The Valuation of Copyrights in the Digital Era

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SUMMARY

Digitization is a drastic innovation that reduces significantly the dissemination costs of music and books, thereby challenging the delicate balance between the creators' right to a fair compensation and the users' right to the benefits of digital technologies.

The excludability that copyright was supposed to ensure may have become too severe for the digital world, hence less efficient and less effective than before.

The situation is made even more challenging as music and literary works are "information" goods.

The digital revolution comes at a time when the "value" of copyrighted works, musical and literary, is both significantly underestimated and continuously eroded by new copyright exceptions and challenges.

AGENDA

A difficult multifaceted endeavor, problem and solution.
I offer today some preliminary thoughts on some facets only.
I will concentrate on music.

I. Music Copyright Systems: US and Canada

II. Some analytical solutions

III. The Search for value: Hertzian radio, Internet radio, Streaming.

IV. Implementation: the proposed reforms

V. Other concerns

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The US music copyright system

Hertzian radio, live venues, and other public places (clubs, restaurants, etc.)

Rights Rightsholders	I	II
Public Performance	PRO*: ASCAP, BMI, SESAC, GMR	N.A.
Mechanical (Reproduction)	xxx	xxx

Internet radio (non-interactive) Pandora, Songza, +>2500 others, Sirius XM

Rights Rightsholders	I	II
Public Performance	PRO*: ASCAP, BMI, SESAC, GMR	SoundExchange 801b: Sirius XM WBWS: Pandora
Mechanical (Reproduction)	Xxx	Xxx

Music Streaming (interactive) Spotify Rdio, Apple Music, Google Play, …
Permanent downloads

Rights Rightsholders	I	II
Public Performance	PRO*: ASCAP, BMI, SESAC, GMR	----
Mechanical (Reproduction)	HFA	

The Canadian music copyright system

Hertzian radio, live venues, and other public places (clubs, restaurants, etc.)

Rights / Rightsholders	I	II
Public Performance	SOCAN	RE:SOUND
Mechanical (Reproduction)	CSI (CMRRA, SODRAC)	CONNECT, SOPROQ +++

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II. ANALYTICAL SOLUTIONS:

1) **First-best allocation:**
    - **Determine the proper efficient production level (Lindhal)**
    - **Ensure free distribution of musical and literary works to the benefits of citizens, with compensation from public sources (Governments)**
2) **Second-best allocation (regulated markets and non-zero pricing):**
    - **Implement appropriate wedges between prices and marginal costs to meet a budget objective, here a proper competitive compensation for creators**
    - **Regulate market pricing in order to minimize distortions from first-best (Ramsey "inverse elasticity" pricing rule, applied to the whole chain from creators to end users)**
3) **A combination of the above.**
4) **What is the proper "value" and what are the proper prices?**

    Example: the market value and pricing of financial options

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III. THE DISCOVERY OF VALUE

The case of terrestrial Hertzian radio and Internet radio

What is the business of a radio station?

- **Objective: to maximize profits or station value by capturing a particular audience to be sold to interested advertisers.**
- **By offering a combination of music and talk of a particular genre.**
- **At the margin, the last minute of T and the last minute of M brings the same net advertising revenue**

Theorem: the competitive market values or compensations of M and T are necessarily proportional to their "share" of broadcast time

Caveats

- **Competitive markets compensate inputs at their marginal values, not at their total values: hence, competitive market values of Music and Talk are as usual much lower than their total values for commercial radio broadcasters.**
- **The competitive market value of music is <u>revealed by / inferred from</u> the behavior/choices of commercial radio broadcasters.**

Key point

- **The above <u>theorem</u> is NOT obtained from an heuristic or historical approach and it is NOT an opinion, a belief, or a value judgement.**

Data (Canada)

In HR: (M,T) = (60%,40%)*, hence music royalties should be $450m [Audley-Boyer 2007; PWC 2008)], that is,
0.3¢ per play (0.235¢, 0.325¢)
versus $100m or 0.044¢ per play
(versus US: US$381m or 0.022¢ per play)

Where is the *missing* value "due to" creators/rightsholders?
In Canada $80m due to deductions of all sorts
Therefore $270m unaccounted for!

If music is mispriced, its missing value is captured by other stakeholders.

WHO are the stakeholders of CR total industry value?

1. **Music content: authors, composers, songwriters, publishers, artists, performers, sound recording rightsholders**

2. **Talk content**

3. **Other inputs: capital and technology (owners-entrepreneurs, financiers), labor, materials, etc.**

4. **Advertisers**

5. **Consumers and their "Collective", that is, their Governments**

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HR to IR webcasters and MS services

Differences in cost structures, namely cost of entry and cost of audience reach, favor royalties: per play in IR, a % of revenues in HR

If per play rates in IR are <u>properly set</u> on the basis of HR data to achieve a level playing field between IR and HR, they

a) **Allow rightsholders to avoid being "residual payees"**
b) **Can easily incorporate a premium to take account of the contribution of selectivity/interactivity in MS services**
c) **Favor healthy competition in IR and between IR, MS and HR by:**
   i. **eliminating uncompetitive IR webcasters who use huge amount of recorded music with little revenue generating capacity**
   ii. **reducing destructive competition intensity (Bertrand trap)**
   iii. **inducing IR webcasters, as resellers of recorded music, to develop value added features above the value of music**

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IV. PROPOSED REFORMS

A. Among the most important recommendations of the USCO:

- **Extend the public performance right in sound recordings to terrestrial radio broadcasts;**
- **Adopt of a unique market-based rate setting standard (WBWS or 'fair market value'), mimicking negotiated rates in markets:**
  "There is no policy justification for a standard that requires music creators to subsidize those who seek to profit from their works."
- **License mechanical rights on a blanket basis bundled with performance rights, possibly under the same collectives, with an opt-out option (digital);**
- **Create a general music rights organization GMRO to maintain a publicly accessible database of musical works and sound recordings appropriately matched to rightsholders to simplify and facilitate more efficient licensing;**
- **Regroup all government rate setting under the Copyright Royalty Board, hence abolish "rate courts" for musical works.**

B. Technology Policy Institute, Washington:

Thomas Lenard and Lawrenced White, "Moving Music Licensing into the Digital Era: More Competition and Less Regulation," December 2015

- **Comprehensive standardized database of compositions and their owners through proper identifiers**
- **Emerging aggregator agents of "various categories of music ownership rights" and emerging differentiated bundles of musical works and sound recordings**
- **Direct negotiations and transactions between publishers and labels (rightsholders) as sellers and music distributors as buyers**
- **Implementation of Ramsey-type pricing through competition**

C. Reforms in Europe: expanding fair use/dealing

- **Caroline de Cock, *The Copyright Manifesto* (January 2015);**
- **Julia Reda (Committee on Legal Affairs of the European Parliament), *Draft Report on the implementation of Directive 2001/29/EC of the European Parliament and of the Council of 22 May 2001 on the harmonisation of certain aspects of copyright and related rights in the information society* (January 2015);**
- **Maurice Malka, *2015: The End of Copyright – Taking for free is Stealing*.**

D. SOME QUESTIONS on Reforms

- **Is the observation of WBWS negotiated contracts (including those with lower prices than regulated ones) under the threat of regulated prices really indicating that competition is viable or is it simply an avoidance of court costs?**
- **Ramsey pricing under competition is not easy to manage: it may lead to a Bertrand trap. It could be achieved by letting a musical monopoly fixing prices to different users under a Laffont-Tirole Global Price Cap constraint. Note: David Strickland, a member of the US CRB, suggested in *RERCI* Dec 2015 to apply Baumol-Willig ECPR to access the stock of musical works and recordings.**
- **Are negotiated WBWS prices reflecting <u>competitive market values</u> or are they significantly influenced by government rate setting experience? Example of the history of financial options.**
- **There is today no clear evidence of the competitive market value of copyrighted music ….. Need more research into this. Hence the above THEOREM**

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V. OTHER CONCERNS

1. **The sharing/allocation of common value and costs among members/partners through proper allocation methodologies (Nash bargaining, Shapley value, Cooperative game theory, etc.); Fair compensation: per play v per subscription (per play)?**

2. **Investments, risks, risk sharing, compensation for risk taking, for both users and creators (RAROC, ROI, ROV)**

3. **The economic analysis of fair use/dealing could shed light on its proper implementation: fair dealing is both an economic and a legal issue. Boyer, *RERCI* 2012.**

4. **The economic analysis of new exceptions strongly argues for the reexamination of the pre-exception situation: once exceptions are put in their proper context, they may not bite (competitive response).**

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