument works the same for subscription-fee services whose income depends on their popularity (which determines their customers' willingness to pay for the service), and even for public broadcasters whose funding comes from taxpayers' money. In their case too - although indirectly - the popularity of the broadcast determines the income of the station because the station's ability to maintain its public funding depends, although not solely, on the political support of its audience.

¹⁷⁵ Because at any given time there are numerous songs that can increase the advertising revenue of the radio station, in a non-cooperative setting the copyright holder cannot capture the whole revenue stream that the radio station receives as a result of the broadcast of music, only the value that can be attributed to his particular music, *see supra* note 39 and accompanying text.

Second, even if such decrease generated an increase in airplay time,¹⁷⁶ the individual copyright holder has no guarantee that the additional airplay time would include more of *his* music rather than of his competitor and would therefore not find an attempt to influence the level of the blanket license fees useful for increasing the airplay of *his* works. Under such circumstances the copyright holder is more likely to seek other methods to promote his own music. Direct agreement between the copyright holder and the broadcaster to pay payola is an example of such a method. Unfortunately, however, the flow of payments from the copyright holder to the broadcaster that is likely to be part of such an agreement could undercut the benefits accruing under the blanket license. The benefits from banning payola, therefore, are not limited only to reducing advertising and other promotional costs. Banning payola thus is essential to preserving the ability of copyright holders to obtain, through collective licensing, supra-competitive revenues for the public performance right. As a simple analysis of the numbers suggests, banning payola may be essential to obtain *any* meaningful revenues.

According to the NMPA, US music publishers earned performance-based income of \$811.9 million in 2000, almost 36% of which (\$291 million) came from radio.¹⁷⁷ It is estimated that record companies spend annually more than \$100 million on radio promotion through independent promoters,¹⁷⁸ a sum greater than one-third of what copyright holders (including the record companies' publishing subsidiaries) collect from radio stations.¹⁷⁹ The music industry's efforts to ban payola suggest that its members believe that the ban is at least partially effective and that absent such a ban the payments paid by the copyright holders to public performers would increase, reducing the net payments collected from public performers even further. Indeed, in the past, before payola was illegal, instances

¹⁷⁶ This can happen, for example, as a result of the terms of the consent decree. Under Section IV(H) of the AFJ2 ASCAP is prohibited from basing the fee upon a percentage of the income received by the licensee from programs that include no ASCAP music, unless the broadcaster prefers do. Therefore in response to lower license fees a radio station can increase the total time of programs that include music and decrease the time of talk-only programs.

¹⁷⁷ National Music Publishers' Association, *supra* note 159; similar account is made by Einhorn *supra* note 138, at 349.

¹⁷⁸ Boehlert, *supra* note 128. Sidak & Kronemyer, *supra* note 115, at 554 (quoting reports from 1985 that the spending on independent promotion reached between \$60 and \$100 million).

¹⁷⁹ The actual share of the promotional expenditure might be even higher because US PROs do not distribute all the money that they collect to the record companies' affiliated publishers. PROs deduct their overhead expenditures and the remainder is divided 50:50 between publishers and individual songwriters. I do not have data about promotional payments in the TV industry, which is equally important in terms of royalty revenues, nor about other non-broadcast sectors.

when spending on payola to radio had exceeded the royalties collected by ASCAP from radio were not uncommon.¹⁸⁰

* * *

Commentators have generally neglected to incorporate the phenomenon of payola and the attempts to ban it into the analysis of PROs.¹⁸¹ My analysis, however, which looks at payola and anti-payola rules as the other side of collective licensing, supports a more skeptical view of the benefits to society from collective licensing, and of the natural monopoly argument. Payola partly undermines the natural monopoly argument because its existence is evidence that PROs are not the only form of intermediation between copyright holders and public performers.¹⁸² Payola demonstrates that in fact copyright holders find ways to deal directly with users about the performance of their music, as well as to monitor these deals. If they can do that as payors, they might well do so as payees.

Second, payola shows that collective licensing creates a completely distorted pricing system for the performance of music. This distortion, however, goes beyond the distortion that is generally created by monopoly pricing. When backed by anti-payola rules, collective licensing enables copyright holders to charge a price that is far above, and loosely connected to, the true market value of their products. But because this price is not an equilibrium price, there exists a system of side-payments which are probably less efficient and indeed may be socially troubling. Against the background of payola, it is more difficult to regard PROs as, in the words of the US Supreme Court, “market arrangements reasonably necessary to effectuate the rights that are granted [by copyright law]”. Instead they can be regarded as arrangements necessary to charge prices that far exceed the true value of the rights that are granted by copyright law.

F. Conclusion

The natural monopoly paradigm seems to dominate the analysis of PROs and prevails in all jurisdictions that endorse the model of regulated PROs. The idea of a competitive market for performing rights is generally considered

¹⁸⁰ SEGRAVE *supra* note 119, at 37.

¹⁸¹One exception is Goldstein, *supra* note 70, at 415 (briefly mentioning the possibility that payola may indicate that the traditional analysis of PROs does not account for the fact that record producers may have an interest in reversing the flow of revenues from broadcasters).

¹⁸² More evidence is described in Part III.B.1 *supra*.

impracticable or at least substantially less efficient. PROs and their use of blanket licenses undoubtedly yield economies of scale and scope and confer benefits on their users – not only on their members. From this perspective the US Supreme Court's refusal to condemn PROs as *per se* anti-competitive is good law-making; thorough economic analysis is required before we can sensibly determine the social balance of collective licensing. Unfortunately, however, it seems that the natural monopoly framework is applied too easily to PROs; and we often tend to be fooled by simple assumptions, rather than being guided by deep investigation. My preceding analysis expressed some skepticism about the traditional justifications for collective administration and the associated benefits – not so much as to whether those benefits exist but rather as to whether they could only be achieved under monopoly. I have shown that although direct negotiations between writers and users is indeed highly impracticable, direct negotiations between intermediaries such as publishers and record companies and retailers are highly feasible and in fact happen all the time. I have also shown that the perception of highly diffused copyright market is probably inaccurate and that while writers are indeed many and scattered, the number of publishers who administer the rights for the most performed songs is considerably smaller.

I have also shown than many of the benefits that are associated with PROs may be overstated. The problem of fragmentation of copyright – although solved by collective licensing – is also perpetuated by it, and could be solved through less restrictive arrangements as well. I have additionally challenged the importance of rapid access and risk-minimization that collective licensing provides and argued that it is unclear whether these functions are essential to users because they really need risky rapid and unplanned access to music, or whether they only consume music in a rapid and unplanned manner because the blanket license allows them to do so safely and does not offer them any incentives to economize by altering their mode of consumption. I have nevertheless identified two elements that may support a theory of natural monopoly. One is enforcement which is considerably less costly when done collectively, and the other is the potential tragedy of the anticommons that might in specific circumstances be avoided by PROs. In both cases only further empirical analysis can determine whether the cost savings are really so significant that monopoly is more desirable than competition and whether other solutions such as source-licensing could be applied. I have finally shown that the existence of payola and the attempts to ban it may suggest that the flow of revenue, which currently goes from users to copyright holders, may change dramatically under competition and therefore

PROs can be seen as a mechanism that seriously distorts the pricing system for music.

Even if we accept that PROs exhibit some natural monopoly characteristics and that their associated advantages outweigh their anti-competitive harms, regulators should adopt a fine-tuned approach to their regulation in an attempt to identify what elements are indeed natural monopoly, which aspects of PROs operations could be carried out more competitively and whether there are other arrangements that could obviate the need for collective administration in the first place. The US seems to be a good – even if incomplete – example to such an approach. If one is asked to give a single-word answer to the question “are PROs and blanket licensing legal under the US antitrust laws” the answer would probably be “yes”, at least since the Supreme Court’s decision in *BMI v. CBS*. Yet the divergence of judges’ opinions - among members of the same court, among different courts and in the context of slightly different factual settings - suggests that a short answer would be highly inaccurate. Even the Supreme Court only decided that the blanket license is not *per se* illegal, but rather should be analyzed under a rule of reason.¹⁸³ It clearly did not say that collective administration and every practice of a PRO are *per se* legal; the decision cannot be read as blanket authorization for collective administration of copyright and for blanket licensing in all circumstances. This point has been specifically acknowledged in subsequent decisions.¹⁸⁴ Furthermore, fundamental to the Court was the existing regulation of ASCAP and BMI under the consent decrees and the revisions in their practices mandated therein.¹⁸⁵ For example, the requirement that members of ASCAP and BMI would issue the organizations only non-exclusive licenses was mandated in the consent decrees and the availability of direct and source licensing, as an alternative to the blanket license, is critical to the Courts’ decision¹⁸⁶ and subsequent decisions as well.¹⁸⁷ Furthermore, the two earlier cases

¹⁸³ Justice Stevens, in his dissenting opinion, agreed the blanket license if not *per se* illegal, but suggested that the record contains enough evidence to conclude that the blanket license fails to pass the test of legality under a rule-of-reason inquiry, *see BMI v. CBS, supra* note 2, at 25.

¹⁸⁴ See *Broadcast Music, Inc., v. Hearst/ABC Viacom Entertainment Services, supra* note 94.

¹⁸⁵ *BMI v. CBS, supra* note 2, at 24 (“the substantial restraints placed on ASCAP and its members by the consent decree must not be ignored.”)

¹⁸⁶ *Id.*

¹⁸⁷ On remand, the Court of Appeals concluded that since the record showed that CBS could have obtained individual licenses and it failed to prove otherwise CBS did not meet its burden, under the rule of reason, of proving the restraining effect of the blanket license, *see CBS v. ASCAP supra*, note 125. In *Buffalo Broadcasting, supra* note 111, the court similarly held that blanket license was not unreasonable restraint on trade where opportunity to acquire individual rights through program license, direct license, or source license was realistically available to the stations.

Alden-Rochelle and *Witmark*, which were decided after the 1941 consent decree but prior to the 1950 consent decree, demonstrate that courts were willing to condemn some of the practices of ASCAP when those practices were not properly addressed by the consent decree and when a less restrictive alternative seemed to exist.

This is an important lesson because too often the discussion about PROs is not fine-tuned and does not incorporate distinctions between different modes of organization of PROs and different factual circumstances in which they operate. For example, whereas in the US the non-exclusive nature of the rights held by PROs is fundamental, in most jurisdictions copyright holders assign the performing right to the PRO, which then holds the exclusive licensing authority.¹⁸⁸ Similarly, there seems to be no attempt in jurisdictions other than the US to question, as has been the case in the film industry, whether collective administration is at all appropriate. Moreover, commentators and policy-makers seem too quick to conclude that because collective administration might have pro-competitive benefits in the case of performing rights, collective administration should be equally beneficial for the administration of many other types of copyrights owned by other types of copyright holders and licensed to different users.¹⁸⁹

The lesson from the US antitrust treatment of PROs is that details do matter, that it makes a difference whether PROs obtain exclusive licenses or not, and whether less restrictive practices than blanket licensing to all users all the time could be available. In fact, although *BMI v. CBS* is usually cited to support the notion of collective administration, a careful reader of the decision could find some seeds of skepticism about PROs and blanket licensing that the Court had sown - not only in Justice Steven's dissent but in the majority opinion as well. The Court noted that the necessity for and the advantages of a blanket license for radio and television *networks* "may be far less obvious than in the case when the potential

¹⁸⁸See *MMC Performing Rights*, *supra* note 23, at 340 (Appendix 9.2). Two notable exceptions are Australia and Israel where competition tribunals have recently mandated alternatives to such exclusivity. In Australia, the Competition Tribunal required the Australasian Performing Right Association to implement a system that will allow its members to grant performing licenses individually, *see supra* note 25, and in Israel the Competition Tribunal decided that the members of the Israeli branch of the International Federation of the Phonographic Industry (IFPI) will be allowed to grant their PRO only non-exclusive licenses to license public performance, *see supra* note 26. Apart from these examples, the possibility that there might be less restrictive modes of organization for PROs seems to be totally overlooked in the majority of jurisdictions.

¹⁸⁹The Canadian legislation, which will be discussed later in Part V.B, is an example of such excessive endorsement of the idea of collective administration.

users are *individual* televisions or radio stations, or the thousands of other individuals and organizations performing copyrighted compositions in public,”¹⁹⁰ and adds, in a footnote that: “[a]nd of course changes brought about by new technology or new marketing techniques might also undercut the justification for the practice.”¹⁹¹

In the remainder of this paper I wish to cultivate those seeds of skepticism and explore how such changes brought about by new technologies and the new marketing techniques that they facilitate might change the nature of licensing and how they might undercut the justification for collective administration of performing rights.

IV. New Technologies and Public Performance of Music

My purpose in the following sections is to assess how new technologies and a combination of them could affect the costs of administration of public performance rights – the costs of licensing and distribution, monitoring authorized and unauthorized uses and enforcement, and how such development affect the justification for collective administration by PROs. The technologies are the Internet, Digital Rights Management, and computerized automatic scanning of broadcasts.

1. The Internet

The Internet’s most obvious impact is in reducing the cost of licensing and distribution. The Internet allows users to locate licensors, communicate with them and obtain licenses much more efficiently than was possible in the offline world. If proper databases are maintained and made available online, users can easily identify the relevant right-holders in every song they are interested in performing. If right holders are ready to grant licenses online (either by themselves or by some intermediaries that act on their behalf) the Internet could provide a low-cost mechanism for individual licensing. Since the main justification for the existence of PROs is that they reduce the cost of what would otherwise be prohibitively costly individual licensing, the Internet seems to provide a technical infrastructure that can undermine this justification.

An interesting example for the use of the Internet as a licensing tool is the Rights Clearing House (RCH) – a Canadian online initiative sponsored by some

¹⁹⁰ *BMI v. CBS*, *supra* note 2, at 21 (italics added).

¹⁹¹ *Id.*, note 34.

Canadian copyright collectives and the Canadian Government.¹⁹² The RCH is a web portal that allows users that are interested in publicly performing live or recorded music, creating and distributing CDs containing songs of other artists, or using music in a presentation of a video, to obtain the necessary permission (or permissions) from the relevant copyright collectives who administer those rights in Canada.¹⁹³ The RCH allows users to specify the kind of music and uses that they are interested in. It then asks them to provide data on their operation (such as the size of their business, the size of the audience, the duration of the operation, etc.), and determines the license fees that the user must pay for that use (according to the fee schedules of each of the relevant copyright collectives). After obtaining the user's credit card and mailing details, the RCH processes a license that is mailed to the user.

There are some important features of the RCH that are relevant to our discussion. One is that the RCH only brokers licenses that are then issued by the relevant *copyright collective*, not by the *individual* songwriters or other *individual* copyright holders (e.g., publishers, record companies, etc.). However, this probably only reflects the fact that the RCH is sponsored by copyright collectives as well as the current practice of collective licensing in Canada, whereby many rights are administered exclusively by collectives. Nevertheless technically, a similar concept could work with individual right-holders as well. Such right-holders could in theory authorize multiple portals, not only the RCH, to license on their behalf.

A second point is that the RCH uses the internet only for the purpose of licensing;¹⁹⁴ the RCH does not distribute the music itself, which the user is assumed to hold a copy of. Third, one of the stated purposes of the RCH is to solve the inefficiencies that result when the rights for a single use are fragmented among different right-holders; the RCH obtains the necessary licenses from the relevant right-holders and provides the user with a cleared-parcel (although without the song itself). However, since the RCH has no discretion with regard

¹⁹² See <http://www.rightsclearinghouse.ca/> (last visited, Jan. 16, 2004).

¹⁹³ Each of these options involves different copyright collective. Performance of live music requires a license from SOCAN only; performance of recorded music requires, in addition, a license from the NRCC who administers the rights of producers of sound recording and performers, see *infra* Part V.B. The making and distribution of CDs involves the right to make copies (the mechanical right) and distribute them and the use of music in a public presentation or a video implicates both the mechanical right and the public performance right.

¹⁹⁴ Currently, the licensing process of the RCH is less efficient as it could have been. The RCH determines who should grant the license and calculates the applicable fees, yet the license itself is not delivered online but rather by traditional mail.

to pricing – it only quotes the prices of the relevant collectives – it does not solve the problem of anticommons pricing when multiple licenses are required. The RCH model, thus, uses the Internet to lower the costs of only one aspect of music administration, licensing. The RCH reduces the costs involved in matching between users and right-holders and obtaining information about the user (thus enabling price discrimination). The RCH deals only partially with the problem of fragmentation; it only saves the cost of locating and contacting multiple right-owners but does not prevent inefficient overcharging. The RCH model does not deal with the other aspects of administration: it does not distribute the music itself, nor is capable of monitoring unauthorized uses and does not provide tools for enforcement.

The Internet, of course, could also be used for efficiently distributing the music files themselves, as demonstrated by the unauthorized music online services since Napster and its progeny and the new authorized online music such as Apple's iTunes, Rhapsody, BuyMusic.com or the new Napster. Yet the Internet *per se* does not provide copyright holders an efficient mechanism for effectively controlling the use of their music, and for collecting money for it. This could be achieved by implementing Digital Rights Managements systems.

2. Digital Rights Management

Digital Rights Management systems (DRM) are designed to control access to and use of digital content such as music, video, text or computer software. This can be achieved by implementing various technological protection measures, typically encryption techniques.¹⁹⁵ By implementing DRM technologies a publisher of digital content can determine the conditions of its use and make sure that the content is available to users only after payment has been secured.

DRM systems employ different techniques that can identify users and trace back unauthorized copied content (*e.g.*, serial numbers, digital fingerprints, traitor tracing). Various techniques are used to ensure the integrity and authenticity of digital content, its accompanying metadata and the hardware and software components of a DRM system (*e.g.*, digital signatures, fragile watermarks, challenge-response protocols). Furthermore, tamper-proof hard- and software (*e.g.*, smart cards, code obfuscation) can be used to complicate security attacks on the system, and in order to prevent, or at least make more difficult the copying of

¹⁹⁵ See Stefan Bechthold, *From Copyright to Information Law – Implications of Digital Rights Management*, in SECURITY AND PRIVACY IN DIGITAL RIGHTS MANAGEMENT 213 (Tomas Sander, ed., 2002).

protected content after it has been transformed into an analog format.¹⁹⁶ While many DRM systems are designed to be implemented online, DRM systems could be implemented offline as well.¹⁹⁷

DRM technologies have been implemented by all of the new online services that allow legal downloading of music such as Apple Computer's iTunes Music Store, Real Networks' Rhapsody music service, BuyMusic.com, or Pressplay, re-launched as the new Napster in October 2003. These services allow users to listen to samples of songs, and buy individual songs for prices starting from US\$0.79 or full albums from US\$7.95. Once songs are purchased, the embedded DRM technology determines whether the file could be saved on a hard disk and the number of PCs on which it could be saved, determines whether and how many times the file could be transferred to portable devices, or whether and how many times the file could be burned on a CD. These conditions vary among the different services, and sometimes among the different songs within a service.¹⁹⁸

Several points are worth noting. First, the repertoires of all services are largely overlapping; all of them offer the repertoires of the five major music groups, as well as songs from independent artists and record labels. These repertoires, however, are smaller than the entire worldwide repertoire currently offered by PROs to their customers. It does not seem that an ability to offer the whole worldwide repertoire is considered imperative by those services and apparently a smaller scope of songs is sufficient to satisfy most of their customers' needs. Since it is reasonable to assume that generally the music that is sold and purchased is the same music that it publicly performed, one of the advantages of collective administration – the accessibility to the whole worldwide repertoire – is probably overstated.¹⁹⁹ Second, online distribution of music seems to be

¹⁹⁶ Id.

¹⁹⁷ DVD disks and players, for example, contain technology that protects prevents their copying (the Content Scrambling System – CSS) and imposes geographic limitations on the use of DVDs. Regional DVD coding prevents users who bought a DVD disk in one of zones of the world (assigned by the creators of the technology) on a player bought in another, thus facilitating geographic price discrimination. DVD disks and players can be purchased online, yet as physical objects they cannot be delivered online.

¹⁹⁸ See e.g., <http://www.apple.com/itunes/overview.html>, http://www.listen.com/rhap_about.jsp, <http://www.buymusic.com/support/legal.aspx>, <http://www.napster.com/terms.html>, (all last visited Jan. 20, 2004).

¹⁹⁹ Although home users and public performers are different kinds of customers, it seems that public performers and home users generally demand the same music because the audience of public performers is ultimately the same home users. The correlation between was music that is publicly performed and music that is privately purchased by home users is verified by the exiting of payola discussed above, in Part III.E.

developing into a competitive business. In addition to the services mentioned earlier, Wal-Mart recently launched its own online music service, cutting down prices to US\$0.88 per song, and many other players, such as Microsoft, Hewlett-Packard, Sony and Dell, are planning to enter the market soon. Such developments have been stated as one of the reasons for the US Department of Justice decision to close its digital music antitrust investigation, opened in 2001.²⁰⁰

Interestingly, however, none of these services offers the licensing of performing rights, nor does any other online service. The limitation of technology at its current stage might provide only a partial explanation. Technically, DRM technology cannot probably distinguish whether, once access to the music is granted, its performance will be public or non-public. The technology can prevent the transformation of the digital file into an analog signal, yet it cannot determine how many people would listen to the sound that will be produced by the loudspeaker after it transforms the analog signal into actual sound, nor what the social or economic context of the performance is (*i.e.*, whether it is public or private, for-profit or non-profit, etc.). Similarly, as long as broadcasting technology is not fully digital (and this might change in the near future), DRM cannot prevent a broadcaster from broadcasting the analog signal that it produces from the digital file, whether it has been protected or not. However, such limitations do not imply that DRM technology could not be used to license and enforce performing rights online. If *access* to the song is enabled only after payment has been secured, DRM technology can facilitate an effective form of price discrimination because the user may be required to identify herself in advance and be monitored afterwards.²⁰¹ Thus home users (and different types thereof) will pay different prices from public performers, and payment among different public performers would vary as well.²⁰²

²⁰⁰ See Statement By Assistant Attorney General R. Hewitt Pate Regarding the Closing of the Digital Music Investigation, Dec. 23, 2003, *available at* http://www.usdoj.gov/atr/public/press_releases/2003/201946.htm (last visited Jan. 21, 2004).

²⁰¹ See Jonathan D. Putnam, *The Economics of Digital Copyright in the Knowledge-Based Economy*, in INTELLECTUAL PROPERTY RIGHTS AND INNOVATION IN THE KNOWLEDGE-BASED ECONOMY (Jonathan D. Putnam ed., Calgary: University of Calgary Press, forthcoming 2003). In fact, if DRM technology is effective and is also backed by anti-circumvention rules, it effectively nullifies the need for the public performance right.

²⁰² In a sense, the control over access to music created by technology obviates the role of copyright law in facilitating price discrimination. If technology can determine that a radio station would pay more than a home user for access and use of music it, there is no practical need in a separate right for public performance. *Cf.* Corey Field, *New Uses and New Percentages: Music Contracts, Royalties, and Distribution Models in the Digital Millennium*, 7 UCLA ENT. L. REV. 289 (2000); and Lemley *supra* note 67 for a discussion of the convergence of rights in the digital realm.

Of course, users might try to cheat by identifying themselves as home or low value users when in fact they are high value users. This might not be so simple, nonetheless. Unlike today, when the purchase of a CD is usually anonymous, DRM can require the user to identify in advance. Users might provide false identities, but doing so might invalidate the license and have other legal consequences. In addition, since identification or authentication might be required for each transaction or each use – at least when DRM is used online - the chances of being detected increase. Moreover, broadcasters, which are the most important users of music and to whom music is a primary input, are easily detectable and probably cannot cheat on a regular basis without taking significant risks. In addition, technological advances in detection (such as those described in the next paragraph) can make cheating more difficult. Using such systems, a radio station that gained access to DRM protected music by falsely identifying itself as a restaurant, for example, could be easily detected. In sum, while DRM technology itself might not necessarily distinguish between public performers (and different kinds thereof) and other users, by creating a gatekeeper that requires identification prior to access and by enabling continued monitoring, technology could reduce the cost of effective identification and monitoring, and limit the opportunities to falsified identifications and arbitrage, thus making price discrimination less costly, and therefore more prevalent, than it would have been otherwise.

3. Advances in Monitoring Technologies

Until recently, monitoring technology was a low-tech enterprise. In order to know whether music had been publicly performed, what music had been performed and by whom, copyright holders needed to physically monitor every user on a constant basis. The cost ineffectiveness of this monitoring technology is obvious. PROs issuing blanket licenses have been the cost-effective solution for the problem of identifying who performs music, while detailed reports by broadcasters indicating the music they had played, and surveys in the case of other public performers, were used in order to know what music had been performed and distribute the royalties accordingly.

This is probably changing. Technologies that enable computerized automatic scanning and tracking of all songs, jingles, movies and video clips as they are aired are currently available. Such technologies can allow copyright holders to know which of their works have been broadcast and by whom. Such a system has been recently implemented by ACUM, an Israeli PRO, and is reported to

significantly improve the accuracy of monitoring and the resulting accuracy of royalty distribution.²⁰³ It is not imperative, however, that only PRO use such a system; it could be used by individual publishers or outsourced to third parties that would sell the information to copyright holders. It is worth noting, however, that the system, because it is based on capturing music that is broadcasted over the air cannot be used to monitor other, non-broadcast, public performances.

4. Managing Performing Rights Digitally Online

My purpose now is to evaluate the possible effects of such technologies on the case for collective administration of performing rights. This is a tricky task, however, because currently there is no operating business model that could be analyzed. In addition, each of the three technologies that I described: the Internet, DRM, and computerized scanning could be utilized to improve the efficiency of the administration of performing rights with or without being combined with the other technologies. Therefore, I will analyze a hypothetical business model on the premise that my assumptions and predictions are realistic.

My hypothetical model combines two technologies, the Internet and DRM, and is similar to the several existing online sellers of music. My hypothetical model involves online licensing and distribution of music protected by DRM technology. In this model music in a digital form (a single song or an entire album) is 'wrapped' in DRM technology that prevents its unauthorized use and specifies what uses are allowed. The file is distributed online and contains a micro-payment system. The payment can be on a per-song-per-use basis (*i.e.*, different prices for different songs and different prices for different types of uses, *e.g.*, listen only, copy, share with other users, publicly perform, etc.), or be based on various kinds of blanket licenses (*e.g.*, use any song from the seller's repertoire unlimited times, use any song a limited number of times, use only a specific song but unlimited times, etc.). The model could be supplemented by computerized scanning technologies in order to discourage broadcasters from airing music obtained by cheating on the DRM system or from airing music obtained in a non-DRM-protected form (*e.g.*, existing CDs).

Despite the lack of such services in practice it is not difficult to imagine DJ's in radio stations or a discotheque disposing of their collections of CDs and

²⁰³ See ACUM, *The Future is Already Here*, Sept. 19, 2002, at <http://makeashorterlink.com/?H33E51976>, see also Press Release: ACUM Israel Copyright Society Moves to Fully Deploy Idioma CopyrightScanner™, Jan. 7, 2002, available at <http://www.idiomasolutions.com/> (last visited November 7, 2003).

replacing them in a PC displaying on its screen a catalogue of songs available for performance by an online seller of music.²⁰⁴ The imagination needs not to be stretched very far in order to envision a price tag attached to each song, to different bundles of songs or to other various modes of payment. Additionally, the DJ can deal with a single or multiple competing sellers offering different or overlapping catalogues and choose the best available offer at any moment.

5. The Internet, DRM and the Case for Natural Monopoly

In the previous part of the article I analyzed the cost advantages that are usually attributed to PROs and considered whether they fit the natural monopoly paradigm. One set of efficiencies emanated from economies of scale and scope of licensing: the reduced costs of search, negotiations, and distribution of royalties that occur when licensing is done by at a one-stop shop. I argued, however, that while such economies of scale and scope can explain the existence of music publishers and other intermediaries they insufficiently explain why the minimum efficient scale for the administration of performing rights leads to a natural monopoly. Since the Internet can reduce many of these costs the case for a natural monopoly is weakened even further.

In addition, DRM can streamline the processes of licensing and royalty collection and simplify and automate the process of royalty distribution between all rights-holders. While users would probably still find it attractive to source their music from sellers who can offer a wide repertoire of songs it seems entirely plausible that there could be multiple sellers offering overlapping wide catalogues (as is currently happening in the online business of home digital music), as well as some niche sellers specializing in specific genres or artists. Even if there are diseconomies of scale for the application of DRM by *individual songwriters* (assuming that individual authors do not necessarily have the economic resources or the technical skills to implement DRM technologies for their own works) this hardly implies that the application of such technologies requires collective action on behalf of *all* of them.

An area which perhaps exhibits some more convincing tendencies towards natural monopoly is monitoring and enforcement. Recall that it is much easier to monitor infringement when the only two options are either that a user had

²⁰⁴ In fact, ASCAP and BMI already have online databases of the titles in their respective repertoires. For each title, it is possible to find the names of the songwriters and the names, contact persons, addresses and, in most cases, phone numbers of publishers to contact. The databases do not contain, however, functions of licensing or enable access to the works. See <http://www.ascap.com/ace/ace.html> and <http://repertoire.bmi.com> (last visited Feb. 21, 2003)

obtained a blanket license from a PRO (and is therefore entitled to perform any song, anytime), or had not obtained such a license (and therefore is not entitled to perform any song at all). Recall also that enforcement is much more efficient when a PRO can credibly threaten to withhold the entire repertoire, compared to an individual songwriter or publisher that can only threaten to withhold his own songs. These two advantages become less significant when DRM technology is implemented because DRM makes obtaining a license a precondition to access a matter of business reality rather than only a legal requirement; with DRM a license is required *de facto*, not only *de jure*. If technology makes access to music and its performance available only to users who obtain a license, monitoring and enforcement are built-in to every song. The minimum efficient scale for monitoring and enforcement thus depends on a copyright holder's ability to implement the technology. There is no reason to suggest that only PROs would have the minimum efficient scale to implement such technologies.²⁰⁵

Similarly, DRM technology obviates the benefit for users from using the blanket license as a tool to minimize the risk of inadvertently playing unlicensed songs (which is most effective when all music is covered by that license).²⁰⁶ With DRM technology there is no need for such a tool because copyright holders and users alike can be assured that only licensed music would be performed. This can be achieved without impairing users' ability to have rapid and unplanned access to music. In order to minimize the legal risk associated with public performance all that a user would have to do is to perform only music downloaded from or streamed by legitimate online sellers and the technology would further ensure that it would be difficult for unauthorized sellers to offer such music. Therefore, as long as that risk-management function has been critical to risk-averse users and made PROs natural monopolies, DRM technology could provide such users the same assurance under competition.

The problems of anticommons in public performance – another possible justification for collective administration – do not seem to be directly changed by the Internet or by implementation of DRM technologies. At the level of individual songs, the fragmentation of copyrights would remain a potential obstacle for efficient licensing as long as songwriting and production remain a collaborative undertaking. Yet, DRM and the Internet could, by enabling

²⁰⁵ Those predictions assume that music will be distributed only in protected form and that unprotected music will be no longer available. In Part VI.2 *infra* I will relax this assumption and discuss further complications, such as the need to enforce rights for existing music which is available in an unprotected form.

²⁰⁶ See Part III.C.2 *supra*.

potentially more competitive markets, contribute to the creation of incentives to create cleared-parcels that solve this problem. Additionally, just as it is possible for a DRM system to automatically charge a user's account and credit the seller's account, it is possible to further credit the accounts of all claimants in each song according to the royalty distribution ratio that they have contractually predetermined.

The Internet and DRM technology cannot solve the problem that arises when complementary works are licensed by separate right holders,²⁰⁷ yet the difference between the economies of music licensing and distribution in the offline world and the online world can narrow the extent of this problem. Transactions in the offline world are characterized by some relatively high fixed cost per transaction and an additional infinitesimal marginal cost for licensing additional songs in the same transaction. One manifestation of this is the music album on a CD (or its predecessor, the vinyl record). Because a single CD can contain more data than the data of a typical song and there is some fixed cost in burning, packaging and shipping every CD regardless of the number of songs on it, the per-song cost of an album (several songs bundled together) is lower than the per-song cost of a single. Therefore, it makes sense to sell albums and not singles. Similarly, because granting a license for performing rights involves some fixed cost and almost no cost for each additional song it is more efficient to sell blanket licenses, whether the licensor is a PRO or an individual copyright holder.²⁰⁸ In the online world, however, there is no significant cost advantage in such bundling and per-song licensing of songs is therefore more likely.²⁰⁹ This has important implications for the licensing of performing rights, because the problem that arises from complementarity correlates to the number of available options that the consumer can choose from; this number influences the question whether songs are predominantly complements or substitutes. I have earlier hypothesized that public performance might be create anticommons situations if

²⁰⁷ See Part III.B.2.b *supra*.

²⁰⁸ See Besen et. al., *supra* note 39, at 408.

²⁰⁹ The assumption here is that because DRM automates many aspects of the transaction (verification of the identity of the parties, negotiation, and payment) there are no significant economies of scale in licensing a bundle of several songs relative to the licensing of a single song. This is not to say that online per-song licensing could not be more costly than online blanket licensing, as a result dependency on increased computing resources, for example. But whether such additional cost makes per-song licensing prohibitively costly is, of course, an empirical question. My assumption is that it is not. A partial verification of this assumption is the tendency of all of the new online music sellers to offer their repertoires on a per-song basis, *see supra* note 198 and accompanying text.

users could not effectively compete with each other without obtaining a blanket license from each of the majors.²¹⁰ If the dominant model changes to per-song licensing, however, the number of available substitutes could grow substantially. If the market moves to per-song distribution of songs it may also positively affect the creation of cleared-parcels because the competitive advantage of pre-cleared songs might become more apparent.

Online distribution of DRM protected music cannot solve the problem of users who need a blanket license because they perform music selected by others, on which they have no, or very limited, control (*e.g.*, establishments that perform music broadcast on the radio, TV stations that broadcast syndicated programs, theater owners that exhibit films, etc.). In their case PROs remain a solution to what otherwise could turn into a tragedy of the anticommons. Yet, as I have earlier argued, source-licensing by the producers of such programs at the time of production could be a more competitive and equally effective solution to the problem. So far, apart from the case of the US film industry, courts and regulators have been reluctant to compel source-licensing, and attempts by users to force copyright holders to source-license their works in other cases have failed.²¹¹ Nevertheless, the emergence of new technologies that can facilitate a competitive market for performing rights as an efficient alternative to blanket licensing might serve as an invitation to courts and regulators to revisit their former attitude, particularly if it could be shown how PROs and the blanket license reduce the incentives for the development of such alternative.²¹² The AFJ2 which contains new provisions aimed at encouraging such developments and discouraging former practices that barred them, might signal a first step in this direction.

* * *

The combination of the Internet and DRM technology can alter the way music will be distributed and can introduce new and efficient methods for administering performing rights. By reducing the costs of all aspects of administration, these technologies could be used to create a competitive market place for public performance and present an alternative to the practice of blanket licensing by PROs. Although I have serious doubts whether this has truly been the case, so far PROs have been widely assumed to be a solution to the impracticability of efficient individual administration, despite their adverse

²¹⁰ See Part III.B.2.b *supra*.

²¹¹ See *e.g.*, *Buffalo Broadcasting*, *supra* note 94.

²¹² See Part III.D *supra*.

impact on competition. Therefore, if technology can make a competitive marketplace for individual licensing of performing right at least as efficient as collective licensing, it must be assumed that this alternative – which does not require trading-off the efficiency of administration against the efficiency of competition – is preferable, at least until otherwise shown.

V. The Prospects of DRM-Based Licensing in the US and Canada: A Comparative Outlook

The fact that technology can render more competitive models of organization possible does not, of course, imply that these models would develop *sua sponte*. Economic and legal barriers may impede such evolution and the removal of those barriers might be thwarted by those who are likely to lose from the change. In this part I will speculate on the possibility of the development of a DRM-based competitive market for performing rights; whether market forces alone would be powerful enough to change existing practices or whether regulatory intervention – under the antitrust laws or perhaps through other forms of regulatory reform – would be necessary. I will also explore the question of whether there should remain any role for PROs in the future of digital music. My analysis will compare the market for performing rights under two models: the US model and the Canadian model (which is similar to the model applied in many industrialized countries).

For the ease of the analysis I will use a simplified version of the US model, that existed prior to 1995, before new and additional performing rights in certain online transmissions were granted to producers of sound recordings and to performing artists.²¹³ Under this model, which still applies to the majority of the industry, there is only one layer of performing rights, *i.e.*, authorization is required only from authors and composers, but not from producers of sound recordings and performing artists. In addition, under the US model PROs hold only non-exclusive rights. Finally, there exists a lack of statutory support for PROs; rather they have a legacy of antitrust scrutiny and antitrust-based oversight. In contrast, the Canadian model is a multi-layered copyright system: producers of sound recordings and performing artists have intellectual property rights in public performance in addition to authors and composers; right-holders grant their PROs exclusive rights for licensing public performance; and the operation of PROs has been traditionally regulated under the provisions of the Copyright Act, with virtually no role for competition law. Since both models

²¹³ See Part V.A.1 *infra*.

developed in earlier years I will explore their adaptability to the new world of online digital music. I will also examine how the recent changes in the US copyright law affect that adaptability.

A. The US Model

The US seems to be the ideal market for the development of a competitive, DRM-enabled, market for performing rights. It is a center for both sectors: music and technology, and a primary place for the development and marketing of new digital technologies. Unsurprisingly, all of the new initiatives for online distribution of music are based in the US.²¹⁴ In addition the US is home for some members of the broadcast industry – the main customers of performing rights – who are probably powerful and sophisticated enough to seek opportunities that would lower their costs.²¹⁵ Moreover, relative to other jurisdictions, the regulatory environment in the US is probably the most conducive to such developments. Unlike many other jurisdictions, copyright holders in the US do not assign their copyrights to the PROs and are legally free to license their rights individually if they wish. Moreover, section IV(B) of the new consent decree governing the operations of ASCAP (AFJ2),²¹⁶ provides that ASCAP cannot impede its members from issuing licenses directly or through an agent. While a member's right to license directly was part of the terms of the previous consent decrees, those terms were ambiguous as to whether ASCAP could prohibit (or refuse to recognize) licenses granted by its members through agents. The new provisions of the AFJ2 make it clear that members can license through agents as well.²¹⁷ Since even in a competitive DRM-enabled market most songwriters would probably not license their music directly but use intermediaries, the new consent decree removes an important barrier to the development of such a market.

Furthermore, because in most cases the US system comprises only one layer of copyright, users must obtain licenses only from the songwriters (or the publishers who acquired their rights), and do not need an additional license from

²¹⁴ At the time this paper is written the market for legal online music is US exclusive, *see* May Wong, Legal Online Music Business Is U.S.-Only at http://news.findlaw.com/ap/ht/1700/7-29-2003/20030729063003_08.html (last visited July 31, 2003).

²¹⁵ *Cf.* Cirace, *supra* note 41, at 281 (describing the market for performing rights, in the case of broadcast, as bilateral oligopoly whereby several sellers, ASCAP and BMI, confront three major buyers, CBS, ABC and NBC).

²¹⁶ AFJ2, *supra* note 17.

²¹⁷ *See* AFJ2 Memorandum at 19.

the record company or the performing artists. This feature makes the life of potential entrants to the online licensing market easier, since they need to negotiate with only one set of copyright holders. In addition, US PROs have no special statutory status and although attempts to undermine their existence were unsuccessful, the legal system is accustomed to reviewing their practices under the antitrust laws and has outlawed some of them.²¹⁸ Hopefully, this history of review causes US PROs to be wary of blatant anti-competitive behavior aimed at discouraging the development of alternative licensing methods.

The existence of three US PROs (rather than one as is the case in most countries) might also lower barriers to entry because users would probably prefer experimenting with a new licensing service before they decide to actually switch to a new system on a full scale. If only one PRO existed, a user who wished only to experiment with the new service would have to pay an extra cost for the new service, or alternatively, the provider of the new service would have to subsidize the experiment. When more than one PRO exists, however, such users could choose, for example, to substitute for a trial period the new service for songs from the ASCAP repertoire while keeping a blanket license from BMI for the rest of their music needs.

In sum, if there is a market in which DRM technology could be introduced and profitably facilitate efficient individual and competitive licensing of performing rights, the US would be such a market. In fact, the US music industry has embarked, perhaps hesitantly, on several initiatives for online licensing of music. Services such as Apple's iTunes, Real Networks' Rhapsody or Pressplay use DRM technologies to distribute music online for the home user on an on-demand basis. Warner-Chappell Music, through its OneStopTrax.com website, offers limited opportunities for licensing pre-cleared songs for synchronization in motion pictures, TV programs and other media but not for traditional public performance. ASCAP and BMI have made their databases available online where it is possible to obtain information, if imperfect, about the songs in their repertoires, including the publisher of every song and its contact details.²¹⁹ BMI

²¹⁸ But see Noel L. Hillman, *Intractable Consent: A Legislative Solution to the Problem of the Aging Consent Decrees in United States v. ASCAP and United States v. BMI*, 8 *FORDHAM INTELL. PROP. MEDIA & ENT. L. J.* 733 (1998) (blaming the consent decrees governing ASCAP and BMI for creating "artificial and illusory constraints on ASCAP monopoly power [that] would create a market structure in an atmosphere of governmental neglect that, even after years of sometimes bitter litigation by the nominal beneficiaries of the decrees, would insulate ASCAP from the more natural constraints of price competition.")

²¹⁹ ASCAP's database is available at <http://www.ascap.com/ace/>; BMI's repertoire is available at <http://repertoire.bmi.com/>;

also offers online licensing for websites on a blanket basis. SESAC allows similar online access to its database of works and also offers online licensing for some classes of users.²²⁰

The experience so far indicates that the industry has not yet combined the online distribution of music with online licensing of its public performance. It seems that the industry maintains the traditional division between what is sold individually and what is sold collectively. Digital songs are sold online on an individual basis by online merchants just like records or music sheets have been traditionally sold by music stores; similarly, synchronization rights, which have also been licensed individually, are partially available online. Performing rights, however, even when licensed online, seem to be licensed only by PROs and on a blanket basis.

There could be several explanations for the absence of performing rights licensing from the online world. One explanation is that we do not see new DRM-based business models for licensing performing rights *yet*, because the technology is not ripe enough, but once it matures the appropriate business models will start to emerge. Under this explanation it is just a matter of time before copyright holders begin offering their DRM-protected content to public performers through online sellers. This optimistic scenario is based on an assumption that the ability of copyright holders and public performers to efficiently transact directly will ultimately destabilize the collective mode of licensing, because when individual licensing is practicable, PROs become unstable like any other cartel. This view would stress that defection should be especially likely within organizations like PROs, given that their thousands of members cannot practically agree not to license except through the PRO, and given what seems to be low barriers to entry to songwriting.

A variant of this scenario does not necessarily predict the total demise of collective licensing. The argument is that DRM technology makes individual licensing a better competitor to collective licensing than it has traditionally been – *i.e.*, that the market for licensing is more contestable – so, if PROs are not to disappear it is because they still offer some cost savings for users not attainable through individual licensing. The increased contestability, however, would set an effective ceiling on the prices that PROs can charge and would force those

²²⁰ See <http://www.sesac.com/licensing/click.asp>.

prices further down towards the competitive level.²²¹ Under this explanation PROs are still natural monopolies but will be more contested than ever.

Another explanation is more pessimistic – at least with regard to the prospects of competition. Under this scenario the Internet and DRM technology will not fundamentally change the economics of the administration of performing rights and therefore will not change the natural monopoly character of PROs. Technology will not make individual and competitive licensing a viable alternative to blanket licensing by PROs, who would remain the only practicable method of licensing performing rights. Therefore, the only way to tackle PROs' monopoly power would remain regulatory oversight. The even more pessimistic variant of this scenario is the adoption of DRM technology by PROs in a manner that will only enhance their power. In this scenario, DRM systems will identify users who publicly perform music and will deny them access to music until they paid what the PRO demands. The checks on the power of the PRO will be significantly smaller than they presently are, because unlike today, the denial of access would be immediate and not contingent on a court's willingness to issue an injunction.²²²

Between the optimistic and the pessimistic scenarios is the realistic one. The realistic scenario sees the potential for DRM-based licensing models to replace collective licensing but recognizes that there are impediments that may prevent or delay that process from occurring. The argument here is that market forces alone might not be powerful enough to destabilize existing PROs in the foreseeable future, nor to render them free of any anti-competitive aspect. For example, the same factors that have limited the contestability of PROs so far (the effect of the blanket license, the high concentration level in the industry and high barriers to entry) might also prevent or significantly retard the switch to the new technology and the new competitive market that it may create.

In addition, anti-payola rules and anti-payola sentiments among the public may have a chilling effect on competition, at least in such cases when the competitive process would lead to a reverse flow of payments: from copyright holders to public performers. Therefore, some form of regulatory intervention might be required for pushing the market in the competitive direction. This intervention may not be simple. The copyright industry is well known for successful lobbying, and there is no reason to assume that heavy lobbying efforts would not

²²¹ Cf. Landes, *supra* note 19, at 634 (describing the role of potential direct licensing in imposing a limit on the prices of ASCAP).

²²² Such potential development will be discussed in more detail in Part VII *infra*.

be made to prevent such intervention. International obligations in the area of intellectual property might have an additional chilling effect on the ability and willingness of regulators in a single country to try eliminating a practice widely endorsed worldwide.²²³

1. Digital Performance Right in Sound Recordings

Another complication that may impede the development of a competitive market for performing rights is the Digital Performance Right in Sound Recording Act (DPRA)²²⁴ that the US Congress enacted in 1995. The DPRA created a new performing right in sound recordings granted to producers of sound recording and performers. It did not create, however, a general performing right in sound recordings, but rather a “carefully crafted and narrow performance right, applicable only to certain digital transmissions of sound recordings.”²²⁵ The new public performance right in sound recordings was limited to: (1) transmissions, as opposed to live performances (thereby exempting concerts, restaurants, dances, amusement parks, etc.); (2) of audio works, as opposed to audiovisual works (thereby exempting transmissions of movies); (3) that occur in digital format, as opposed to analog (thereby exempting contemporaneous AM and FM radio stations, and contemporaneous TV stations as well); and (4) even as to digital audio transmissions, almost exclusively to subscription and interactive services (which themselves are subject to compulsory licenses and regulated

²²³ For example, since collective administration is the norm throughout the world and the practice is considered indispensable for the exploitation of the performing right, an individual country’s attempt to ban the practice might be challenged on the grounds that it undermines the economic value of the performing right and thus incompatible with this country’s international obligations under Article 9 of TRIPS (Agreement on Trade-Related Aspects of Intellectual Property Rights, Apr. 15, 1994, Marrakesh, Agreement Establishing the World Trade Organization, Annex 1C, LEGAL INSTRUMENTS – RESULTS OF THE URUGUAY ROUND vol. 31, 33 I.L.M. 81 (1994)) (which incorporates the rights granted in the Berne Convention (Paris Act of the Berne Convention for the Protection of Literary and Artistic Works of July 24, 1971), including the right of public performance). My point here is not to argue whether such an argument is valid or not, and even if it is, whether a country can still ban the practice on the basis of Article 8 of TRIPS which allows countries to take appropriate measures needed to prevent practices that unreasonably restrain trade or Article 13, which allows countries to set reasonable limitations and exceptions to copyrights. My point here is simply to demonstrate the possibility that international obligations in the area of intellectual property might create a chilling effect on an individual country’s ability to challenge collective administration, because doing so might involve international scrutiny.

²²⁴ The Digital Performance Right in Sound Recording Act of 1995, Pub. L. No. 104-39, 109 Stat. 336 (1995).

²²⁵ H. Rep. (DPRA), p. 12.

“voluntary” licenses, respectively).²²⁶ In 1998, the Digital Millennium Copyright Act (DMCA) amended the DPRA and added more services, such as webcasters (which offer neither subscription nor interactive services), to the list of services that must obtain a license for the transmission of sound recordings.²²⁷ The public performance right established by these laws falls primarily into two categories. One category is services such as interactive or on-demand services, for which copyright owners have an exclusive right. This means that individual copyright owners are free to decide whether to license or not to license such transmissions. Other services may qualify for a “statutory license” - granted by law provided that the transmission service abides by certain conditions. The DPRA provides that the rates applicable to statutory licenses should be negotiated and agreed on by the affected parties and, absent such agreement, by the copyright arbitration royalty panel.²²⁸

The DPRA envisages a model of collective licensing, particularly in the case of uses that qualify for a statutory license. The Act authorizes copyright holders to designate common agents on a nonexclusive basis in order to negotiate, agree to, pay, or receive payments, and grants interested parties an exemption from any provision of the antitrust laws if they pursue this course.²²⁹ In large part the DPRA follows the US model for the regulation of PROs under the ASCAP and BMI consent decrees. In both cases copyright holders are allowed to license their rights collectively, but their rates can be determined by a judicial third party should negotiations with users fail. In both cases the copyright holders’ common agent may hold only non-exclusive rights. In fact US record companies embraced the collective licensing model and designated the Recording Industry Association of America (RIAA), their trade association, as a new PRO that licenses and collects royalties under the compulsory license regime. The new PRO has been named SoundExchange and is an unincorporated division of the RIAA, directed by a separate Governance Committee.²³⁰

In the case of voluntary licenses (*i.e.*, services not entitled to a statutory license) the Act envisages a different model. Copyright holders “may designate common agents to act on their behalf to grant licenses and receive and remit royalty

²²⁶ Melville B. Nimmer & David Nimmer, *Nimmer On Copyright*, §8.21[B] (Release 59, December 2002).

²²⁷ *Id.* at §8.22[D]

²²⁸ 17 U.S.C.A. §114(f).

²²⁹ 17 U.S.C. § 114(e)(1).

²³⁰ <http://www.soundexchange.com/qanda.cfm> (last visited April 2, 2003).

payments.”²³¹ The antitrust exemption applies only as long as “each copyright owner shall establish the royalty rates and material license terms and conditions unilaterally, that is, not in agreement, combination, or concert with other copyright owners of sound recordings.”²³²

The vast majority of current public performances of music are not affected by the new performing right in sound recording. Nevertheless, as I explain below when I describe the Canadian model, the addition of a new set of right holders does complicate the possibility that cleared-parcels of music, which are part of a competitive market, will emerge - at least for the services affected by the new right. It might also be that those digital services which operate online are technically and managerially more adaptable to a model of online licensing compared to ‘traditional’ users such as radio and TV stations or bars, whose managers might be more conservative. If this is the case, the addition of the new right complicates the creation of the competitive model particularly in the area where such development could have been natural.²³³

B. The Canadian Model – Even More Hurdles to Competition

1. Assignment of Performing Rights as a Barrier to Competition

If the transition to a competitive market for performing rights is likely to face hurdles in the US, the prospects for such a change in Canada are even slimmer. Unlike in the US where the consent decrees require that members of ASCAP and BMI grant the PROs only non-exclusive rights to license, SOCAN, their Canadian equivalent, administers exclusive performing rights. Any member of SOCAN must sign the Membership Agreement and Assignment of Performing Rights.²³⁴ By signing the agreement the writer or publisher, as the case may be, assigns to SOCAN *all* his performance rights in his existing and future works for the term of the agreement. The agreement not only uses the term ‘assignment’ - it explicitly states that the rights assigned are exclusive to SOCAN.

²³¹ 17 U.S.C. § 114(e)(2)(A)

²³² *Id.*

²³³ It must be noted, however, that unlike the Canadian case, the US legislation does not *mandate* collective licensing of the new right and preserves the ability to obtain individual licenses and form cleared-parcels that are essential for a competitive market.

²³⁴ A sample of the agreement is available in PAUL SANDERSON, *MUSICIANS AND THE LAW IN CANADA: A GUIDE TO THE LAW, CONTRACTS AND PRACTICE IN THE CANADIAN MUSIC BUSINESS* (3rd. rev. ed. 2000) (Appendix 1: SOCAN Membership Agreement and Assignment of Performing Rights).

Two elements in the agreement preclude any possibility for individual licensing by copyright holders or through third parties. One is the exclusivity granted to SOCAN and the other is the totality of the assigned rights, which prevent members from even experimenting with alternative methods of licensing by dedicating some works to other, non-SOCAN, licensing schemes. The only alternative for a Canadian songwriter or publisher who wishes to license his works individually is to terminate her membership or not to join SOCAN in the first place. The agreement also requires every SOCAN member to insert into any contract for the creation of a musical work a provision making such agreement subject to the SOCAN Membership and Assignment Agreement, thus limiting the ability to commission works from SOCAN members that will not be part of its exclusive repertoire.

These restrictions in the conditions for membership in SOCAN create an almost insurmountable barrier to the development of alternative licensing sources, because any entrepreneur seeking to enter the licensing market would find virtually no sources of supply of music, in addition to the barriers to entry that the blanket license creates. Of course, the entrepreneur could source her songs from SOCAN, (or any other PRO), but SOCAN would have no interest in granting her such licenses, at least not on competitive terms. Unfortunately, as we shall see next, this system discourages innovative licensing initiatives, yet seems to be able to withstand almost any challenge under Canada's competition law.

2. Specific Regulation and a Minimalist Role for Competition Law

Whereas south of its border antitrust law has been the major vehicle for the regulation of PROs, Canada's competition law has so far played virtually no role in their regulation. Although Canada was a pioneer in its attempts to regulate its PROs,²³⁵ it chose to do so by creating a special regulatory regime within its copyright legislation. As early as 1931 the *Copyright Amendment Act, 1931*²³⁶ attempted to impose on PROs a new mechanism for the setting of their royalty fees. The new act required that PROs submit to the Minister at the Copyright

²³⁵ *Composers, Authors and Publishers' Association of Canada Limited v. Sandholm Holdings Ltd.*, [1955] Ex. C.R. 244, 252 (Ex. Ct.) (Thorson J.: "So far as I am aware the Copyright Appeal Board was a unique institution. Canada was the only country in which the fixing of the fees, charges or royalties of performing rights societies was taken from them and vested in an administrative body such as the Copyright Appeal Board. The change was a radical one.")

²³⁶ S.C. 1931, c. 8.

Office lists of the works in their repertoires and the fees that they intend to charge for licensing their public performance. Subsection 10(2) expressed concern with the monopolistic nature of PROs and provided a mechanism for the revision and determination fees by the Governor in Council

“[w]henever in the opinion of the Minister, after an investigation and report by a Commissioner appointed under the *Inquiries Act*, any such society ... which exercises in Canada a substantial control of the performing rights ... unduly withholds the issue or grant of licenses for or in respect of the performance of such works ... or proposes to collect excessive fees ... or otherwise conducts its operations ... in a manner which is deemed to be detrimental to the interests of the public.”

Subsection 10(3) provided that PROs were not entitled to sue and collect fees in excess of the fees that they filed or those that were determined according to subsection 10(2). In 1935 the Copyright Act was amended by inserting two additional subsections to section 10 quoted above, providing additional restraints on the operations of PROs. One restraint barred a right of action for infringement of the performing right against any person who has tendered or paid the fees specified, revised or otherwise prescribed pursuant to that section; the other restraint barred (under certain conditions) the right of action pending enquiry pursuant to subsection 10(2).²³⁷ Fourteen months later, on June 1936, the Copyright Act was amended once again.²³⁸ A new mechanism was created, requiring PROs to submit all their proposed fees for review by a new administrative body – The Copyright Appeal Board - which became the price-setting authority.

Although the introduction of this regulatory regime in the 1930s parallels in time the first US antitrust challenge of ASCAP,²³⁹ it represents an entirely different approach. By the filing of criminal charges against ASCAP the US government challenged the mere existence of the PRO on antitrust grounds; in contrast, the Canadian initiative seems to have endorsed the idea of collective licensing and only tried to impose limits on the exercise of PROs' market power.²⁴⁰ It might be

²³⁷ An Act to amend The Copyright Amendment Act, 1931 (S.C. 1935, c. 18).

²³⁸ An Act to amend The Copyright Amendment Act, 1931 (S.C. 1936, c. 28).

²³⁹ See *supra* note 17.

²⁴⁰ Of course, the US and the Canadian approaches later converged and the US government has not tried to challenge the mere existence of PROs ever since. By entering into the consent decrees and through their periodical amendments the US government, like its northern neighbor,

representative of the Canadian approach at that time to favor imposing limitations on the exercise of intellectual property rights by special legislative mechanisms rather than through competition laws enforced by the judiciary.²⁴¹ It might also represent the general Canadian perception of that era that the problem with combines among businesses was not necessarily their existence, but rather their abusive behavior, which could nevertheless be regulated.²⁴²

The provisions of the Canadian Copyright Act concerning PROs have been modified several times since then – the last time in 1997. None of these amendments seem to envisage an important role for competition law in the oversight of PROs – perhaps the contrary. Under the current regime the existence of PROs is not questioned; rather, it is assumed. Section 2 of the Canadian Copyright Act²⁴³ contains a very broad definition of the term ‘collective societies’ to which to provisions of the Act apply. The definition, which is not limited to PROs but extends to other forms of collective administration in almost any imaginable aspect of copyright law, reads as follows:

“collective society” means a society, association or corporation that carries on the business of collective administration of copyright or of the remuneration right conferred by section 19 or 81 for the benefit of those who, by assignment, grant of licence, appointment of it as their agent or otherwise, authorize it to act on their behalf in relation to that collective administration, and

(a) operates a licensing scheme, applicable in relation to a repertoire of works, performer's performances, sound recordings or communication signals of more than one author, performer, sound recording maker or broadcaster, pursuant to which the society, association or corporation sets out classes of uses that it agrees to authorize under this Act, and the royalties and terms and conditions on which it agrees to authorize those classes of uses, or

endorsed a model of on-going regulation rather than competition. In *BMI v. CBS* the US government even filed an amicus brief in support of the idea of collective licensing, see Brief of Amicus Curiae United States, *BMI v. CBS*, 441 U.S. 1 (1979) (No. 77-1578, 77-1583) 1978 WL 207043.

²⁴¹ See generally Michael J. Trebilcock et. al, *The Law and Economics of Canadian Competition Policy* 588 (2002).

²⁴² *Id.*, at 13.

²⁴³ R.S. 1985, c. C-42 [hereinafter in this Part – *Copyright Act*].

(b) carries on the business of collecting and distributing royalties or levies payable pursuant to this Act;”

Sections 67 to 69 deal with PROs. Under these sections PROs in Canada must answer all requests from the public for information about their repertoires²⁴⁴ and must file with the Copyright Board²⁴⁵ their proposed tariffs.²⁴⁶ The Board must then consider the proposed tariff and any objections made thereto.²⁴⁷ If a PRO fails to file its tariffs with the board it is prohibited from enforcing its (and/or its members’) rights without written consent from the Minister of Consumer and Corporate Affairs.²⁴⁸ The definition of collective societies also contains the requirements that PROs operate licensing schemes pursuant to which they set out classes of uses that they agree to authorize.

3. PROs and the Regulated Industry Defence

The result of Canadian statutory scheme is that as long as a PRO agrees to license its repertoire and files its tariffs with the Copyright Board much of its actions, as well as mere existence, are probably immune from the provisions of Canadian competition law through the application of the Regulated Industry Defence.

The Regulated Industry Defence might be applicable in the case of a federal regulatory scheme that appears to conflict with the *Competition Act*.²⁴⁹ In such a case the conflict is resolved through an attempt to interpret the statutes so as to eliminate any apparent operational conflict. If such a conflict is unavoidable the courts will determine which of the regimes Parliament would have intended to take precedence.²⁵⁰

This defence has been applied specifically to PROs by the Canadian Federal Court in *Society of Composers, Authors and Music Publishers of Canada v. Landmark Cinemas of Canada Ltd.*²⁵¹ In this case the defendant unsuccessfully argued that the setting of the fees by the Canadian PRO (as altered and certified by Copyright

²⁴⁴ Copyright Act, s. 67.

²⁴⁵ The Copyright Board replaced the Copyright Appeal Board in 1988.

²⁴⁶ Copyright Act, s. 67.1.

²⁴⁷ *Id.*, s. 68.1.

²⁴⁸ *Id.*, s. 67.4.

²⁴⁹ R.S. 1985, c. C-34.

²⁵⁰ TREBILCOCK ET AL., *supra* note 241, at 691.

²⁵¹ [1992] 60 F.T.R. 161 [hereinafter – *SOCAN v. Landmark*]. S. 32 of the Competition Act deals with anti-competitive use of intellectual property rights and empowers the Federal Court to issue orders, upon application of the Attorney General, to remedy such abuses. It is unclear why s. 32 was used in this case and not s. 45 which deals more directly with conspiracies to fix prices.

Board) constitutes an illegal price fixing scheme, and otherwise contravenes the Competition Act.²⁵² The Federal Court dismissed that defense, noting that:

“[T]he activities of plaintiff and the Copyright Board within the framework of s. 67 of the Copyright Act are expressly sanctioned by federal legislation and therefore exempt from the operation of s. 32 of the Competition Act under the “Regulated Industry Defence”. The Board’s fee-setting activities fall within its explicit legislative mandate and its activities are deemed to be in the public interest.”²⁵³

The explicit regulatory scheme established in the Copyright Act and developed and extended over the years lends support to the application of the regulated industry defense and the line of reasoning adopted by the Federal Court in *SOCAN v. Landmark*. This approach can be strengthened by recourse to section 70.5 of the Copyright Act, which establishes a regulatory mechanism for the regulation of other types of collective societies that administer some rights other than public performance.²⁵⁴ Unlike PROs, collective societies subject to the regime of section 70.5 are not obliged to file their tariffs with the Board. Instead they may file with the Board agreements that they conclude with users, and if they do so section 45 of the Competition Act becomes inapplicable with regard to the agreement. In addition, the Commissioner of Competition may request the Board to examine the agreement if he believes that the filed agreement is contrary to the public interest. Although the inapplicability of section 45 of the Competition Act does not necessarily bar the application of other provisions of this act, the explicit but limited role designated for the Commissioner of Competition implies that Parliament did not envision a broader role for the Competition Act in the regulation of collective societies in cases other than those mentioned in section 70.5.

Even challenging the restrictive nature of SOCAN’s members’ total assignment of rights seems to be barred by the language of section 2 of the Copyright Act, which explicitly refers to ‘assignment’ as one of the forms of a creation of the collective society that is regulated by that Act.

However, since the Regulated Industry Defence is based on the presumed intent of Parliament, one could argue that the regulatory regime prescribed by the

²⁵² *Id.*

²⁵³ *Id.*

²⁵⁴ Such as the reproduction right.

Copyright Act rests on the presumption that PROs are an indispensable mechanism for the licensing of performing rights, and therefore the defence should apply only when the presumption is true. The argument would go that if it could be proved that PROs do not best serve the public interest anymore, as might be the case in the event of technological change, Parliament could not have intended to immunize PROs from the provisions of the *Competition Act*.

An attempt to conclusively resolve this issue is beyond the scope of this paper; for our purposes it is enough to note that if indeed the *Copyright Act* shields the existence of PROs from liability under the *Competition Act* (as seems to be the view of the Federal Court), competition law could not be used as an instrument for transforming the market for performing rights into a competitive one, even if the justification for collective licensing no longer exists. Such transition would require legislative reform. Since such reform is likely to be opposed by current copyright holders and their collective institutions it is difficult to predict whether the political process would yield such reform.

In any event, the Canadian Government currently unequivocally supports the model of collective licensing. The recent amendments to the *Copyright Act* in 1988 and 1997, which have widely endorsed the idea of collective licensing, were a result of a series of reports that unanimously supported the idea.²⁵⁵ In a recent report issued in the copyright reform process,²⁵⁶ the Canadian Government describes its efforts to encourage the model of collective copyright management, proudly mentioning that there currently exist 36 collectives in Canada, more than in any other country.²⁵⁷ In contrast to the view advocated in this article, the current position of the Government is that collective management of copyright is particularly relevant and important in the digital age.²⁵⁸ The Government's position rests on the assumption that "[c]ollective societies ... enable the licensing of copyright material when the individual management and enforcement of rights for specific uses [is] unmanageably complex, costly and time-consuming"²⁵⁹ and that the advent of digital technology only creates additional pressures to streamline collective management.²⁶⁰ The Government

²⁵⁵ Gervais & Maurushat, *supra* note 8, at 17.

²⁵⁶ Government of Canada, Supporting Culture and Innovation: Report on the Provisions and Operation of the Copyright Act 30-31 (2002), available at <http://strategis.ic.gc.ca/epic/internet/incrp-prda.nsf/vwGeneratedInterE/rp00863e.html>.

²⁵⁷ *Id.*, at 31.

²⁵⁸ *Id.*

²⁵⁹ *Id.*, at 30.

²⁶⁰ *Id.*, at 31.

does not seem – at least for the moment - to consider the possibility that digital technology will enable efficient individual licensing, *i.e.*, that technology may also be an important part of the solution. Whether the advent of new technologies will change the Government’s point of view in the future is yet to be seen, but it seems unlikely that at least in the near future the Government will adopt a policy that discourages institutions that it only recently encouraged.

4. A Further Complication – The Multi-Tiered Copyright System

Transition to a competitive model of performing rights licensing is even more complicated under the Canadian model than it is under the simplified pre-DPRA US model because public performance of music in Canada requires the simultaneous clearance of rights from two PROs rather than one. This is because under Canadian copyright law fees for public performance must be paid not only to authors and composers (the rights of which are managed by SOCAN) but also to producers of sound recordings and performers of these sound recordings. Section 19 of the *Copyright Act* grants such producers and performers a right for equitable remuneration and provides that this remuneration will be in the form of royalties paid to a collective society and then be equally divided between the producer and the relevant performer or performers. The collective society to which such payments are made is The Neighbouring Rights Collective of Canada (NRCC).²⁶¹

This multi-tiered model creates a barrier to the creation of a competitive model for performing rights for several reasons. First, a precondition for the efficient operation of the competitive model is the existence of songs available for online distribution in a form of cleared-parcels. Thus, the more holders of rights in each song the greater is the difficulty in creating those cleared-parcels.²⁶²

Second, when legislation mandates collective administration, as in the case of producers’ and performers’ rights in Canada, the creation of such cleared-parcels becomes legally impossible. It makes little sense to introduce competition in one

²⁶¹The NRCC was created in 1997 to administer the rights of performers and makers of sound recordings. This is done through five member collectives: the American Federation of Musicians (AFM), ArtistI, the Audio-Video Licensing Agency (AVLA), the Société collective de gestion des droits des producteurs de phonogrammes et vidéogrammes du Québec (SOPROQ) and the Alliance of Canadian Cinema Television and Radio Artists Performers Rights Society (ACTRA PRS), *see* Gervais, *supra* note 20, at 92.

²⁶² *See* Part III.B.2.a *supra*. Moreover, in the case of multi-tiered copyright system, the existence of a copyright collective in each level may create new problems of inter-layer fragmentation that arise from the need to deal with different collective for a single use, *see* Gervais & Maurushat, *supra* note 8.

layer, even if it were feasible, unless competition is introduced in both because any reduction in the price resulting from competition in the one layer would be captured by the monopoly in the other layer which is an essential complement.

Suppose hypothetically that in a burst of unexpected benevolence SOCAN members decided to dissolve their organization and adopt a competitive model for the licensing of their performing rights. Such a move would hardly benefit users, because even if users were able to individually license the performing right from the individual songwriters they would still be required to pay royalties to the NRCC. But because a payment to NRCC is a complement to a license from the songwriter, and NRCC has a monopoly in the supply of this complement, NRCC would be able to hold up users and capture the price reductions resulting from the competition between authors and composers.²⁶³

This ability may be somewhat hindered by the design of the right for remuneration as an entitlement protected by a liability rule – the value of which (*i.e.*, what constitutes equitable remuneration) is determined by the Copyright Board - rather than by a property rule which allows the right-holder to set the

²⁶³Support for this proposition can be found in ASCAP's and BMI's traditional opposition to the introduction of a public performance right in sound recordings. Their opposition was based on the "one pie" theory. This theory holds that broadcasters (who pay the royalties) have a limited sum of money - one pie – that they are willing to pay for the right to perform music, and if sound recording copyright owners are granted performance rights as well, ASCAP, BMI, and music publishers will have to share the pie, *see* William Patry, *The Failure of the American Copyright System: Protecting the Idle Rich*, 72 NOTRE DAME L. REV. 907 (1997). When Congress finally enacted a limited digital performance right in sound recordings it chose to mitigate ASCAP's and BMI's concern by adding Section 114(e) which provides that "License fees payable for the public performance of sound recordings ... shall not be taken into account in any administrative, judicial, or other governmental proceeding to set or adjust the royalties payable to copyright owners of musical works for the public performance of their works. It is the intent of Congress that royalties payable to copyright owners of musical works for the public performance of their works shall not be diminished in any respect as a result of the rights granted by section 106(6)" 17 U.S.C. §114(e). The 'one pie' argument, while correctly indicating that both types of licenses are complements, deserves closer look when used to assess the size of the slice that each type of right-holders will get from that pie. If there truly is only one pie whose size is fixed, section 114(e) must result in no slice left for producers. However, since ASCAP and BMI operate under the terms of consent decrees they probably cannot capture the whole value of music from public performers. This means that there is an additional surplus that could be squeezed out from users, *i.e.*, that while there is one pie, its size could increase. Section 114(e) therefore should be read as an attempt to assure that while ASCAP's and BMI's share of the new pie would decrease, their net income would remain the same.

price for it freely as it sees fit.²⁶⁴ Thus, theoretically, the Board could restrain the ability of the NRCC to capture the consumer surplus that results from the competition among ex-SOCAN members. Indeed, the Board's current jurisprudence could be used to effectuate such a move. The Board has used the fees payable to one PRO as a benchmark in the determination of fees payable to another and therefore can equate the fees payable to the NRCC under the mandatory collective management scheme to the fees paid to individual copyright owners in our hypothetical.

In a 2000 decision concerning the royalties that the Canadian Broadcasting Corporation (CBC) Radio should pay NRCC the Board decided that "the royalties that CBC pays to NRCC be based on the amount of royalties that CBC pays to SOCAN, adjusted to reflect CBC's relative use of the repertoires of these two collectives."²⁶⁵ One of the reasons for the Board's preference for this method of determining the royalties was the following:

"[C]ollective societies largely represent the same rights holders. The more overlap, the more one is entitled to wonder why users should be required to pay these rights holders royalties based on different, even incompatible formulas. Since most users view all these rights as a single input, one might even consider integrating price formulas. A sound recording cannot be communicated without communicating the underlying work and performances at the same time. ... The SOCAN and NRCC tariffs deal with a similar use in a similar market. There is no reason to believe that sound recordings are more valuable in radio airplay than the underlying works. They involve the same uses, the same recordings, the same broadcasters. In the absence of evidence to the contrary, a pre-recorded performance is no more and no less valuable to a broadcaster than a pre-recorded work."²⁶⁶

Under this approach the Board might seem to be capable of determining a competitive price for NRCC under the mandatory monopolistic regime in the

²⁶⁴ See generally Guido Calabresi & Douglas A. Melamed, *Property Rules, Liability Rules, and Inalienability - One View of Cathedral*, 85 HARV. L. REV. 1089 (1972), and Merges, *supra* note 51.

²⁶⁵ Statement of Royalties to be Collected by NRCC for the Public Performance or the Communication to the Public by Telecommunication, in Canada, of Published Sound Recordings Embodying Musical Works and Performer's Performances of such Works [Tariff 1.C - CBC Radio in 1998, 1999, 2000, 2001 and 2002], 9 C.P.R. (4th) 504 ((Copyright Bd.) 2000) .

²⁶⁶ *Id.* at p. 509-10.

hypothetical case that SOCAN has dissolved, yet it might not be simple. First, it is relatively easy to compare the fees paid to SOCAN and NRCC because in both cases the royalties are in the form of a blanket fee. If instead of SOCAN there are individual copyright holders acting in a competitive market the products to be compared are different from each other. Second, assuming that not all songs have the same value and hence price, there is no single price for a song that could be aggregated but rather an array of prices, presumably changing over time. It might be possible to determine an average price, or use other statistical measures to make a comparison but it is not difficult to foresee the potential for manipulation of data, different interpretations and results that do not necessarily reflect the royalties that would have been paid under competition. Third, because the rights of the songwriters of a song and the rights of the producers and performers of that song are strict complements for its public performance, the price charged for a cleared-parcel will be lower than the aggregate price for each right sold separately. Therefore, if the Board wishes to replicate the competitive price it should factor in this consideration also; but once again there is no guarantee that the result will indeed reflect the competitive price – whatever that might be.

It follows that effective transformation of the market for performing rights into an effective competitive market requires the concurrent dissolution of collective licensing by all PROs in all layers. In Canada that cannot be done without legislative reform. Naturally, the existence of more types of right holders, organized in multiple organizations but sharing a common interest in preserving the non-competitive model, may make a political struggle to dissolve them much more difficult.²⁶⁷

* * *

Canada's model for the regulation of PROs fits well into the Natural Monopoly paradigm. If PROs are indeed natural monopolies then the main concern is

²⁶⁷ The political system generally favors obtaining the consent of the people or groups that are going to be affected by the proposed legislation. The consent of each of the affected groups can be seen, for that matter, as a commodity provided by each group and when a general consensus is required each group's consent is a complement. When this is the case each group can behave strategically and withhold its consent in order to get some concessions from the legislator or from the other groups - this may prevent the groups from achieving a consenting consensus. When these groups' consent is necessary for reform this behavior could prevent the adoption of the legislation. If, on the other hand, the groups lobbying for reform are stronger, the consent of the affected groups may be less important and in this case the slightly diverged interests of the affected groups may be used to manipulate them and dismantle their opposition.

justifiably with their pricing and licensing practices, not with their mere existence. In that case it might even be more sensible to regulate them using a specific regime, such as the Copyright Board, tailored to the task of on-going price regulation, rather than using the more general tools of competition law. However, the Canadian model is based on an outmoded concept of regulation, one that is based solely on rate regulation by the Copyright Board and fails to introduce mechanisms that would increase the contestability of the regulated PROs, such as those that have long existed under the US consent decrees and have been reinforced in the recent AFJ2. Moreover, it fails to take into account the possibility of technological change that would change the market entirely. This is a major drawback because if technological change can create opportunities for competition that had not been available previously then the existence of regulatory institutions designed to oversee natural monopolies might create an impediment to such development and become a burden for consumers, rather than a means to protect them.

VI. Will There Still Be a Role for PROs

Let us suppose that a DRM-enabled competitive model of licensing is indeed feasible and despite the obstacles described earlier is adopted by the industry, with or without regulatory intervention. Is there still a role for PROs or are they doomed to total demise? The next part reveals several roles that existing PROs could play in the world of competitive online distribution of performing rights.

1. Existing PROs as New Digital Merchants

One possibility is that existing PROs would not disappear as entities but change their functions. Even if there is no place for collective licensing anymore, PROs can reposition themselves in the new market as new digital merchants. That is, entities like ASCAP or SOCAN would stay in the business of music licensing but not as PROs. Instead, they could sell rights for individual songs or bundle songs together just like any other online seller of digital content. They might function as mere agents for individual rights holders (whereas price and other terms of use are determined exclusively by the copyright holder) or as distributors who obtain the right to license from the copyright holders and then resell it, maintaining freedom to determine the terms of the transaction vis-à-vis users.

Practically, existing PROs might possess some competitive advantages in this new market compared to other sellers. They already have contractual relationships with numerous users, and most importantly with right owners.

Even if those existing contracts would have to be modified to apply to the new online distribution business (for example, the contracts might need to contain a right to distribute copies online), it would probably be easier for the (ex)PRO to obtain the rights from its members compared to a new entrant. Second, existing PROs might own valuable reputational assets in the field of licensing; domain names such as www.socan.org in Canada or trademarks such as BMI® in the US are likely to attract users interested in music licensing. In addition, existing PROs already have an installed base of customers and they might hold valuable data about them (e.g., what music they prefer,²⁶⁸ how financially credible they are, etc.) and in general they know how the industry works. All of these are valuable assets that can be used for successfully competing in the new business regime.

Some may even argue that the possession of those assets by an entity in which all the important copyright holders have an interest would thwart any prospect for competition by third parties and that therefore incumbent PROs should be partially or completely restricted from migrating to the business of online distribution of performing rights, in order to allow competition to develop. Whether this is true is beyond the scope of this article.

2. Existing Collections of CDs and other Unprotected Media

The model of online distribution of performing rights envisages a reality in which all the music that is performed is sourced from online sellers and is DRM protected. However, as long as unprotected media, such as CDs, are still available and as long as corresponding players, such as CD players, are not obsolete, users can publicly perform music (at least their old collections) using these technologies. As long as this is the case PROs might still retain some of their existing roles, because users who are not willing to migrate to the new technology or do not have access to it would still be required to obtain licenses, and might find it useful to make use of PROs and blanket licensing just as they always have.²⁶⁹

²⁶⁸ Despite the use blanket licenses that allow performing any composition, PROs gather information on which songs have been actually played in order to distribute the collected royalties among their members. The information is gathered in several ways such as reports by broadcasters and surveys and sampling of other users.

²⁶⁹ Even such users would benefit, although indirectly, from the emerging competition, because they would always be free to switch to the competitive technology and this would force down the price of the blanket license. This might not be true for those users who do not have access to the new technology. They might remain captives of the PROs.

Some other users might have access to the new technology but prefer not to use it and use their CD collections instead, to evade payment by taking advantage of the high cost of monitoring and enforcement under the old technology. Another potential source of unauthorized performances is the millions of unprotected digital music files that already exist and inhabit the Internet. In each of these cases copyright holders would still need to have an efficient mechanism for monitoring and enforcement. Yet this need should not be overstated. The most costly performance occasions in terms of detection and enforcement are small venues such as bars, restaurants, shops, etc. They are small and numerous, sometimes remotely located, may be rapidly changing and may not necessarily be aware of their legal obligations to obtain a license. But at the same time these venues are the least important in terms of royalty revenue. The main source of royalty revenue in the US (more than 80%),²⁷⁰ is radio and television stations, which are more easily detectable and less likely to base their business on persistent illegal performance of music. This observation implies that if offered the opportunity to source their music legally from online sellers on competitive terms (*i.e.*, pay less than they currently pay) radio and television stations will prefer to do so, and will not use their existing collections of CDs and records to avoid payment.

It does not mean that there is no place for collective action on behalf of copyright holders. Collective monitoring might be needed for deterring users from opting to illegal use, but still the functions of monitoring and enforcement might be separable from the function of licensing. Existing PROs could continue their monitoring and enforcement activities against infringers without necessarily licensing the rights to legitimate users and ex-infringers. Technological development, such as automatic scanning of all broadcast music, discussed above, can facilitate this.²⁷¹ Separation between *ex post* enforcement and *ex ante* licensing is not unknown to the industry. In its early days ASCAP used infringement detectives who were paid a commission from the proceeds of subsequent enforcement. ASCAP even appeared to use quasi-independent lawyer-sleuths who received the right to represent ASCAP in the case in exchange for discovering a violation of its members' rights.²⁷² There are other examples in other areas of copyright. The RIAA's or the Business Software

²⁷⁰ See Einhorn, *supra* note 138.

²⁷¹ See *supra* Part IV.3. Such technologies, however, need not necessarily be employed by PROs – they can be used by individual right-holders or even private infringement detectors.

²⁷² See Merges, *supra* note 51, at 1331 note 116; *Buck v. Elm Lodge, Inc.*, 29 U.S.P.Q. 444 (N.D.N.Y. 1936); Note, *Musical Monopolies and Legislative Control* 53 HARV. L. REV. 458, 459 n.5 (1940).

Alliance's (BSA) legal actions against music file sharing or software piracy are current examples of collective enforcement which does not involve acts of music sales or software licensing.

3. Existing PROs Can Facilitate Future Online Trading

Existing PROs can play an important part in facilitating the creation of competitive online trading of performing rights, such as the model offered earlier, by assisting in creating standards that will be necessary for the efficient operation of these markets. For example, in order for a DRM technology to work efficiently online, it is important that individual works be distinguishable from each other, so that a user interested in a specific work will be able to obtain this, and only this, work, and similarly, that only those who are legally entitled to get payment for this work will receive it. PROs, as organizations that represent important stakeholders in this process, can play an important part in it. The RIAA and the International Federation of the Phonographic Industry (IFPI), although not strictly PROs,²⁷³ have recently developed such a system named GRid (Global Release Identifier) that provides unique identifiers for sound recordings in order to facilitate their electronic distribution over the Internet.²⁷⁴

4. PROs and Back Catalogues

Although I have earlier argued forcefully that under competition copyright holders would face strong incentives to create cleared-parcels of music in order to make their works marketable, this approach might not work well for back catalogues of music or parts thereof. Because traditional PROs have solved the problem of fragmented copyrights, right holders have faced weaker incentives to form the contractual relationships that would create cleared-parcels. Because such right-clearing was not done when the music was initially created, it might turn out to be too costly to do *ex post* – particularly if the future commercial prospects of the relevant song are low and the cost of re-contracting might exceed the expected benefit. In such cases there is the danger that some copyrighted works currently covered by PROs' blanket licenses would become inaccessible under the competitive model. Therefore there might be good

²⁷³ These two organizations are more trade associations than strict PROs yet the IFPI has national affiliates who often administer record producers' performing rights and the RIAA is involved in PRO activity under the DPRA, *see supra* note 199 and accompanying text.

²⁷⁴ *See* <http://212.134.114.163/grid/index.html> (last visited Apr. 3, 2003).

reasons for allowing users to obtain blanket licenses for back catalogues from PROs.

However, even if PROs remain indispensable for enabling efficient access to back catalogues, it might be wise to plan their gradual phasing-out by not allowing PROs to accept new works to their repertoires, and letting them administer only existing works until they become public domain. This way the problem of fragmentation of existing catalogues would be solved without being perpetuated.

* * *

All of the examples described above suggest that existing PROs are not necessarily going to disappear, nor should they, even if a competitive DRM-enabled marketplace replaces the traditional collective licensing of performing rights. Nevertheless, whether existing PROs become online merchants, infringement monitors or standard setting organizations, or are limited to handling only back catalogues their traditional functions of collective administration would no longer exist.

VII. Alternative, Unhappy Endings

1. Monopoly with DRM

My story so far has been quite optimistic. It envisages the use of the Internet and DRM technology to facilitate the creation of a competitive marketplace for performing rights. While such a development may not necessarily please copyright holders (as long as the transition to a competitive environment decreases their profits), or some of them,²⁷⁵ it will benefit users of copyright protected material and will obviate the need to regulate PROs. But this is not the necessary result from the use of DRM technology. If copyright holders implement the technology but maintain the collective licensing of their rights, the results, at least from the perspective of users, could be quite unpleasant.

I have earlier described how the public performance right allows the copyright holder, by withholding his consent to the use of his work, to capture as much

²⁷⁵ Online distribution may allow songwriters to bypass the middlemen (current publishers and record companies) and sell or license their music directly, so that although the overall industry profit from public performance would decline, the songwriters' share of this profit and that from other sources of income (*e.g.*, the sale of music) might increase. Under these conditions the competitive model might actually benefit songwriters.

surplus as possible from the user.²⁷⁶ In practice, however, there are several limitations on this ability. I have already mentioned three of them: competition from other products, incomplete information on the user's preferences, and arbitrage. I will now add another limiting factor which exists when users have *de facto* access to the work and practical ability to publicly perform it (even if *de jure* they have not been authorized to do so).

Currently, in the pre-DRM era, users have - as a practical matter - unhindered access to music. All that they have to do in order to perform music is to obtain a CD and play it publicly. If they do that without the consent of the copyright holder he might sue them for damages and obtain an injunction prohibiting the further use of the copyrighted material. But, practically, only when the injunction is issued or at least imminent (assuming that the user would obey it fully and promptly) will the copyright holder be able to capture the whole value of his music in return for his consent. The need to have recourse to the judiciary in order to enforce his right adds costs that decrease the net revenue to the copyright holder. The right-holder would therefore discount this expected cost from the maximum price that he anticipates being otherwise able to charge and offer the user a lower price if he agrees to purchase a license now rather than after the injunction has been issued.²⁷⁷ The costs of enforcement thus create an additional limit on the price that copyright holders can charge.

Unlike the judicial system, DRM technology is a tool of self-help, a very powerful one indeed;²⁷⁸ it is "like an infallible "injunction" controlled completely by one party."²⁷⁹ When applied to the licensing of performing rights, and particularly when those rights are licensed by PROs, DRM technology can dramatically change the relative bargaining power of PROs and their customers. By enabling the copyright holder to unilaterally prevent access to music, a move which in the case of some users means an ability to shut down the user's business, DRM enables the PRO to hold-up the user much more effectively and obtain a larger portion of the consumer surplus. When implemented by PROs, DRM technology

²⁷⁶ *Supra* Part III.2.

²⁷⁷ For example, if music is worth \$1000 to the user, under a credible threat of injunction the user will be willing to pay up to \$1000 for a license. If it costs \$300 for the copyright holder to make the threat credible (send warnings, file a suit, etc.) he would rather offer a license for \$700 now than \$1000 later. Of course, the user might have costs too. If he expects to pay statutory damages later, he might prefer paying \$1000 now rather than \$30,000 later. Both parties' expected costs will determine the actual price that will eventually be paid.

²⁷⁸ See generally Cohen *supra* note 171.

²⁷⁹ Margaret J. Radin, *Regulation by Contract, Regulation by Machine*, 160 J. INST. THEORETICAL ECON. 1, 11 (2004).

can practically negate many of the protections that the regulation of PROs provides to users. Currently, in both the US and Canada, PROs cannot prevent a user who dispute the fees that the PRO seeks to charge from having lawful access to the music. In the US the consent decrees grant a user a right to perform pending proceedings for the determination of reasonable fees by the court.²⁸⁰ In Canada, if the PRO seeks to raise its fees users are entitled to perform under the old terms until the new tariff is approved by the Copyright Board, and until the approval of the new tariff the PRO cannot bring legal action against the user.²⁸¹ Nevertheless, while in both jurisdictions the PRO cannot bring a legal action against users who challenge the new fees, there is currently nothing that expressly prevents them from using technology to shut-down music supply to a user who does not agree to pay the new fees. Even if such a conduct would be considered a breach of the obligations under the US consent decree or the Canadian Copyright Act, it will be the user that will have to ask for the court's intervention to secure compliance with the law - rather than the copyright holder who carry this burden today. In the US, an attempt by a user to regain access to music by circumventing the DRM technology, as he is entitled to under the consent decree, might implicate liability under the Digital Millennium Copyright Act.²⁸² This may indeed be one great step forward for copyright holders, but one giant step backwards for users.

2. Oligopoly with DRM

My optimism assumed that as a result of technological change the market for performing rights will become competitive. This assumption resonates with the *BMI v. CBS* Court's perception of "thousands of copyright owners, and millions of compositions"²⁸³ and highlights the potential of the DRM and the Internet to reduce transaction costs and lower barriers to entry. If, however, the music industry remains concentrated as it is today, the gains from competition might not be so high for consumers, even if PROs would no longer exist. One unhappy outcome is that the oligopoly equilibrium in such a market could result, under many oligopoly models, in prices that are not much far below the price that a monopolist PRO would have set, particularly because songs are differentiated

²⁸⁰ AFJ2, Section IX(E).

²⁸¹ *Copyright Act*, section 68.2.

²⁸² 17 U.S.C. §1201 *et seq.* ("DMCA"); see *Universal City Studios, Inc. v. Reimerdes*, 111 F.Supp.2d 294 (S.D.N.Y. 2000), *aff'd*, 273 F.3d 429 (2d Cir. 2001) (holding that the DMCA forbids circumvention of technological access controls even in cases when the technology had been circumvented in order to gain lawful access to the underlying material).

²⁸³ *CBS v. BMI*, *supra* note 2, at 20.

products. Combined with DRM – as described in the previous paragraph – copyright holders would be able to charge higher prices than they could without DRM, but unlike in the case of PROs there will be no or weaker legal basis to regulate them. The result in this case would be that users will pay higher prices relative to the prices that they pay if regulated PROs existed.

VIII. The Political Economy of PROs

The prevalence and persistence of PROs around the world is nonetheless a puzzle if one accepts my skeptical approach to them. There could be several explanations for that. One is that despite the weakness of the economic case for them, there are some other efficiencies that render PROs the most efficient method of administering performing rights, even if such efficiencies have not been uncovered yet. While possibly true, being non-falsifiable, such a hypothesis does not advance our understanding much, and we must therefore look for another explanation.

One potential explanation is persistence of an analytic error. That is, PROs are viewed as natural monopolies, even though they are not, just as with other markets, such as long-distance telephony that have been considered natural monopolies, which later proved to be wrong.

Alternatively, the prevalence and persistence of PROs could be explained in terms of public choice theory.²⁸⁴ Developing a complete public choice theory for the existence of PROs would exceed the scope of this article, so at the moment I will only offer this as a brief and tentative hypothesis. Under this public choice story, PROs exist because copyright holders (especially publishers and record companies), being a relatively small group, could gain much by cartelizing at the expense of broad, diverse and unorganized group of users.²⁸⁵ The fact that in most jurisdictions PROs are regulated monopolies may support this theory. The adoption of a regulated monopoly model, often embodied in legislation, thus reflects the political bargain: the state sanctions a monopoly status and in

²⁸⁴ See generally LANDES & POSNER, *supra* note 19, Ch. 15 (describing some aspects of the political economy of intellectual property law and discussing the strengths and weaknesses of the application of public choice theory in this area); Stewart E. Sterk, *Rhetoric and Reality in Copyright Law*, 94 MICH. L. REV. 1197, 1244-1247 (1996) (offering public choice as an explanation to the expansion of copyrights); see also Kretschmer, *supra* note 5, at 128-30 (describing the lobbying efforts of composers and publishers in Germany and the UK).

²⁸⁵ See Landes and Posner, at 407.

exchange PROs agree to be subject to some supervision.²⁸⁶ The form and intensity of their regulation thus reflects the political power of the opposing interest groups: copyright holders and users.

Consider, for example, the more intrusive, antitrust-based, regulation under the US model as opposed to the regulatory model of other industrialized countries. In the US, broadcasting, the major source of income for PROs, has been traditionally commercial, while in the rest of the industrialized world broadcasting has been predominantly, throughout most of the 20th century, public. The commercial broadcasting business in the US has been quite concentrated and broadcasters, therefore, could establish countervailing power to PROs. It is not surprising therefore that most of the attempts to judicially challenge PROs came from broadcasters and that the US Department of Justice first intervened against ASCAP in the 1930s, when radio became big business and the relations between ASCAP and the radio industry soured.²⁸⁷ This might also explain why the US regulatory model of PROs is biased towards broadcasters who, unlike small users, can, and sometimes do, challenge the fees proposed by ASCAP and BMI in the Federal Court in New York, a task which is presumably too costly for a small and disperse users such as a night clubs.

In contrast, *public* broadcasters might have been less interested in challenging the existence of PROs and their practices for several possible reasons. One is that for a long period of time broadcasters themselves have been state-monopolies which, given the value of broadcasting *for* copyright holders, have had countervailing monopsony power. Alternatively, as state-owned enterprises, public broadcasters have probably been less motivated in challenging the mere requirement to pay license fees to PROs or the amount of such fees, because for them license fees are a cost that in any event will be covered by taxpayers. In addition, many public broadcasters have a specific mandate to encourage local culture, and might therefore see it as part of their responsibility to pay royalties to local artists and an attempt by them to vigorously seek to reduce such royalties might be seen as incompatible with that mandate.

Another possible political story has a more historical dimension. When the phenomenon of PROs spread throughout the industrial world in the late 19th

²⁸⁶ In fact, unless the supervision of the state is effective, a proposition that could be highly questioned given the inherent difficulty to determine what the right price for intellectual property is, there is no real exchange here, on the contrary. The existence of regulatory supervision can enhance the power of PROs vis-à-vis users, in the sense that it legitimizes their existence and gives them a shield against antitrust and other claims by users.

²⁸⁷ Sobel, *supra* note 51, at 5; Charles, *supra* note 51, at 140.

century and early 20th century, PROs were not formed with significant antitrust concerns in the minds of their designers. At that time no competition laws existed in Europe and even in the US and Canada, where competition legislation preceded the creation of PROs, such laws did not seem to have caused major concerns for copyright holders, at least not in the early years. In Canada, as we have seen, competition law is not a major concern even today. When regulators and private plaintiffs in the US and in other countries ultimately attempted to use competition laws to challenge the existence or some of the practices of PROs they had to face a well established phenomenon with entrenched business models and practices, and almost no alternative models to compare them with. Naturally, radical changes under such circumstances are likely to create forceful opposition from existing copyright holders and cannot be easily achieved. Any prudent regulator, as well as some prudent users, would hesitate to advocate a complete overhaul of a system when no operational alternative is in sight.

IX. Conclusion

Whatever theory best explains the prevalence of PROs, their existence continues to be an intriguing challenge for advocates of competition. Arguments about market failures and natural monopoly have been harnessed to explain and legitimize what would otherwise seem like a strongly anti-competitive arrangement. It is widely argued (and axiomatically accepted) that in the majority of cases the various transaction costs involved with individual licensing are substantially higher (or even prohibitive) than they are in the case of collective licensing, and this makes collective licensing the most efficient mechanism for the administration of performing rights. Although not always articulated in this way, the argument is that PROs are a form of natural monopoly. And when a natural monopoly exists, so we have been trained to believe, the best regulatory response is to endorse it and regulate it.²⁸⁸

While PROs and their use of blanket licensing undoubtedly reduce some costs, especially when compared to a hypothetical model of a market with “thousands of users, thousands of copyright owners, and millions of compositions”,²⁸⁹ it is not entirely clear that the only alternative to collective administration is a

²⁸⁸ Interestingly, the greatest challenges by the US government and US courts to collective administration was during the heyday of natural monopoly and regulation theories, in the 1930s and 1940s; and just when skepticism about these theories grew (with regard to traditionally regulated industries) and became the “deregulation” movement of the last decades, similar theories were revived so smoothly and consensually in the area of intellectual property.

²⁸⁹ *Supra* note 76.

dysfunctional market. In other words, while there should be little doubt that there might be economies of scale and scope in the administration of copyrights, it does not necessarily follow that those economies of scale could only be achieved under monopoly, and that the benefits of monopoly indeed exceed its costs.

In this article I have argued that PROs and their almost exclusive use of blanket licenses create a source of presumably supra-competitive earnings that is quite stable and not easily contested. Undoubtedly, by creating a one-stop-shop and by granting blanket licenses PROs do provide benefits to their users, but because the use of the blanket license creates disincentives for any individual licensing, even when the law requires that such licensing be available, we cannot know whether those benefits really are worth their costs in terms of consumer welfare. Because the collective model of licensing creates strong disincentives for copyright holder to deviate from it, it is almost empirically impossible to test what would have happened without it. We do, however, have some anecdotal evidence that the market is indeed quite capable of overcoming many of its perceived failures. We have seen, for example, that in the US film industry source licensing developed when collective licensing was banned; we saw how music publishers figured out ways to overcome the problem of fragmentation in their pursuit of competitive advantage. We can observe that the actual number of copyright holders from which users have to obtain licenses is *de facto* rather small, and that because performance is the best promoter of music, it might well be that under competition copyright holders would prefer not to charge (or even pay) for public performance, as was the case throughout the 19th century in Europe²⁹⁰ or as the present incidents of payola in the US indicate.

What we have also seen is that even if one endorses the idea of collective administration generally, there could still remain extensive variance with regard to the details, which can make PROs less or more contestable. For example, we saw that PROs should not necessarily hold exclusive rights; that there might be areas in which direct or source licensing can work quite well; that collective enforcement does not necessarily imply collective licensing, and so on.

While that body of evidence should invoke deep skepticism about the transaction-costs / natural monopoly rationale for collective administration, it might be insufficient to make a completely compelling case against the practice. However, even if endorsing the regulated monopoly framework for dealing with PROs has not been totally erroneous given old technologies, any theory based on

²⁹⁰ Kretschmer *supra* note 5, at 129.

transaction costs should be revisited when innovative technology dramatically changes those costs. The long-distance component of the telephone network, for example, a prime example of a natural monopoly, ceased to be one with the rise of microwave and satellite communication, and this component soon became competitively structured.²⁹¹ Because new digital technologies can dramatically alter the cost of licensing, monitoring and enforcing public performance rights, serious reconsideration of the collective model of administration is warranted. Given my prediction that market forces alone would not create countervailing incentives to challenge the collective model (and that if left unchecked PROs could use DRM technology to even improve their position vis-à-vis their customers), it might be wise for governments to step-in and revisit their current endorsement of PROs.

* * *

Almost quarter a century ago, the US Supreme Court in its landmark decision in *BMI v. CBS*, endorsed the transactions-cost justification for the idea of collective administration, but noted that “changes brought about by new technology or new marketing techniques might also undercut the justification for the practice.”²⁹² Thus, in an often overlooked footnote, the Court has sown the seeds for subsequent review of the applicability of its own ruling. New technologies now seem to be available; they may facilitate new marketing techniques. The time for such review may soon be ripe.

²⁹¹ HOVENKAMP *supra* note 4, at 701.

²⁹² *BMI v. CBS*, *supra* note 2, at 21 n34.