

MUSIC LICENSING FOR NON-INTERACTIVE AND OTHER RADIO-STYLE SERVICES: IS IT FINALLY TIME TO MOVE AWAY FROM BLANKET LICENSING?

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ABSTRACT. Advances in technology over the last two decades have led to significant changes in the way that music is consumed, with music streaming services now being the dominant means through which people listen to music and the primary means through which music copyright owners monetize their intellectual property. The way that music rights are licensed by these digital streaming services, however, has not meaningfully changed. Blanket or collective licensing is still the norm and the marketplace is almost entirely devoid of any actual price competition between rightsholders to have their music performed. But some of the same technological advancements that have allowed digital streaming to emerge also can be used to transform the way that music is licensed – moving towards a more competitive alternative. In this paper we review the economic tradeoffs that have provided the primary justifications for the current blanket licensing systems, and then describe the institutions and regulatory environment that have developed to implement those systems in the U.S. That sets the stage to describe an alternative competitive marketplace taking advantage of streaming technology and data, which we do in our companion paper, Ebin and Reitman (forthcoming). Such a marketplace, if implemented appropriately, would allow for individual rightsholders to set their own prices subject to the forces of competition, while still maintaining many of the transactions costs efficiencies associated with blanket licensing.

1. INTRODUCTION

Over the last two decades, music consumption patterns have changed significantly, driven in large part by advances in technology. This technological progress has led, among other things, to the rapid rise of digital streaming services, which have become the dominant way that people listen to music. Along with this change in music consumption patterns, there has been a shift in how music copyright holders are compensated for the use of their intellectual property, with the royalties paid by digital streaming services accounting for a larger and larger portion of overall royalty payments. Copyright law protections have expanded to include the use of music on digital streaming platforms, but the methods for licensing music and the approach for compensating rightsholders retains

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the same basic framework used for older music-delivery platforms – one that is based on blanket licenses, uniform pricing, regulatory oversight in certain cases, and almost no role for price competition.

The traditional forms of licensing were arguably a reasonable way of doing things given the transaction costs of direct negotiations, scale economies from collective administration, the available technology for monitoring usage, and the information requirements of a competitive alternative. However, the rise of new technologies opens the door to a radically different way of compensating rightsholders for the use of their music. This alternative potentially could provide a market-driven licensing approach for non-interactive streaming services, and plausibly others, with advantages to rightsholders, music services, and consumers alike.

The above noted advances in technology allow digital streaming services to track exactly what songs are streamed to which listeners. And, whenever streaming services are picking or recommending the next track to be heard, these technological advances allow for the possibility that they could account for the prices charged by rightsholders to use their individual works. This ability makes it possible for actual price competition between individual rightsholders to take place – it provides rightsholders with the opportunity to compete with each other on price to have their works included on playlists. Such a system would allow individual rightsholders to take advantage of the socially desired market power created by the copyright they hold in their individual work, while limiting undesirable aspects of the market power created through the current systems of collective licensing.

But such a competitive system for the licensing of rights has not taken off – there have been only a handful of instances of which we are aware in which rightsholders have engaged in any form of actual price competition. While the way music is consumed has changed as a result of technological progress, those technological breakthroughs do not appear thus far to have had any meaningful impact on the way that music services license the music rights necessary to offer their products. Streaming services continue to secure those rights largely through collective licensing of one type or another, whereby a service secures the

rights to perform and/or reproduce thousands or even millions of individual works for a set price or at a price that does not vary based on the particular works used. While collective licensing takes on a variety of forms, in all cases it limits, and in some cases it eliminates, the incentive for individual rightsholders to actually compete with each other on price.

With respect to the licensing of musical works public performance rights – the right that a service must secure from a composer or music publisher (or their performing rights organization (PRO)) in order to “publicly perform” the rightsholder’s musical works – these rights continue to be secured in the same fashion that such rights have been secured for decades, primarily through “blanket licenses” from PROs. These blanket licenses provide access to the entire repertory of works controlled by the PRO for a fixed price (typically expressed either as a percentage of service revenue or a fixed dollar amount). To be sure, digital streaming services, at least in some cases, are able to secure musical works public performance rights directly from individual music publishers, and this has happened, but even when that happens, the licenses tend to cover the entire catalog of the music publisher for a fixed fee. In other words, the licensed product is still a blanket license for a large collection of rights. Because of such blanket licensing practices, there is limited room for actual price competition between individual rightsholders or between individual works.

Musical works reproduction rights, to the extent they are needed by digital streaming services, are also typically secured on a blanket basis. Often, the service will pay a fee set by the Copyright Royalty Board (CRB), a regulatory body that is part of the U.S. Copyright Office, for the right to reproduce any copyrighted musical work. Other times, the service will pay a negotiated fee to individual music publishers for the right to reproduce all of the works in the publishers’ catalog. As with musical works performance rights, this approach to licensing leaves very little room for price competition between individual rightsholders or works.¹

¹As discussed below, the Music Modernization Act of 2018 changed the licensing framework for musical works reproduction rights, but only by introducing a new copyright collective that offers a blanket license for a fee that is subject to oversight by the CRB.

Sound recording rights – the rights necessary to use the particular recording of a musical work – also continue to be licensed on a blanket basis. Non-interactive services typically pay a per-play rate set by the CRB to SoundExchange, an entity charged with negotiating and/or litigating on behalf of the entire record industry with certain music services and collecting royalty payments from those music services. SoundExchange takes the royalties paid by the non-interactive services and pays them out to the individual artists and record labels. While the royalties paid by non-interactive services do vary based on the amount of music consumed by listeners, the rate paid for each track is the same. As a result, there is again little room for actual price competition between individual rightsholders or between individual songs.

In this paper, we review the literature discussing the tradeoffs between equitable remuneration, transaction costs, and efficiency that arise when licensing music to music services. Against that backdrop, we review the patchwork of licensing institutions, regulations, and mechanisms that have arisen in the U.S. for licensing rights to broadcast or stream music. Our purpose is to highlight some of the benefits and drawbacks with the current licensing regime and explore whether the technological innovations that have led to changes in the way that music is consumed might also allow for the licensing of music rights directly with individual rightsholders with radically lower transaction costs than has historically been presumed would be necessary, and thereby potentially tilt the balance in favor of a more competitive licensing framework. Such a marketplace plausibly offers the advantages of competitively determined rates that mitigates market power concerns, avoids the necessity of regulatory rate determination, and moves away from one-size-fits-all pricing, while preserving much of the transaction cost efficiencies associated with blanket licensing. We describe what a competitive system might look like in a companion paper, Ebin and Reitman (forthcoming).

2. RELATED LITERATURE

The landscape of institutions and regulations for licensing music has evolved alongside the evolution in technologies for obtaining and listening to music, from player piano rolls

and sheet music through radio, successive analog and digital recording media, and most recently digital streaming services. In some countries the result has been a reasonably consistent system, with much of the market licensed through copyright collectives offering blanket licenses at rates subject to regulatory oversight. In contrast, the United States has developed a more haphazard and inconsistent system (Cardi, 2007). In the absence of systematic oversight of the different copyright requirements for different technologies, the result has been a mix of different regulations, different governing bodies, different legal standards, and different royalty rates (United States Copyright Office, 2015). In the words of Rosenblatt (2018): “The patchwork of laws and deals has led to today’s complex and confusing situation, in which different types of digital music services have to license different rights and pay royalties according to different schemes under different conditions.” See Portnow (2014) and Krueger (2019) for similar assessments.

The copyright system in some other countries reflects more of an attempt to systematize the royalty system under a unified regulatory framework. For example, in Canada the Copyright Board has oversight over licensing and royalties for both musical compositions and sound recordings, and for both performance and reproduction rights. Recent Copyright Board decisions have explicitly tried to align royalty rates across different media.² The Copyright Board has also sought to preserve consistent musical works and sound recordings royalty ratios, as in its 2014 webcast determination and between performance and reproduction rights royalty ratios in its 2017 online music determination. Nevertheless, inconsistencies slip into the royalty structure, such as switching to a percentage of revenue royalty structure for musical works in the 2017 online music determination despite the Copyright Board having recently certified a per-play rate for sound recordings for the same services. And in any case, the underlying compromises between a regulatory framework that provides some measure of efficiency and fairness, versus a truly competitive licensing environment, are for the most part common across countries.

²For example, the Copyright Board of Canada (2017) Online Music Determination states, “The technologies used by commercial radio broadcasters and the ones used by noninteractive and semi-interactive webcasters to communicate music to their respective listeners are similar and their functions, although achieved differently, are equivalent. We see no reason in the present case to implement a differential treatment, from a copyright valuation standpoint, between radio broadcasting and corresponding webcasting technologies.”

In the next section, we will review in more detail the disparate regulations and mechanisms for licensing music in the United States. But first we review the conflicting goals of efficiency, competition, and incentives for creation as they have been discussed in the literature, and the implications for market versus regulatory determination of royalties.

The rationale for regulatory oversight has historically been based on two economic considerations: the efficiency of collective administration of rights, relative to licensing through many separate rightsholders, and market power concerns about the royalties that would emerge from consolidating pricing power in an unregulated marketplace. The efficiency of collectives derives from the transactions cost savings of licensing from a single entity as well as from scale economies in administration, monitoring, enforcement, and distribution (Watt, 2015). These costs are particularly worrisome in the absence of transparent information about the rightsholders for individual works.³ The U.S. Supreme Court in *BMI v. CBS* (1979)⁴ endorsed this transaction cost justification for certain copyright collectives in some circumstances. But even in 1979, it also envisioned technological change that would obviate the need for blanket licenses issued by copyright collectives (“And, of course, changes brought about by new technology or new marketing techniques might also undercut the justification for the practice.”)

Katz (2005) questions whether the transaction costs are sufficient to justify treating national music copyright collectives as natural monopolies. More importantly for our purposes, Katz (2006) and the Center for Copyright Studies (2015) explore whether the development of new forms of distribution of music and new technologies changes the balance of factors that had previously tipped in favor of copyright collectives for music performance rights. Katz (2006) observes that the change is perhaps most apparent in monitoring and tracking usage, both for broadcast media and more recently for streaming.

Kobayashi (2015) addresses the same question using a Coasian framework to evaluate transactions costs of copyright collectives relative to market provision of rights. He concludes that transactions costs are dramatically lower with digital technologies due to

³Towse (2012) discusses the assembly of a database of works as another scale economy that leads to natural monopoly.

⁴*Broadcast Music, Inc. v. CBS, Inc.*, 441 U.S. 1 (1979). <https://supreme.justia.com/cases/federal/us/441/1/>.

the ease of monitoring and reporting usage of copyrighted works on the service, and also because the scale economies of national streaming services will lead to far fewer licensees than with traditional media and other music outlets.

One response to the development of new technologies, and to the perceived inequity of the current regulatory framework to rightsholders, is to free rightsholders to negotiate with music services without regulatory oversight, as interactive streaming services do now for sound recording rights. Such a proposal is found in Schultz (2018), which assumes that the same agents – publishers and collectives – will negotiate royalty rates with services on behalf of individual rights holders, with an expectation that royalty rates will rise as a result. While this approach would liberate rightsholders and royalty rates from regulatory constraints, it likely would not result in efficient pricing, due not only to the market power that is inherent in such collective licensing, but also the inherent complementary nature of the rights that music services must license.

A music service must license different rights for both musical compositions and sound recordings, and any one of those rights may itself be owned jointly by multiple rightsholders. Without all of the necessary licenses, the music service is not able to legally stream music, and is subject to potentially crippling copyright infringement claims. This implies that the individual licenses are perfect complements: each license is obtained separately but must be used together by buyers (and, from the perspective of the buyer, each is of no value until all are obtained).⁵ Because suppliers of such complementary licenses in circumstances such as these would not be expected to internalize the impact of their pricing decisions on the suppliers of complementary products, they have an incentive when setting prices to raise them above the level that is optimal for rightsholders collectively (Cardi, 2007).⁶ As each rightsholder has similar incentives to raise royalty rates, the effect is an excessive total royalty rate.

⁵There are also other similar problems that stem from the need to secure complementary licenses that arise in the current licensing marketplace. For example, because a blanket license from one PRO is, at least in most circumstances, not a substitute for a blanket license from a different PRO, streaming services typically require licenses from all of the PROs to operate without fear of potentially crippling copyright infringement lawsuits. The need to secure blanket licenses from each PRO raises similar concerns.

⁶This pricing impact follows as long as either services or users have heterogeneous willingness to pay and perfect price discrimination is not possible.

The implication of complementary rights is that overall royalty rates would be set too high if owners were freed from regulatory constraints, resulting in high costs for music services. If services pass along those costs through either higher subscription rates for users (in the case of subscription services) or more frequent advertisements (for advertising-supported services), or if they were to degrade their service in some other way given higher costs, the total amount of streaming will be inefficiently low. It is important to note that all market participants would be better off by internalizing the complementarity externality. If individual rightsholders could jointly set a royalty rate (without running afoul of antitrust laws) they would prefer a lower total royalty rate than what they would end up with when pricing independently. Music service users also would prefer a lower royalty rate, and, when the lower rate is passed on in the form of lower subscription prices, fewer advertisements, more works streamed, or greater innovation, so would consumers.⁷

One solution to the complementarity externality from unregulated licensing of multiple rights is to allow a single, “uber collective” to negotiate all royalty rates as a single bundle, either freely or under a single, unified regulatory process (Cardi 2007). This approach was adopted in Australia starting in July, 2019 through OneMusic Australia, which provides users with a single license that authorizes performance of works in the repertoire covered by APRA AMCOS (musical works) and PPCA (sound recordings). The US Copyright Office (2015) notes that, “Both digital music services and record companies have urged the Office to consider such an approach.”

An alternative solution would preserve some roles for copyright collectives to take advantage of scale economies, but allow for competitive licensing. Besen, Kirby, and Salop (1992) examine one version of this alternative: rightsholders would still participate in a collective that performs the costly functions of monitoring usage and enforcing licensing,

⁷A more recent term for this sort of problem emerging from the need to secure multiple essential complementary rights is the tragedy of the anticommons (Heller, 1998; Buchanan and Yoon, 2000; Parisi and Depoorter, 2003; Katz, 2005), which captures the welfare implications when buyers must obtain multiple essential, complementary inputs by contrasting it with the more familiar tragedy of the commons. Unlike the tragedy of the commons, in which multiple users have rights to a common resource that results in overproduction beyond the socially efficient level, in the tragedy of the anticommons each supplier of essential complementary inputs exploits its ownership rights by demanding an excessive price, resulting in an inflated overall price for rights that results in underproduction relative to the social optimum.

but rightsholders would negotiate license fees individually with users. They note two welfare improvements from this change: lower prices as rightsholders compete for adoption by services, and less incentive for the collective to limit membership. These gains are mitigated by higher costs as the collective would need to monitor usage of every individual rightsholder's catalog, rather than, for example, sampling usage under a collective blanket license to distribute royalties to individual rightsholders. Besen *et al.* do not discuss the greater transaction costs of negotiating with every rightsholder whose music the service wants to license. They also assume that rightsholders will continue to offer blanket licenses, and do not address how to mitigate inefficiencies arising from the complementary externality that stems from having to secure multiple rights before a work can be streamed. As discussed in the commentary on the Besen *et al.* article in Goldstein (1992), the outcome could well be greatly inflated valuations of individual works, unless an antitrust exemption is given to allow collective negotiation.

Goldstein concludes by briefly contemplating the possibility that new technologies will enable computer-based licensing, with individually priced works rather than a blanket license. Katz (2006) also raises the possibility of a digital system for licensing individual works along with micro-payments for their use.

In 2010, the UK commissioned Ian Hargreaves to review the intellectual property landscape in the country and discuss how the system can be modernized and made more effective in promoting innovation. One of the primary recommendations in Hargreaves (2011) is the creation of a Digital Copyright Exchange to facilitate copyright licensing. The exchange would simplify and automate licensing, with accessible information on ownership, licensing terms, and potentially pricing. The report notes broad endorsement for a digital exchange among potential users and multiple proposals to implement such a system globally. The discussion in the report refers to copyrights in diverse media, and does not attempt to describe how the exchange would operate, though some form of regulatory supervision is expected and, according to Towse (2012), some role for regulation in licensing copyrights was anticipated. With respect to music, the Hargreaves report notes that commentators raised a number of practical concerns about implementation, but also

notes that the music industry potentially has the most to gain from implementing a digital exchange.

Moving towards a system with the licensing of individual works means moving away from blanket licensing. The economic advantages of blanket licensing through collectives, including streamlined licensing, a reduction in monitoring costs and the ability to use additional works at zero marginal cost, have been described by various commentators (Besen *et al.*, 1992; Towse, 2012; Watt, 2015; United States Copyright Office, 2015). As already noted, the principal cost of blanket licensing to the marketplace is the elimination of price competition and the creation of a monopolistic seller (Katz, 2005). Moreover, buyers' only option is to get a license to everything, rather than selectively limiting the works they are able to use, potentially at a lower cost.

The question, then, is whether there is a way to craft a marketplace for licensing rights to play music that navigates the conflicting goals of efficiency, deregulation, competition, and fairness in a marketplace where users predominantly consume music by subscribing or listening to streaming services and broadcast radio rather than by listening to purchased media such as CDs, digital downloads, and vinyl records. Such a marketplace could take advantage of algorithmic technologies for sequencing music on radio and radio-like (“non-interactive”) streaming services. It could also take advantage of a comprehensive, public database of works and rightsholders. The goal is to facilitate a licensing framework that allows for efficient licensing of individual works and permits rightsholders to freely set royalties for the use of their works, while, at the same time, allowing for competition and avoiding the market distortions from complementary ownership of necessary rights and collective licensing, and all without creating undue transactions costs for rightsholders and services. That is what we attempt to do our companion article. In the remainder of this paper, we describe in more detail the landscape of music copyrights and regulation currently operating in the U.S. market, with a focus on radio-style music services, and then discuss some of the implications for market participants from moving to a more competitive licensing alternative.

3. MUSIC LICENSING LANDSCAPE IN THE UNITED STATES

The current U.S. music licensing landscape is complex. There are different types of rights that can be implicated when music is used, and different rights are triggered by different types of uses. This complexity is matched by an array of regulatory regimes governing how those rights are licensed. The type of regulation varies depending on the particular right at issue and the way music is being used. There are also certain uses of certain rights for which there is no regulatory regime and other uses of certain rights for which no license is required at all.

In what follows, we provide an overview of some of these complexities. We begin with a summary of the different types of rights that are needed by certain large-scale music users, and describe the owners of those rights. We then provide a summary of the different intermediaries that play a role in the licensing of these rights. Next, we provide an overview of the different regulatory regimes that are currently in place that impact the rates and terms ultimately agreed to for these rights. Finally, we describe how these pieces fit together for non-interactive streaming services and other radio-style services – the types of music services that are the primary focus of our forthcoming companion paper describing a more competitive licensing alternative. This discussion is not intended to be a comprehensive description of the entirety of the music licensing marketplace, but is only intended to provide the necessary context to critically evaluate the impact of an alternative competitive music licensing system for these services.

3.1. The Rights at Issue. Broadly speaking, there are two different types of music copyrights that are of relevance here. First, there is the copyright in the musical composition itself (the notes and lyrics), generally referred to as the copyright in the “musical work.” Second, there is the “sound recording” – a particular “fixation” or recording of a performance of a musical work. These are distinct copyrights that can be held by the same individual/entity or by different individuals/entities. For example, if a composer writes a musical work, that composer will own the copyright in the musical work. If that same

composer creates a recording of that musical work, the composer will also own the copyright in the sound recording. But, as often happens, someone else may create a recording of the musical work. In that case, the copyright in the musical work will be owned by the composer while the copyright in the sound recording will be held by the individual or entity that created the particular recording of the musical work. When licenses to both the sound recording and the musical work are required for a particular use, the licensee typically separately secures the necessary rights from the sound recording and musical works rightsholders (or their licensing agents).

Musical works copyrights are typically not just held by the composers. In most instances, composers enter into agreements with music publishers. In exchange for the support of the music publisher (whose services can include collection of royalties, payment of advances, assistance with marketing, etc.), the composer will often assign the musical works copyright that he or she owns (or a portion thereof) to the music publisher. The musical works royalties are typically split between the actual composer(s) and the music publisher(s) pursuant to a pre-determined formula. Currently, there are three “major” music publishers – Sony/ATV Music Publishing, Warner/Chappell Music, and Universal Music Publishing Group – a handful of mid-sized music publishers, and a long tail of thousands of smaller music publishers.

Ownership of the copyright in the sound recording is typically determined pursuant to a contractual relationship between the recording artist(s) and their record label. In many cases, in exchange for ownership (complete or partial) in the sound recording copyrights, record labels provide recording artists with financing for the production of the sound recordings, promotion, and distribution through both physical (CDs, vinyl, etc.) and digital (digital downloads, streaming) means. As with music publishers, there are three “major” record labels – Universal Music Group, Sony Music Entertainment, Inc., and Warner Music Group. There are also thousands of “independent” record labels, although many of these independent labels use “aggregators” to handle at least some of the licensing of their sound recordings.

To further complicate things, each of the sound recording and musical work copyrights include a bundle of different rights. These distinct rights can be, and often are, licensed separately. The types of rights that are most often implicated by radio-like services are the right to publicly perform the musical work and, in the case of digital streaming services, the right to publicly perform the sound recording. The right to reproduce and distribute the musical work (sometimes referred to as “mechanical” rights), and the right to reproduce and distribute the sound recording can also be implicated, depending on the nature of the use of the music.

A final complication with respect to musical works is that they are often written by more than one composer. In such cases, each composer (and their publisher) can have ownership rights over the musical work (there can also be joint ownership of sound recordings, although it is a less prevalent issue.) The default rule under U.S. copyright law is that each co-owner, absent agreement to the contrary, has the right to license the entire work on a non-exclusive basis, with or without the consent of the other co-owners. The licensing co-owner is then under an obligation to account to his or her co-owners, i.e., the licensing owner must share the proceeds with the other owners. This default rule, however, seems to be becoming more of an exception rather than the norm. Over the last few years, the licensing agents of musical works rightsholders have asserted that they are not granting the full rights necessary to exploit the musical works they control.⁸ Instead, these licensing agents are offering “fractional” rights licenses – granting the rights to only the portions of the work that they control. Such fractional licenses require that the music user secure all of the fractions of rights from other co-owners (or their licensing agents) before the music user can actually use the work (U.S. Department of Justice, 2016).

3.2. Licensing Intermediaries. In addition to copyright owners (composers, recording artists, music publishers, and record labels), there are many intermediaries that play significant roles in the licensing of musical works and sound recording copyrights.

⁸Certain music users and musical works licensing agents disagree as to whether such “fractional rights” licensing has been the norm or whether, historically, these licensing agents have granted “full works” licenses. See U.S. Department of Justice (2016).

Perhaps the best-known intermediaries are the PROs. PROs aggregate the public performance rights for musical works of many individual composers and music publishers and license those works on a collective basis to a wide variety of entities that publicly perform music, ranging from digital streaming services, to radio and television broadcasters, to establishments that play music like bars, restaurants, gyms, and retail stores.⁹ PROs are only involved in the licensing of musical works public performance rights. They do not license any other musical works rights, nor do they license any sound recording rights.

The most common license type offered by PROs is what is known as a “blanket” license. This license gives the licensee (the music user) the right to use as much of the music in the PRO’s repertory as it wants in exchange for a fixed fee, typically expressed as a fixed dollar amount or a percentage of revenue.¹⁰ After deducting a portion of the royalties received from the licensees for administrative expenses, the PROs then distribute the balance to their affiliated songwriters and music publishers. The two largest PROs in the U.S. – the American Society of Composers, Authors and Publishers (ASCAP) and Broadcast Music, Inc. (BMI) – are not-for-profit organizations. These PROs represent hundreds of thousands of composers and music publishers and have repertories with many millions of musical works. There are also two significant for-profit PROs that operate today – SESAC, Inc. (SESAC) and Global Music Rights (GMR). These two PROs are smaller than ASCAP and BMI but still have sizeable repertories that include the performance rights to many thousands of musical works.

There are also third-party administrators that assist with licensing of reproduction (or mechanical) rights for musical works. Both the Harry-Fox Agency and Music Reports, Inc. act as such intermediaries. Because of the complexity of the system that was until very recently in place (requiring, among other things, that the music user serve a notice to the copyright holder notifying them that the service intends to use their musical work(s)

⁹The lower transaction costs associated with the licensing of streaming services have led some musical works rightsholders to try to license their rights through PROs for certain users but rely on market based licensing for others (Kobayashi, 2015).

¹⁰Certain PROs offer alternatives to the blanket license, including “per-program” licenses or “adjustable-fee” blanket licenses. These licenses still give the user the right to use as much music in the PROs repertory as they like, but allow for certain fee reductions under certain circumstances, most notably when the PRO licensee is able to secure some of the necessary performance rights directly from the composer or music publisher rightsholder.

as well as monthly reporting of royalties on a song-by-song basis) those streaming services that require mechanical rights licenses often turned to these third parties to assist with the administration of such licenses.

As a result of the recently passed Music Modernization Act, the reliance on such third party mechanical rights licensing administrators may change. Beginning January 1, 2021, a new licensing intermediary known as the Mechanical License Collective (MLC) is charged with handling many of these administrative tasks for mechanical rights. Specifically, the MLC is tasked with, among other things, taking the list of sound recordings that each service that requires mechanical rights licenses has played (along with the frequency of play), determine the corresponding musical works rightsholders, and then determine the appropriate royalty payment to each musical works rightsholder.

A key part of the mission of the MLC is to develop a comprehensive database of sound recordings and the musical works embedded in those recordings. While creation of such a database has been discussed for some time, the MMA has spurred its development.

There is also an intermediary that is involved in the licensing of sound recording rights to certain music users, performing a function that is in many respects quite similar to that performed by the PROs. SoundExchange, Inc. (SoundExchange) represents the collective interests of record labels and recording artists in negotiations, and, if necessary, litigation, with certain non-interactive music services over sound recording royalty rates and terms. In addition, SoundExchange collects royalties from these services and, after deducting a portion of the license fees to cover administrative expenses, pays out the remainder to the recording artists and record labels associated with the copyrighted sound recordings that were performed on these services, pursuant to a statutorily-set formula. These licenses grant the music service the right to use any sound recording so long as the service meets the requirements set forth in the governing statute. Some of the more prominent services that are able to take advantage of these statutory licenses and pay royalties through SoundExchange include non-interactive custom radio services such as Pandora (for its primary non-interactive service), Sirius XM for both its satellite and its internet-based

service, simulcast streamers of over-the-air radio broadcasts, and Music Choice and other similar services that provide music through cable and satellite television systems.

3.3. Regulatory Regimes Currently in Place. The intermediaries, including PROs, SoundExchange, and now the MLC that have emerged over time all license copyrighted musical works and sound recordings on a collective basis. Because such collective licensing can raise antitrust concerns, a variety of regulatory regimes have emerged that attempt to mitigate the ability of these entities to take full advantage of their market power when licensing rights and negotiating royalty rates.

Both ASCAP and BMI are regulated through consent decrees that they entered into with the U.S. Department of Justice (DOJ) in the 1940s. While these decrees have been amended from time to time, and have been periodically reviewed by the DOJ, they remain in place today (U.S. Department of Justice, 2016 and 2021). These decrees place a number of restrictions on the activities of ASCAP and BMI. Perhaps most relevant here is that, in the event that one of these PROs and a music user are not able to reach agreement on license fees and terms, either party may commence a “rate court” proceeding, in which a federal district court judge in the Southern District of New York is empowered to determine “reasonable” license fees and terms. Among other things, the purpose of the consent decrees is to place certain constraints on ASCAP and BMI such that the license fees that are negotiated (or, if necessary, determined by the “rate court”) between those PROs and music users more closely resemble those that would emerge in a workably competitive market.¹¹

The other two significant PROs in the United States today, SESAC and GMR, are not subject to consent decrees, though both have separately been subject to private antitrust litigation, in some cases resulting in settlements in which the PRO has agreed to constraints similar to those contained in the ASCAP and BMI consent decrees.

A second form of regulation impacts the rates and terms for musical works mechanical rights licenses for on-demand music streaming services such as Spotify and Apple Music.

¹¹This standard has been confirmed by judicial review. See *In re Pandora Media, Inc.*, 6 F. Supp 3d 317 (S.D.N.Y. 2014).

Unlike the types of services that are the focus of this and our companion paper, these services allow users to select the works that get streamed. The rates and terms for this statutory license are set either by negotiation between music publishers and songwriters (and their trade associations), on the one hand, and the on-demand music streaming services (and their trade association), on the other, or, in the event of a negotiating impasse, by the CRB. In the U.S., the types of services we focus on: radio-style services where the listener is not able to select what they want to hear and when, are not obligated to secure musical works mechanical rights licenses; various other countries require such licenses for radio and radio-like services.

The final regulatory regime of relevance here applies to performances of sound recordings on digital-audio services that meet certain statutory requirements. The rates and terms for these licenses are, absent a negotiated settlement, set by the CRB, and are administered by SoundExchange. The Music Modernization Act requires that going forward, all of the CRB sound recording rate proceedings will be governed by a standard that sets rates based on what a willing buyer and willing seller would agree to. In several recent determinations, the CRB has concluded that this willing buyer / willing seller standard calls for setting a rate that would emerge in a workably competitive market.

The common theme that is seen across the various types of regulation that govern the rates and terms for certain uses of musical works and sound recordings is that rates should approximate those that would emerge in a workably competitive marketplace. Of course, one of the challenges in determining such rates is that there is not actually a robust competitive marketplace for most music rights.

Several significant uses of music fall outside of these regulatory structures. One prominent example is sound recording rights for those digital music streaming services like on-demand streaming services that do not qualify for statutory licenses. These services secure licenses directly from sound recording rightsholders. Typically, this is done through individual negotiations with each of the three major record labels, with some independent labels, and with “indie aggregators” – entities that represent many independent labels in a single negotiation with a music service (Merlin, for example).

At the other end of the spectrum is over-the-air AM/FM radio. Not only is there no regulation of the rates paid by radio broadcasters for sound recording rights in the U.S., but there is no need for these broadcasters to secure a license at all, as the exclusive public performance right held by sound recording rightsholders is limited to *digital* audio transmissions. As a result, when a radio station broadcasts its signal over the air, it does not need to secure a license, or pay any royalties, to record labels or recording artists (AM/FM radio does pay royalties for musical works public performance rights). But, if identical content is simulcast by the same radio station over the internet, then a sound recording performance rights license is required and royalties are owed (typically at rates set by the CRB in the “webcasting” proceedings.)

3.4. Putting the Pieces Together. With the above-discussed background in mind, we now summarize how these pieces fit together for the types of music services discussed in this and our companion paper that could potentially benefit from a deregulated competitive marketplace. We begin with non-interactive streaming services.

These services provide a radio-like experience to their listeners: the service selects the songs played for each listener along with the frequency with which each particular song is played overall on the service. Listeners do not have control over which songs are played or when they are played, nor do they know what songs are upcoming. As a result, the service has complete control over what songs are ultimately heard by each listener. While a service may feel that it needs to play certain songs to attract or retain listeners and/or subscribers, it is still ultimately up to the service to determine exactly what songs will be played and with what frequency.

That is not to say that a listener never has any ability to influence what is played. Certain of these non-interactive services, such as Pandora’s flagship ad-supported service, do allow the listener to provide feedback to the service, such as whether the listener likes or dislikes a particular song, and allows the listener to select a song, artist, or genre for the service to build a playlist around. Some of these services also allow their listeners to “skip” songs (i.e., jump to the next song in the playlist before the “skipped” song is

finished), although, to qualify for the statutory license, there are limits on the number of times a listener can skip a song.

These services are required to secure licenses to publicly perform musical works. The rates and terms for these licenses are subject to some oversight as these rights are typically secured by entering into licenses with each of the four U.S. PROs. The largest two – ASCAP and BMI – are subject to consent decrees and, as a result, if the service and either of these PROs are unable to agree on rates and terms for a license, either side can petition the rate court to determine a “reasonable” fee. SESAC and GMR are not regulated, by consent decree or otherwise. As a result, the service must negotiate with these PROs without the backstop of rate court oversight.

Non-interactive webcasting services are also required to secure sound recordings performance rights (along with any necessary “ephemeral” rights¹²). So long as the service meets the statutory requirements, it is able to take advantage of the rates and terms set by the CRB. Historically, non-interactive services have paid a fixed rate for each performance of a sound recording (a “per-play” rate).

As a result of having a uniform price that applies to all sound recordings, the service has no incentive to account for price when creating playlists; price is effectively removed from the equation. The same is true on the musical works side, although for a slightly different reason. PROs typically license non-interactive services through a blanket license – a license that gives the licensee the right to use any of the works in the repertory of the PRO as much as they like for a fixed fee (generally expressed as a percentage of service revenue or a flat dollar amount). Because the fee does not vary based on which songs are played or the frequency of play, there once again is no reason for the service to consider price when creating playlists.

While the regulation of these collective licensing systems is intended to lead to prices that reflect those that would emerge in a workably competitive market, there are only a few glimmers of actual competitive forces at work. That need not be the case. Since these non-interactive services have the ability to control exactly what is played, a record label

¹²An “ephemeral” copy of a sound recording is one made to facilitate the transmission of that sound recording.

could, for example, offer a non-interactive service a reduced price in an effort to secure additional plays of its sound recordings on the service. At the same time, a record label could conclude that it has a particularly desirable catalog, and could ask for a higher price. While that may lead to fewer plays of its sound recordings on the service, the record label presumably would account for this, and expect that the higher price per play will more than make up for the decrease in the quantity of plays.

Similarly, with the right infrastructure in place, a label could offer different prices for different sound recordings within its catalog – perhaps seeking a relatively high price for its most popular sound recordings, knowing that the service is likely to play those recordings even at a higher price, and offering a lower price for its less popular recordings, in an effort to provide the service with the incentive to increase the plays of those recordings, ideally (from that label’s perspective) at the expense of a sound recording controlled by a different record label. Absent collusion and exploitations of market power, such market forces would be expected to lead to different prices charged by different labels and, if feasible, different prices for different sound recordings. But due in large part to the current structure of the marketplace, we generally do not see such manifestations of price competition today.¹³

In addition to non-interactive streaming services, there are other forms of listening that also provide a “lean back” experience. These include traditional over-the-air radio stations and satellite radio. Like the non-interactive streaming services, these services create playlists for the listener and the listener has no control over which songs are played or when they are played and has no visibility into what songs are coming next. As a result, these services also have complete control over what songs are ultimately heard. But unlike non-interactive services, these services do not create an individualized playlist for each listener. Instead, there is a single playlist for each station or channel that is broadcast to all listeners. And unlike with non-interactive streaming services, these services do not have the ability to track precisely how many people are listening to any given performance.

¹³A relatively recent CRB Determination of rates and terms for non-interactive webcasting (Web IV) was based in part on two instances of rates being negotiated between a statutory service and a record label outside the statutory license. Peoples (2016) observes that the use of such contracts to set overall statutory rates may deter future contracts from being negotiated outside the statutory license.

Both over-the-air radio stations and satellite radio providers are required to secure licenses to publicly perform musical works and typically do so in the same fashion that non-interactive streaming services do – from each of the U.S. PROs. As noted above, the larger two U.S. PROs are subject to consent decrees; the smaller two are not subject to regulation.¹⁴ The resulting licenses are similar in structure to the PRO licenses for non-interactive services.

Satellite radio services are also required to secure sound recordings performance rights (along with the related “ephemeral” reproduction rights). The only operating satellite radio service – SiriusXM – meets the requirements to take advantage of the statutory licenses covering all necessary sound recording rights. The rates and terms for these licenses are set by the CRB, with payment being made to SoundExchange, which then is tasked with making sure that the proper record labels and recording artists are compensated. To date, the CRB has always set a fixed percentage of revenue rate for this license. As a result, like with the PRO licenses noted above, there is a fixed fee that is paid to SoundExchange in exchange for the rights necessary to perform all sound recordings and that fee generally does not vary with use.¹⁵ Here again, because of the blanket nature of the statutory license, there is no incentive (except in limited circumstances) for the service to consider price when selecting which sound recordings are actually performed.

Unlike satellite radio services, over-the-air radio stations do not need to pay any royalties, or even secure a license, for any of the sound recordings they perform. When sound recording rightsholders were granted rights in public performance, those rights were limited to performances made by digital audio transmissions. The Copyright Act explicitly exempts public performances of sound recordings on over-the-air radio from the sound recording performance right.

¹⁴As a result of a private antitrust lawsuit brought by a radio industry trade association, SESAC has agreed to restrictions, similar to some of those in the ASCAP and BMI consent decrees, that relate to its licensing dealings with the broadcast radio industry.

¹⁵The statutory license does allow a service to reduce the fee payable to SoundExchange if the service enters into a license directly with individual record labels, and Sirius XM has done so for a relatively modest percentage of its plays.

The historic justification for the lack of a sound recording performance right has been that radio broadcasters and record labels (and the artists they represent) enjoy a mutually beneficial relationship whereby over-the-air radio stations are allowed to perform sound recordings at no cost to attract the listener pools that generate advertising dollars, and, in return, sound recording owners receive exposure that promotes record sales and other revenue streams. This historic rationale, however, has been challenged (Liebowitz, 2004 and 2007, United States Copyright Office, 2015). Establishing a competitive marketplace in which sound recording rightsholders can set their own prices to have their works performed on the radio would enable rightsholders and users to incorporate the actual promotional effect in the royalty rates paid. While the end result may be that there should be a positive price for sound recording performance rights, if it truly is the case that performances on the radio are highly promotional of other record label and artist revenue streams, it may very well be that a competitive market would lead to record labels and artists offering to pay radio stations to perform at least some of their works.¹⁶ In other words, the sound recording performance royalty for over-the-air radio plays that emerges in a competitive market might be zero or negative for some sound recordings, but only if the legislative justification for not creating a sound recording performance right for broadcast radio still holds for those recordings in the current marketplace.

As with non-interactive services, in a workably competitive market (absent collusion and exploitation of excessive market power) over-the-air and satellite radio broadcasters would be expected to pay different prices for different catalogs and even, if feasible, for different sound recordings within a single catalog. But due in large part to the current structure of the marketplace, we do not generally observe competition being manifested as price dispersion, and therefore users have little incentive to make decisions about what music to play based on price signals.

¹⁶So-called “payola” laws currently prevent this from happening (Coase, 1979). In our view, such laws should be eliminated if over-the-air radio stations are required to pay royalties to perform sound recordings and if a competitive market for such rights emerged. In short, the price, whether positive or negative, should be determined in a competitive market.

3.5. Discussion. The current landscape of institutions and regulations for licensing music to non-interactive and other radio or radio-like services is complex and seemingly haphazard, with varying standards and institutions governing different aspects of licensing. But abstracting away from these complexities, music licensing for radio-like services has generally settled into a particular approach toward balancing the conflicting goals of equity, efficiency, and availability: blanket licensing of large collections of works, with regulatory or competition oversight to promote fair pricing.

A competitive alternative has not been seriously considered due largely to the transaction costs of moving away from blanket licensing in the direction of licensing individual works (or smaller groups of works, such as for those owned by an individual rightsholder). However, the combination of an ownership database such as the one currently being propelled by the MMA in the U.S. with the advances in technology that allows for the technologically driven selection and monitoring of works performed by radio-style services has the potential to largely eliminate the transaction cost basis for maintaining the current licensing regime. This raises numerous questions: is there a competitive alternative that satisfactorily promotes equity and efficiency? How would such an alternative operate? And how would the resulting licenses and remuneration differ from the current system?

Presuming that the transaction costs of a competitive licensing mechanism are minimal, the competitive alternative has the potential to increase the efficiency of music licensing through flexible, competitive pricing that reflects differences among buyers and sellers and allows for a price mechanism to better allocate resources. There may well be some resistance to flexible pricing on the grounds of equity, or simply unfamiliarity—would copyright owners be willing to charge prices that differ across owners and across works? And are listeners actually better off if services are taking price into account when deciding what works to play? The analysis of payola practices by Coase (1979) is informative here; Coase concluded that the prevalence of payola payments in the 1950s and the tolerance for such payments on the part of radio stations suggests that copyright owners would allow for differential pricing of different works and that such pricing would benefit both music

services and their listeners through the impetus of competition to promote both low costs and high quality services.

In our forthcoming companion paper we describe how a competitive mechanism can be designed to minimize transaction costs, limit inefficiencies that could arise due to joint ownership, and to promote efficient pricing. We then discuss some of the ways that such a mechanism would impact copyright owners, collectives, users, and listeners. Inevitably the impact would vary across participants, particularly since the starting point of the status quo differs across services. Needless to say, these differences are important considerations for evaluating the impact of an alternative licensing mechanism and the prospects that such a mechanism would be adopted.

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