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FACILITATING COMPETITION BY REMEDIAL REGULATION

Kristelia A. García†

ABSTRACT

In music licensing, powerful music publishers have begun—for the first time ever—to withdraw their digital copyrights from the collectives that license those rights, in order to negotiate considerably higher rates in private deals. At the beginning of the year, two of these publishers commanded a private royalty rate nearly twice that of the going collective rate. This result could be seen as a coup for the free market: Constrained by consent decrees and conflicting interests, collectives are simply not able to establish and enforce a true market rate in the new, digital age. This could also be seen as a pathological form of private ordering: Powerful licensors using their considerable market power to impose a supracompetitive rate on a hapless licensee. While there is no way to know what the market rate looks like in a highly regulated industry like music publishing, the anticompetitive effects of these withdrawals may have detrimental consequences for artists, licensees and consumers. In industries such as music licensing, network effects, parallel pricing and tacit collusion can work to eliminate meaningful competition from the marketplace. The resulting lack of competition threatens to stifle innovation in both the affected, and related, industries.

Normally, where a market operates in a workably competitive manner, the remedy for anticompetitive behavior can be found in antitrust law. In music licensing, however, some concerning behaviors, including both parallel pricing and tacit collusion, do not rise to the level of antitrust violations; as such, they cannot be addressed by antitrust law. This

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is no small irony. At one point, antitrust served as a check on the licensing collectives by establishing consent decrees to govern behavior. Due to a series of acquisitions that have reduced the music publishing industry to a mere three entities, the collectives that are being circumvented by these withdrawals (and whose conduct is governed by consent decrees) now pose less of a competitive concern than do individual publishing companies acting privately, or in concert through tacit collusion. The case of intellectual property rights, which defer competition for creators and inventors for a limited period of time, is particularly challenging for antitrust.

Running contrary to conventional wisdom, this Article posits that regulation—not antitrust—is the optimal means of enabling entry and innovation in the music licensing market. While regulation is conventionally understood to restrict new entry and to interfere with competition, this Article demonstrates that where a market becomes highly concentrated, regulation can actually encourage competition by ensuring access to key inputs at competitive rates. While not without its drawbacks, including an increase in the cost of private action, remedial regulation in music licensing corrects anticompetitive behavior and ensures ongoing access to content and fair payment to artists, while supporting continued innovation in content distribution.

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I. INTRODUCTION

On March 30, 2015, rapper Jay-Z and a dozen of his closest artist-friends came together at a press release event in New York City to announce a new music streaming service that was widely billed as "revolutionary."[1] The service called Tidal was touted as artist-owned and promised to pay artists more than any other music streaming service. While the logistics around Tidal's business model were foregone in favor of star power and flashy showmanship, this much is clear: The only way Tidal is going to command $19.99/month (twice the monthly cost of competing services) from customers is if the participating artists—which include Jack White, Beyoncé, Daft Punk, and Kanye West—withdraw their content from all other music streaming services and thereby allow Tidal to create scarcity and command a higher subscription rate.

While this reduction in the number of distribution outlets may seem undesirable from a consumer perspective, this result is precisely what unregulated intellectual property (IP) rights do when they protect the

1. *See, e.g.*, Ben Sisario, *Jay Z Reveals Plans for Tidal, a Streaming Music Service*, N.Y. TIMES (March 30, 2015), http://www.nytimes.com/2015/03/31/business/media/jay-z-reveals-plans-for-tidal-a-streaming-music-service.html [http://perma.cc/M4ZX-CJ9W]

rights holder from competition for a limited period of time.[2] The real concern, and the subject of this Article, is the potential to stifle innovation in the content distribution space (here, the burgeoning music streaming industry) and to lock listeners into to the current distribution technology. Arguably, this is *not* what IP seeks to do—or at least not what it should do.

From a regulatory (if not a contractual) perspective,[3] the withdrawal scenario posited above is a real possibility. Take the recent American Society of Composers, Authors and Publishers (ASCAP) withdrawals, for example. ASCAP is a "performance rights organization" (PRO) that handles the collection and administration of public performance royalties, which are royalties incurred from the playing of a song on terrestrial or digital radio. At the beginning of last year, two of the nation's three major music publishers[4] withdrew their digital copyrights from ASCAP in order to license them through private deals.

The idea that a music publisher might forego the ease and convenience of collective licensing of its IP rights in order to do all of the work itself is counterintuitive. Conventional wisdom justifies collectives because they

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2. Concededly, not a limited enough time for some. *See, e.g.*, Jane C. Ginsburg et al., *The Constitutionality of Copyright Term Extension: How Long is Too Long?,* 18 CARDOZO ARTS & ENT. L.J. 651 (2000) (discussing the constitutionality, and overall desirability, of copyright term extension from the perspectives of incentives, natural rights, international law, and legislative history). To be clear, it is not suggested that IP prevents Taylor Swift from having to "compete" with Katy Perry for listeners, but rather that IP prevents Taylor Swift from having to compete with others for the reproduction and distribution of her own content.

3. In order to withdraw his content from Spotify, for example, Kanye West would have to rely upon the terms of his contracts with each of his publishing company and record label, and, in turn, their respective contractual obligations to Spotify, making the whole enterprise rather unlikely, though Taylor Swift—who controls her own publishing—has successfully done just that. *See, e.g.*, Steve Knopper, *Taylor Swift Abruptly Pulls Entire Catalog From Spotify*, ROLLING STONE, (Nov. 3, 2014), http://www.rollingstone.com/music/news/taylor-swift-abruptly-pulls-entire-catalog-from-spotify-20141103 [http://perma.cc/LN3H-VSXA].

4. A "music publisher" is a company that owns the copyrights on various musical compositions and licenses the use of those compositions to such entities as radio stations, sports stadiums, filmmakers, restaurants, and record labels—traditionally through a collective, but more recently via private negotiation. The three major music publishers in the U.S. today are Sony Music Publishing, LLC ("Sony"), Universal Music Publishing Group ("Universal") and Warner Music Publishing ("Warner"). *See, e.g.*, Ed Christman, *First-Quarter Music Publishing Rankings: SONGS Surges Again*, BILLBOARD, (May 12, 2014), http://www.billboard.com/biz/articles/news/publishing/6084783/first-quarter-music-publishing-rankings-songs-surges-again [http://perma.cc/SR7Z-WZ4N] (showing Sony, Universal, and Warner with 31.9%, 18.1%, and 13.3% market shares, respectively).

are able to reduce transaction costs and consolidate bargaining power.[5] The purported circumvention of ASCAP undermines these justifications and suggests that they no longer hold sway in the digital age. The rights withdrawals marked the first ever attempt at withdrawal and private ordering[6] in the music publishing industry and resulted in a negotiated royalty rate nearly double ASCAP's going rate.

One could view this result as a coup for the free market: Constrained by an antiquated consent decree and faced with conflicting member interests, ASCAP artificially depresses the "market" rate for music licensing. This result could also be viewed as a pathological form of private ordering in which two powerful companies wielded their considerable market power to coerce a supracompetitive rate from a hapless licensee.

Unfortunately, it is difficult to determine what the market rate looks like in a highly regulated industry like music publishing[7] because there has never been a true "market" for music licensing in any economically meaningful sense. While it is true that a songwriter can technically license her own songs, this is not logistically possible (at least in an analog world). Nearly every artist uses a collective for all relevant intents and purposes. The establishment of the music publishing industry arose more or less simultaneously with the creation of collectives that consolidated composition copyrights and set a royalty rate, thereby foreclosing the

5. *See, e.g.*, Robert P. Merges, *Contracting into Liability Rules: Intellectual Property Rights and Collective Rights Organizations*, 84 CALIF. L. REV. 1293, 1302–3 (1996) ("The high costs of contracting . . . drive the right holders to pool their property rights in a collective organization. . . . It is the high transaction costs associated with the initial entitlements that lead the parties to establish the organization—an organization that then dramatically lowers the costs of exchanging the rights."). That bargaining power is, of course, checked by consent decree, *see infra* Part II.B.5.

6. Here, "private ordering" refers to negotiation and deal making between private parties, outside of any statutory or regulatory regime.

7. There exists an ongoing debate about copyright's status as a form of regulation versus as a property right regime. *Compare* Adam Mossoff, *Is Copyright Property?*, 42 SAN DIEGO L. REV. 29, 41 (2005) (proposing that "a person's right to control the disposition of his creation, and thereby enjoy the fruits—the profit—of his labors, is central to the legal definition and protection of property entitlements."), *with* Siva Vaidhyanathan, COPYRIGHTS AND COPYWRONGS: THE RISE OF INTELLECTUAL PROPERTY AND HOW IT THREATENS CREATIVITY 12 (2003) (noting that "copyright issues are now more about large corporations limiting access to and use of their products . . . . We must seek a balance. . . . Instead of bolstering 'intellectual property,' we should be forging 'intellectual policy.'") For the limited purposes of content licensing, at least, the role of copyright law as regulation is undeniable, and this Article will treat it as such. Not only do the copyright laws contain statutory licenses for cable and satellite television, for example, but they also ultimately entrust royalty rate setting to governmentally authorized entities, including the copyright royalty board, and the rate court.

development of a free market for the licensing of musical compositions. For this reason, this Article takes no issue with the rate obtained, but rather with the potential for unchecked anticompetitive consequences for artists, licensees, and consumers. Notably, the two music publishers at issue—Sony and Universal—together control roughly 50% of all digital music publishing copyrights. Without this content, an Internet radio service would be hard-pressed to compete for listeners. This was the argument Pandora advanced in a rate court[8] proceeding that challenged the privately obtained rate as coerced.[9]

In an industry like music licensing, network effects, parallel pricing and tacit collusion can exacerbate the effects of consolidation by removing the threat of meaningful competition[10] from the marketplace.[11] This allows individual companies—acting alone or in tacit collusion with

8. In this context, a "rate court" is a court with exclusive jurisdiction to oversee licensing arrangements between a collective like ASCAP, and a potential licensee, like Pandora. The rate court's jurisdictional authority comes from the consent decree governing the collective. In a recent report on "Copyright and the Music Marketplace," the Copyright Office called the rate court "expensive and time-consuming" and noted an inability to "keep up with the pace set by the new digital marketplace." U.S. COPYRIGHT OFFICE, COPYRIGHT AND THE MUSIC MARKETPLACE: A REPORT OF THE REGISTER OF COPYRIGHTS 93–94 (2015), http://copyright.gov/policy/musiclicensingstudy/copyright-and-the-music-marketplace.pdf [http://perma.cc/45KF-LLUA].

9. *In re* Petition of Pandora Media, Inc., 6 F. Supp. 3d 317, 343 (S.D.N.Y. 2014) [hereinafter Order] (noting that "[u]nless Pandora could do without [Sony's content] and remove [the content] from its repertoire . . . Pandora had to obtain a license from Sony or face crippling copyright infringement claims."). It is also worth noting that withdrawal wasn't necessary from a licensing perspective: ASCAP's authority to license the publishers' content is non-exclusive, meaning the publishers could have readily competed with ASCAP in the market to license their songs without withdrawing those rights from the collective. But the withdrawals worked to reduce the field of competition—afterward, there was only one option for licensing that content, and that was through that publisher itself, sans consent decree.

10. Much can be made about the definition of "competition," and about whether it ought to be used in an economic or antitrust sense, in layman's terms or aspirationally. In the words of prominent antitrust scholar Rebecca Haw Allensworth, "'Competition' has no single monolithic meaning; the values traded off in [antitrust] trade in different currencies, and balancing them thus requires judgment beyond the realm of economics." Rebecca Haw Allensworth, *The Commensurability Myth in Antitrust*, 69 VAND. L. REV. 1, 4 (2016). This Article takes a broad view of competition, and considers both the procompetitive and anticompetitive effects of antitrust law.

11. "Network effects" refer to the increased value to a consumer deriving from an increase in the number of other consumers enjoying the same product or service. "Parallel pricing" is the difficult-to-detect situation wherein competitors recognize that it is in their collective best interest to informally cooperate as to price. "Tacit collusion" refers to low-level, coordinated effort between similarly situated competitors that does not rise to the level of a Sherman Act violation. *See infra* Part III.A.

similarly situated competitors—to engage in parallel pricing of performance rights, or to withhold rights altogether, thereby potentially barring entry to prospective licensees, all while avoiding antitrust scrutiny.

The case of intellectual property, where regulation defers competition or creates monopolies for creators and inventors for a limited period of time, is particularly challenging. Professor Suzanne Scotchmer attributed this dilemma to the fact that "under the Sherman Act, attempts to acquire or maintain a monopoly are illegal, even though merely being a monopolist is not. This distinction is especially important in markets with intellectual property, since intellectual property already grants a 'legal monopoly.'"[12] It is this unique potential for anticompetitive behavior that does not meet the definition of antitrust "harm" (i.e., does not explicitly violate §§ 1 or 2 of the Sherman Act), and therefore is not addressed by that body of law, that is the focus of this Article.

Normally, where a market operates in a workably competitive manner, the remedy for anticompetitive behavior can be found in antitrust law. In music licensing, however, a breakdown in structural competition reduces the ability of antitrust to function, in large part because antitrust law does not provide a remedy to address parallel pricing and tacit collusion.

The failure of antitrust in this marketplace is no small irony. At one point, antitrust law served as a check on the power of the collective licensing entities by establishing a consent decree to govern their behavior. No such consent decrees apply to individual publishing companies. This discrepancy has resulted in a situation where the collective that is being circumvented now poses less of a competitive concern than the individual, powerful copyright holders acting privately.

Previous scholarship offers qualified encouragement of private ordering as a means of increasing efficiency in the shadow of an inefficient statutory license.[13] This Article reaches a different conclusion in the collective context, where collectives are governed by consent decree while powerful individual rights holders are not. Currently, the two largest collectives—ASCAP and Broadcast Music, Inc. (BMI)[14]—function under

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12. Suzanne Scotchmer, Innovation and Incentives 290 (2004).

13. *See* Kristelia A. García, *Private Copyright Reform*, 20 MICH. TELECOM. & TECH. L. REV. 1 (2013).

14. Like ASCAP, BMI is a non-profit music licensing collective that competes with ASCAP for music publishing rights. In 2014, both ASCAP and BMI reported administration of approximately $1 billion each in public performance royalties. *See* ASCAP, ASCAP 2014 Annual Report at 4 (2014), http://www.ascap.com/~/media/files/pdf/about/annual-reports/ascap_annual_report_2014.pdf [http://perma.cc/YD24-UMAJ];

consent decrees that govern their operations. These consent decrees originated from concerns about anticompetitive behavior, including supracompetitive pricing and barriers to entry, that can result from the consolidation of a large number of copyrights in only a handful of entities. Notably, these same concerns apply equally to powerful, independent music publishing companies like Sony and Universal (which also consolidate large quantities of copyrights). The terms of the consent decree, however, do not govern those companies' behavior, nor do they constrain their ability to harm consumers and innovators who depend on access to the content.

Prior work also examines the phenomenon of private ordering around an unpalatable statutory license, or "penalty default license," as the inevitable result of inherent inefficiencies and uncertainty.[15] Similarly, the proliferation of private ordering in public performance rights licensing—where rights are traditionally licensed by collectives—challenges the conventional view that collectives are the optimally efficient licensing mechanism. Instead, this phenomenon demonstrates that collectives suffer many of the same inefficiencies as statutory licenses. While regulation is often criticized as restricting new entry and interfering with competition in the marketplace, this Article argues that where a market is structurally noncompetitive, remedial regulation can open the market to entry and innovation and can maintain competition therein. This approach is consistent with prior IP regulatory reform efforts, such as existing compulsory licensing regimes that ensure ongoing access to content. Indeed, from a historical perspective, IP rights have often been subject to regulatory limits—such as compulsory licensing—designed to facilitate and protect competition in the content distribution marketplace.[16]

The analysis proceeds in four Parts. Part II begins with a music licensing primer, then analyzes the recent rate court proceeding between Pandora and ASCAP to illustrate the emergence of a pathological form of private ordering in an industry historically dominated by collective licensing. In addition, Part II describes the rise and fall of collectives as the preferred means of licensing copyrighted content. Part III discusses the paradox revealed by this narrative; namely, the fact that the licensing

and *BMI Reports Record-Breaking Revenues of Over $1 Billion*, BMI (Sept. 10. 2015), http://www.bmi.com/press/entry/572180 [http://perma.cc/H36T-YCPS].

15. *See* Kristelia A. García, *Penalty Default Licenses: A Case for Uncertainty*, 89 N.Y.U. L. REV. 1117 (2014).

16. *See generally* Timothy Wu, *Copyright's Communications Policy*, 103 MICH. L. REV. 278, 279 (2004) (discussing "copyright's poorly understood role in regulating competition among rival disseminators")

collectives that are being circumvented—once a cause for antitrust concern due to their consolidation of content, but whose conduct is now governed by consent decree—now pose less of a competitive concern than the conduct of powerful copyright holders acting privately. Part IV makes the case for music as unique among other forms of content in order to explain the failings of antitrust in the music licensing space and the need for a different approach. Running contrary to conventional wisdom, Part V suggests that remedial regulation can encourage and maintain competition in the music industry in a way that antitrust cannot. In so doing, the Article provides a powerful case study of how the absence of structural competition leaves antitrust law unable to police competition and instead calls for the introduction of remedial regulatory oversight.

II. PRIVATE ORDERING AS PATHOLOGY

At the beginning of 2014, two of the country's three major music publishers attempted for the first time ever to withdraw digital copyrights that they had previously assigned to ASCAP, in order to license those rights through private negotiation. This preference for private over collective licensing[17]—which resulted in a negotiated royalty rate nearly double ASCAP's collective rate—challenges the traditional justifications for collective rights organizations, such as consolidation of bargaining power and minimization of transaction costs, and questions the conventional view of collectives as the optimal means of licensing copyrighted content.

Those who disfavor the consent decree under which ASCAP operates would conclude that private ordering predictably leads to rates and terms that more accurately represent the parties' respective valuations. This Part challenges that conclusion and instead posits that despite its perceived advantages, private ordering in the shadow of a regulated collective can have negative consequences, including various forms of anticompetitive behavior and other adverse market impacts. Beginning with a brief overview of music copyrights and licensing, this Part presents the recent

17. Not just "over," but in exclusion of, collective licensing (since the grant of rights to a collective like ASCAP is a non-exclusive one, such that the publishing companies could have easily left the digital rights with ASCAP while simultaneously licensing them privately). *See* United States v. ASCAP, No. 41-1395, 2001 WL 1589999, § IV(B) (S.D.N.Y. 2001) *cert. denied* 132 S. Ct. 366 (2011). In theory, at least, this would allow for competition between the music publishers themselves, and even between the publishers and ASCAP (though this would require that the content not be withdrawn).

Pandora–ASCAP rate proceeding as an example of what can go right and what can go wrong in private ordering in the shadow of a collective.

A. (NEARLY) EVERYTHING YOU NEVER WANTED TO KNOW ABOUT MUSIC LICENSING

1. Music Licensing 101

The world of music licensing is incredibly (and, many would argue, unduly) complicated.[18] This is as much the result of piecemeal legislation and powerful lobbyists as it is a reflection of well-intended, yet largely unsuccessful, attempts to anticipate and accommodate ever-evolving technologies and consumer preferences.[19] For the purposes of this Article, it suffices to understand that music is unique among copyrighted content (e.g., films, television programs, novels) in that a single song is actually comprised of two distinct copyrights: One on the underlying musical composition[20] and another on the sound recording of that musical composition.[21] For each of these copyrights, there exists a companion right—that of "public performance"—that gives a licensee the right to play (i.e., perform) a song publicly, such as at a restaurant, sporting event, or over the terrestrial radio airwaves.

These performance rights may be further broken down into digital performance rights (for online plays via an Internet radio service like Pandora), and terrestrial performance rights (for analog plays via an FM radio station). Copyrights on a musical composition and copyrights on a sound recording (and their respective public performance rights) are typically held by different parties and pay royalties differently depending on the platform and the use within that platform. This dichotomy (quadchotomy?) results in a number of interesting and counterintuitive phenomena in music licensing. For example, while the sale of a digital download of The Beach Boys' hit song "Surfin' USA" on Apple's iTunes platform triggers a statutory royalty paid on both the underlying musical composition and the sound recording, playing the same song on an FM radio station results in a public performance royalty payment to Chuck Berry, the song's composer, but no such royalty payment to the Wilson

18. For the especially motivated (or confused) reader, Appendix A offers a more in-depth, graphical representation of the music licensing concepts presented in this section.

19. *See generally* JESSICA LITMAN, DIGITAL COPYRIGHT (2006) (detailing a legislative process that relies on lobbyists for the construction and proposal of copyright laws).

20. *See* 17 U.S.C. § 102(a)(2) (2012). Formerly known simply as "sheet music," a musical composition can range from a formally notated work to an informal transcription or approximation of a musical work.

21. *See id.*

brothers, performers of the sound recording. This Article is concerned only with public performance rights on musical compositions (i.e., Chuck Berry in the above example) and with the collectives that administer those rights—specifically, ASCAP, the nation's largest music licensing collective.

The collective licensing of performance rights for musical compositions evolved in response to a perceived gap in copyright law. § 115 of the Copyright Act of 1976 (hereinafter, the "Copyright Act")[22] provides for a compulsory license that allows recording artists to record cover versions of the musical compositions of other artists. There is no comparable compulsory license for the public performance of musical compositions, however. This means that the licensing of public performance rights for musical compositions must be negotiated between a content owner and prospective licensee. In other words, § 115 allows for the creation of a new sound recording of a composition, but not for the public performance of that composition.

While individual songwriters can technically negotiate and administer their own public performance rights,[23] this is largely impractical—at least in an analog world. For example, there is no practical way for The Beatles' estate to monitor—much less invoice and enforce against—every restaurant, coffee shop, and retail clothing store nationwide that plays any piece of the band's extensive repertoire. For this reason, public performance rights for musical compositions have traditionally been assigned to and managed by a collective like ASCAP.[24]

2. *Collectives, Consent Decrees & Rate Courts*

ASCAP is a non-profit organization that licenses public performance rights for, and collects and distributes royalties on behalf of, its members.

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22. 17 U.S.C. § 115(a)(1).

23. *Cf.* 17 U.S.C. § 114(e)(1) (public performance rights for digital sound recordings, which are subject to a compulsory license).

24. In the United States, the collective management of performance rights for musical compositions vests primarily in three organizations: ASCAP, BMI and SESAC. Most of these rights are held by ASCAP and BMI, the nation's two largest PROs. The Society of European Stage Authors and Composers (SESAC) is a much smaller, privately-held company that handles the remainder or, in rare instances, the individual songwriters manage the rights themselves and operate under consent decree. This comports with Professor Wu's characterization of PROs as more like governmentally regulated compulsory licensors than as private entities. *See* Wu, *supra* note 16, at 280.

Those members range from individual songwriters with a mere handful of copyrights to large music publishing companies with thousands of copyrights. Wielding expertise acquired through repeat negotiation and utilizing consolidated bargaining power deriving from its large quantity of content, collectives like ASCAP offer prospective licensees various licensing options of different configurations, durations, and price points. The most popular offering, known as a "blanket license," offers a licensee the rights to all of the content in a collective's catalog.[25] In exchange for this service, members pay ASCAP a share of the royalties collected on their behalf.[26] The price at which ASCAP offers its various license configurations to licensees is determined in the first instance by its membership, and failing that, by a rate court as detailed below.

ASCAP formed in 1914 in response to a desire for musicians to be paid when their music was played in public spaces, like restaurants.[27] The popular account recalls Italian composer Giacomo Puccini and American composer Victor Herbert lunching in New York City when a band in the restaurant began playing one of Herbert's hit songs. Puccini allegedly grew enraged upon learning that Herbert was not being paid for the use of his song as he would have been in Europe. And so ASCAP was born. Its founding members included such musical giants as John Philip Sousa, Irving Berlin, George and Ira Gershwin, and Cole Porter.[28] Today, ASCAP represents over half a million members and has a catalog of over 10 million songs.[29]

ASCAP operated as the sole public performance rights collective until 1940, when its ongoing battle with the radio industry reached its peak, and the radio stations pulled all ASCAP-licensed content from the

25. *Licensing Help,* ASCAP, http://www.ascap.com/licensing/termsdefined.aspx [http://perma.cc/VTU2-E6TG].

26. As of the publication of this Article, the formula for calculating this share of royalties is: (use weight) × (licensee weight) × ("follow the dollar" factor) × (time of day weight) + (audio feature premium credits) + (tv premium credits) = credits. For further, yet still unsatisfactory, explanation of this calculation, *see ASCAP Payment System*, ASCAP, http://www.ascap.com/members/payment/royalties.aspx [http://perma.cc/9ZF8-2Z48]. Needless to say, the formula is often critiqued for its opacity.

27. To be sure, the Copyright Act of 1909 had a public performance right for sound recordings, but it had yet to be interpreted doctrinally and so there was no practical means of enforcing the payment of royalties earned. *See* Copyright Act of 1909, Pub. L. No. 60-349, 35 Stat. 1075 (1909).

28. *See* Jeff Lunden, *Collecting Money for Songwriters, A 100-Year Tug of War*, NPR MUSIC (Feb. 13, 2014), http://www.npr.org/2014/02/13/275920416/collecting-money-for-songwriters-a-100-year-tug-of-war [http://perma.cc/VY8L-79VA].

29. *Happy Birthday, ASCAP!*, ASCAP, http://www.ascap.com/100.aspx#ascaptoday [http://perma.cc/X5WH-25FV].

airwaves.[30] During the eight months that it took for ASCAP and the broadcasters' association to renegotiate a rate, the broadcasters formed their own collective, BMI, as an ostensible competitor to ASCAP. The potential for anticompetitive behavior resulting from the consolidation of performance rights had been exposed, however, and the Department of Justice (DOJ) took notice.

The long-recognized propensity of collectives to raise concerns about anticompetitive behavior has been recognized by the academic literature[31] and the DOJ alike. The DOJ first alleged ASCAP was an "unlawful combination" in the early 1930s.[32] In 1940, a follow-on lawsuit brought by the DOJ against both ASCAP and BMI alleging unreasonable restraint of trade resulted in the imposition of a consent decree to govern the collectives' operation.[33] ASCAP's consent decree, originally entered into in

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30. Another, less well-documented complaint against ASCAP was its exclusion of certain genres; specifically, jazz, blues, R&B and "hillbilly" (or country) music. *See, e.g.*, CHOSEN CAPITAL: THE JEWISH ENCOUNTER WITH AMERICAN CAPITALISM 144–45 (Rebecca Kobrin ed., 2012).

31. For more on the history of confrontation between ASCAP and radio, see Peter DiCola & Matthew Sag, *An Information-Gathering Approach to Copyright Policy*, 34 CARDOZO L. REV. 173, 203–08 (2012). In another example, Glynn Lunney, *Copyright Collectives and Collecting Societies: The United States Experience*, *in* COLLECTIVE MANAGEMENT OF COPYRIGHT AND RELATED RIGHTS 340 (Daniel J. Gervais ed., 2010), notes:

> In the United States, [collectives] are viewed as something of a necessary evil. By reducing the transaction costs entailed in enforcing and licensing the public performance of musical works, they create a market in which otherwise there would be only infringement. But they do not merely reduce the transaction costs associated with the public performance right, they also eliminate competition between the individual copyright owners over public performance licensing terms and pricing. Because of this anti-competitive potential, copyright collectives in the United States have faced recurring litigation over whether their licensing practices violate the anti-trust laws.

32. *Id.*

33. For ASCAP's original consent decree, see *United States v. ASCAP*, 41 Civ. 1395 (S.D.N.Y. 1941). For BMI's, see *United States v. BMI*, 64 Civ. 3787 (S.D.N.Y. 1941). Due to its relatively small size and market power, SESAC is not subject to a consent decree. It is worth noting that SoundExchange, the designated collective for sound recordings, differs from the music publishing collectives in that SoundExchange was designated by the Librarian of Congress as the sole collective for the collection and administration of sound recording royalties under its regulatory authority. *See* Digital Performance Right in Sound Recordings and Ephemeral Recordings, 80 Fed. Reg. 59588 (Oct. 2, 2015) (to be codified at 37 C.F.R. § 380). As such, it does not pose the same threat of anticompetitive behavior, and therefore does not operate under a consent decree.

1941, arose from a lawsuit brought by the DOJ under § 1 of the Sherman Act of 1890 (hereinafter, the "Sherman Act").[34]

As amended in 2001, ASCAP'S consent decree (hereinafter, the "Second Amended Final Judgment" or "AFJ2") names the U.S. District Court for the Southern District of New York (the "SDNY") as rate court.[35] In that capacity, the SDNY provides a forum for the resolution of rate disputes between content licensors like ASCAP and content licensees like Pandora. Where a licensee and ASCAP are not able to reach a fee agreement, the licensee can petition the SDNY to set a "reasonable fee."[36] At the rate court proceeding, ASCAP has the burden of proving that the rate it seeks is reasonable.[37]

Among other things, the AFJ2 requires that ASCAP grant the right to perform *all* of the compositions in its repertoire to any prospective licensee who requests to do so.[38] It also prohibits ASCAP from engaging in price discrimination between similarly situated licensees.[39] Notably, the consent decree governs only the behavior of ASCAP and not that of its individual members.

3. *Music Publishing Consolidation*

Songwriters assign their copyrights to music publishing companies, who in turn license those compositions to recording artists, record labels, and various analog and digital distribution outlets. When the music publishing industry first began in the 1890s, royalties earned from the licensing of musical compositions comprised the majority of music industry revenues and that continued until the sale of sheet music slowed during the Great Depression.[40] The growing popularity of radio saw public performance revenues take the lead during World War II.[41] The advent of rock and roll led to a massive increase in album sales, which pushed royalties earned on sound recordings to the forefront during the 1960s and 1970s.[42] Before long, the recording industry dwarfed music

34. 15 U.S.C. § 1 (2004). The Sherman Act is one of three primary acts that together constitute U.S. antitrust law. *See infra* Part IV.

35. *See* United States v. ASCAP, No. 41-1395, 2001 WL 1589999, § IX (S.D.N.Y. June 11, 2001).

36. *Id.*

37. *Id.*

38. *Id.* §§ VI, IX(E).

39. *Id.* § IX(C).

40. *See* GEOFFREY P. HULL, THOMAS HUTCHISON & RICHARD STRASSER, THE MUSIC BUSINESS AND RECORDING INDUSTRY 112 (3d ed. 2011).

41. *Id.*

42. *Id.* at 113.

publishing, which in turn morphed from an industry that focused on creating musical works, into primarily a "copyright industry" that focused on licensing musical works.

Given the miniscule bargaining power afforded the owner of a copyright on a single musical composition (however popular the song), it is not surprising that music publishing is an industry built on the acquisition and consolidation of lots of musical compositions. Indeed, the three major music publishers today are the result of extensive consolidation among many smaller publishing companies. Universal resulted from a merger between PolyGram, MCA, Rondor, BMG, and Zomba. EMI Music Publishing (EMI, acquired by Sony in 2012) began in 1974 as a combination of Ardmoor, Beechwood, Keith Prowse, and Central Songs, followed by the addition of Screen Gems and Colgms, SBK, CBS and Jobette. Warner began in 1929 with its acquisition of Chappell-Harms. Sony—currently the nation's largest publisher—got its start in 1989 when the company purchased CBS (then known as Tree), and then scored a coup with the purchase of Michael Jackson's ATV catalog, which included the Beatles' repertoire, for a purchase price of $100 million.[43]

The most plausible explanation for the dramatic consolidation observed in the music publishing industry is money—or, more accurately, the lack thereof. New technological developments including the Internet, the iPod, and the smartphone have changed the way that people consume music. This has resulted in a shift away from traditional revenue streams like CD sales to the sale of digital tracks, and, more recently still, to the sale of streaming subscriptions. These developments have not only dramatically reduced absolute revenue in dollars,[44] but have also forced ongoing changes to traditional business models and to the role of collectives like ASCAP.

B. PRIVATE LICENSING IN THE SHADOW OF A COLLECTIVE: PANDORA V. ASCAP

At the beginning 2014 two of the nation's three major music publishers attempted to withdraw their digital performance rights from ASCAP, the collective that governs those rights. Presumably, publishers had not attempted withdrawal of these rights before for a couple of reasons: First, because ASCAP's governing documents didn't allow for it;

43. *Id.* at 115.

44. *See, e.g.*, David Pakman, *The Price of Music*, RECODE (March 18, 2014), http://recode.net/2014/03/18/the-price-of-music [http://perma.cc/28ZJ-5FK7].

and second, because publishers didn't want to. This section follows the temporal progression of the publishers' withdrawal and the ensuing response.

1. *Music Publishers Attempt to Withdraw Digital Public Performance Rights*

On November 5, 2012 Pandora asked the SDNY to settle a rate dispute with ASCAP over digital performance royalties.[45] ASCAP administers the digital performance rights for two of the country's three major publishers, Sony and Universal. These companies currently hold 31.9% and 18.1% market share, respectively.[46] Pandora is a non-interactive[47] digital radio service that licenses digital public performance rights for the songs offered through its various stations. Pandora users create personalized digital radio stations in which they request to hear songs of a certain genre, or that sound like a particular song or artist. These users can then further refine the listening experience by assigning the songs played either a "thumbs up" or "thumbs down."

In July 2005, Pandora and ASCAP negotiated for a blanket license known as a "form license" that ran from 2005 until Pandora canceled it in 2010.[48] The form license, which the parties named the "5.0 License,"

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45. *See* Order, *supra* note 9, at 6.

46. *See* Ed Christman, *First Quarter Music Publishing Rankings: SONGS Surges Again*, BILLBOARD (May 12, 2014), http://www.billboard.com/biz/articles/news/publishing/6084783/first-quarter-music-publishing-rankings-songs-surges-again [http://perma.cc/3UYW-DZAT]. Already a dominant presence in the industry, Sony became even more powerful when it acquired EMI's publishing assets in 2012. *See, e.g.*, Alex Pham, *Sony completes EMI acquisition, creating largest music publisher*, L.A. TIMES (June 29, 2012), http://articles.latimes.com/2012/jun/29/entertainment/la-et-ct-sony-completes-emi-acquisition-20120629 [http://perma.cc/C6KG-S9WV] (citing the close of the merger, and noting a catalog of over 2 million makes the combined entity the largest publisher in the world). *See also* Ed Christman, *Sam Smith's 'Stay With Me' Is Music Publishing's Big Winner in Q3*, BILLBOARD (Nov. 8, 2014), http://www.billboard.com/biz/articles/6304471/sam-smiths-stay-with-me-is-music-publishings-big-winner-in-q3 [http://perma.cc/7JP3-SP96] (citing the Sony-EMI combined market share at 31.22% in the third quarter of 2014).

47. "Non-interactive" refers to a music service in which the user cannot choose a specific song to listen to, but instead can set parameters such as genre, and artists or albums or songs that the selections should "sound like." The significance of this categorization is that non-interactive services can take advantage of the statutory license. Interactive services – in which users can hear a specific track or artist on demand—cannot use the statutory license and instead must engage in direct negotiations with rights holders. In this way, the Internet radio experience offered by services like Pandora is distinct from digital music platforms like iTunes, on which consumers purchase specific songs and albums, and also from interactive streaming services like Spotify, on which users can populate playlists with specific tracks.

48. *See* Order, *supra* note 9, at 30.

required Pandora to pay the greater of either 1.85% of revenue, or a per-session rate.[49] Citing the difficulty of calculating a per-session rate, Pandora notified ASCAP of its intent to terminate the form license on October 28, 2010, at which point the parties negotiated for a new, "through-to-the-audience" blanket license to run from January 1, 2011 through December 31, 2015.[50]

In accordance with the consent decree under which it operates, ASCAP granted the license on a provisional basis, with rates to be determined after the fact by negotiation.[51] Pandora filed its rate court petition after nearly two years of negotiation with ASCAP without an agreement as to rate.[52] In addition to setting a rate in accordance with Section 9 of the AFJ2, the rate court's opinion details a disturbing level of cooperation among the major music publishing companies. The opinion also highlights a new and significant development in the licensing of public performance rights: partial withdrawal of rights from a collective in favor of private ordering.[53]

EMI[54] was the first of the major music publishers to propose partial withdrawal of its rights from ASCAP. Citing a desire to unify its publishing and recording rights in order to offer licensees a single point of access, as well as a general dissatisfaction with ASCAP's high administrative costs, EMI informed ASCAP in September 2010 that it was considering withdrawing either its digital rights only, or, failing that, its public performance rights entirely, from ASCAP.[55] Shortly thereafter,

49. *Id.* at 30–31.

50. *Id.* at 33.

51. *See* United States v. ASCAP, No. 41-1395, 2001 WL 1589999, § 5 (S.D.N.Y. 2001).

52. *See* Order, *supra* note 9, at 34.

53. One might wonder why, if the music publishers were unhappy with ASCAP and BMI's rates, they didn't simply take their business to SESAC, the remaining collective. As a small, privately-held collective, SESAC is invitation only, foreclosing this option to all but a select few rights holders.

54. EMI's musical composition catalog was acquired by Sony in 2012, and EMI no longer exists. *See supra* II.A.3.

55. *See* Order, *supra* note 9 at 39. As discussed in Part II.A.1 *supra*, two different copyrights protect musical compositions and sound recordings, and these copyrights are often held by different entities, and then licensed by different collectives. This was the case with EMI, whose publishing rights were administered by ASCAP, while its sound recording rights were administered by SoundExchange. If EMI were to withdraw its rights from ASCAP and SoundExchange, and instead license both in-house, prospective licensees wouldn't have to strike two different deals (or so the argument went). In reality, those licensees would likely already have blanket deals in place with each of ASCAP and

Sony and Universal expressed interest in withdrawal as well. There was only one problem at the time: ASCAP's governing articles didn't allow for partial rights withdrawal. As things stood, the publishers either had to withdraw their rights entirely (i.e., digital and analog), or leave them all with ASCAP.

2. *Amendment of ASCAP's Governing Articles*

This state of affairs didn't bode well for ASCAP. Fearing the loss of its largest members (and the associated royalty shares), ASCAP responded with an unprecedented proposal to amend its governing articles so as to allow members to withdraw their digital (also known as "new media") rights, while allowing ASCAP to retain administrative authority over their analog rights.[56] The proposal was met with skepticism from ASCAP's independent writer-members, and rightfully so. The loss of digital revenue from ASCAP's largest publisher-members would leave the much smaller (and less powerful) independent songwriters footing a much larger portion of the collectives' overhead. This overhead was largely attributed to analog collections—physical monitoring of bars, invoicing of sports parks, etc.—such that those costs would not be diminished much by the digital withdrawals.

In an effort to convince the smaller member hold-outs to nonetheless pass the amendment allowing for withdrawal, the major music publishers took a two-pronged approach: First, they agreed to let ASCAP handle the *distribution* (but not negotiation or collection) of digital royalties, albeit at a much lower administrative fee.[57] This would keep at least a little of the digital money coming in. Second, the withdrawing publishers argued that by allowing them to go out into the market and obtain higher royalty rates through private negotiation with licensees, those rates could then be

SoundExchange, and this withdrawal would merely necessitate yet another deal, this time directly with EMI. But I digress.

56. The digital rights withdrawals required multiple amendments to ASCAP's governing documents, effectively removing the withdrawing publishers from the auspices of the consent decree that governs ASCAP. *See* Order, *supra* note 9, at 39. This withdrawal is referred to herein as "partial withdrawal." As it happens, only digital rights might potentially benefit from EMI's purported "rights unification," since only digital rights on the sound recording side are entitled to a public performance royalty. There is no public performance right for sound recordings on the analog side. That is to say, terrestrial radio broadcasters do not pay recording artists when they play their music (they do pay the songwriters), but digital radio broadcasters do. For a full explanation of this conundrum, *see* García *supra* note 15 at 1134–36.

57. *See* Order, *supra* note 9, at 53.

presented to the rate court as evidence of a new "market rate," allowing ASCAP in turn to demand a higher rate for all of its members.[58]

The arguments hit the mark and on April 27, 2011, the ASCAP Board voted to amend its governing articles to allow a member to withdraw its new media rights only.[59] This amendment is especially significant given that technological developments are likely to result in the conversion of most analog ASCAP licensees to digital in the next few years, rendering ASCAP's remaining functions obsolete. In addition, the amendment allows a withdrawing publisher to rejoin at any point, making withdrawal a very low risk option.[60]

Within days of the passage of the amendment allowing it to do so, EMI publicly announced the withdrawal of its digital rights, followed by Sony's announcement in July 2012,[61] and Universal's in February 2013.[62] By early 2013, two of the three major music publishers had done the unthinkable—they had withdrawn their digital rights from ASCAP in an effort to increase profits.

The major music publishers correctly understood the AFJ2's requirement that ASCAP license its repertoire to any and all prospective licensees, preventing ASCAP from using its inherent market power to demand a higher rate.[63] This hand-tying frustrated the music publishing companies because it kept their going rate below that of sound recordings. A digital music service like Spotify currently pays \$0.0052 per play to SoundExchange for the public performance rights to a sound recording, while paying only \$0.00052 per play—or one tenth of the rate paid to SoundExchange—to ASCAP for the same public performance rights to the underlying musical compositions.[64] This disparity reflects a

58. *See* Order, *supra* note 9, at 45. As explored further at Part II.C.3.b *infra*, this would result in the adoption and enforcement of a potentially misrepresentative "market" rate.

59. *See* ASCAP, COMPENDIUM OF ASCAP RULES AND REGULATIONS, Rule 1.12 at 10–14 (2014), http://www.ascap.com/~/media/files/pdf/members/governing-documents/compendium-of-ascap-rules-regulations.pdf (hereinafter COMPENDIUM) [http://perma.cc/9ATQ-QUWM].

60. *See* Order, *supra* note 9, at 48.

61. Effective January 1, 2013. *See id.* at 60–61.

62. Effective July 1, 2013. *See id.* at 72.

63. *See id.* at 41.

64. There is little transparency as to rate—neither for licensees nor artists—but the good folks at Trichordist have extrapolated these commonly accepted figures. *See The Streaming Price Bible – Spotify, YouTube & What 1 Million Plays Means to You*, TRICHORDIST (Nov. 12, 2014), http://thetrichordist.com/2014/11/12/the-streaming-price

determination by Congress that the nature of the industries for sound recordings and musical compositions vary in material and substantial ways. For example, the overhead required to commission and record an album has traditionally outpaced the cost of signing a songwriter.[65]

In a further effort to differentiate between the two rights, Congress included in the Digital Performance Right in Sound Recordings Act (DPSRA) a clause prohibiting the rate court from taking sound recording license rates into account when setting the rates for musical compositions.[66] This congressional prohibition on the rate court, however, did not keep the major publishers from taking note. At the Pandora–ASCAP proceeding, Sony's EVP of Business & Legal Affairs, Peter Brodsky, cited the "massive unfair disparity" between what Pandora pays for sound recordings and what it pays for musical compositions as the principal reason for the company's withdrawal from ASCAP: "It was the 'differential' between the rates paid to the labels and the publishers that was the problem[.]"[67]

By December 2012, the withdrawing publishers had succeeded in wringing yet another amendment from ASCAP—this time, one that would allow them to withdraw their new media rights selectively (on a licensee-by-licensee basis). Publishers could then focus their negotiating efforts on larger, more commercially successful digital partners such as Pandora while leaving the smaller, bootstrap entities—largely believed to be fly-by-night anyway[68]—or ASCAP to deal with.[69]

The second amendment met with even more resistance from ASCAP's embattled writer-members than the first. Nonetheless, it eventually passed

-bible-spotify-youtube-and-what-1-million-plays-means-to-you [http://perma.cc/9U9R-EKGT].

65. For example, a typical record costs between $500K–$2M to produce. *See, e.g.*, *Typical investment by a major record company in a newly signed artist*, IFPI, http://www.ifpi.org/how-record-labels-invest.php [http://perma.cc/M6ZC-7WUC]. A typical songwriter's advance ranges from $18,000–$100,000. *See, e.g.*, DONALD S. PASSMAN, ALL YOU NEED TO KNOW ABOUT THE MUSIC BUSINESS 269 (7th ed. 2009). *See infra* note 88 and accompanying text.

66. Specifically, the DPSRA provides that "[l]icense fees payable for the public performance of sound recordings . . . shall not be taken into account in any . . . proceeding to set or adjust the royalties payable to copyright owners of musical works for the public performance of their works." 17 U.S.C. § 114(i) (2012).

67. Order, *supra* note 9, at 63.

68. ASCAP's VP for New Media and Technology Matthew DeFilippis offered this explanation: "Given the rapidly changing marketplace and the low barriers to entry, new digital music services launch quite frequently. Many will never gain traction with listeners or generate substantial revenue." *Id.* at 52.

69. *See id.* at 51.

permitting a withdrawing member to indicate that it wished to leave with ASCAP its digital rights only for services paying less than $5,000 per year in licensing fees.[70] These smaller services now faced a choice: Accept ASCAP's 5.0 form license without negotiation or go without the content.[71] As a larger digital service, Pandora faced an even more dire fate: Private "negotiation" with the major publishers.[72]

3. "Negotiation"

Pandora's filing of a rate court petition against ASCAP angered the heads of major music publishing companies, like Universal's CEO, Zach Horowitz, who—through a series of emails and other communications—encouraged ASCAP's then-CEO John LoFrumento to "be strong . . . You can really push Pandora . . . They will pay more . . . ."[73] Horowitz also called Pandora's counsel on multiple occasions to encourage them to drop the case by suggesting that in representing Pandora they were losing "huge goodwill with writers and artists."[74] He sent similar communications to ASCAP board members, to BMG Publishing CEO Laurent Hubert, to National Music Publishers Association (NMPA)[75] President David Israelite, and to Sony's CEO Martin Bandier, whose company had also withdrawn its digital rights and was at that time in the middle of private rate negotiations with Pandora.[76]

Meanwhile, by late November 2012, Pandora believed that it had finally reached an agreement with ASCAP, and that it was just waiting for final approval from the ASCAP Board to terminate the rate court

70. See *id.* at 52, and COMPENDIUM, *supra* note 59, § 1.12.2(b) stating:

> If in part, the Member's New Media Transmission Licensing Rights will continue to be licensed and administered by ASCAP for only those 'New Media Services' . . . that: (i) qualify for and are licensed by way of any of ASCAP's form new media license agreements, or, (ii) qualify for and are licensed by an ASCAP 'affiliate' or 'multi-site' license agreement.

71. *See* Order, *supra* note 9, at 52.

72. Pandora's negotiation with EMI post-withdrawal was reportedly amicable, and the parties settled on the going rate of 1.85% in May 2011 (leaving Pandora paying the same as it would under a license with ASCAP, but saving EMI the administrative fees and royalty shares it would otherwise have had to pay to ASCAP). *See* Order, *supra* note 9, at 53–54. Because EMI was acquired by Sony shortly thereafter, however—thereby severely limiting the duration of the agreement—the remainder of this Article focuses on the Sony and Universal withdrawals for all intents and purposes.

73. Order, *supra* note 9, at 57.

74. *Id.*

75. The NMPA is the U.S. trade association for music publishing.

76. *See* Order, *supra* note 9, at 57.

proceeding. But that approval never came because Sony had threatened to sue ASCAP if it reached an agreement with Pandora that encompassed the Sony repertoire.[77] Sony also hinted that it would withdraw the rest of its rights (i.e., its analog rights) if ASCAP otherwise licensed its repertoire to Pandora.[78] As a result of pressure from Sony and from Universal, ASCAP's CEO LoFrumento told the ASCAP Board that he planned to reject the terms they had negotiated with Pandora. None of the Board members asked for an explanation, nor requested to discuss the rejection further.[79]

By this time, Sony had acquired EMI's publishing catalog and now controlled roughly 30% of the market for musical compositions.[80] On October 25, 2012, Sony set the tone for its negotiation with Pandora with this opening remark: "[I]t's not our intention to shut down Pandora."[81] In other words, unless Pandora agreed to Sony's rate or removed all of Sony's content from its service by January 1, 2013, it would face crippling copyright infringement litigation.[82] Interestingly, Pandora anticipated, and had in fact specifically raised, this concern to the Federal Trade Commission (FTC) during its review of Sony's acquisition of EMI, noting that the combination would leave Pandora "no choice" but to agree to whatever terms Sony demanded as it "could not survive without access to the combined Sony and EMI catalogues."[83]

In an effort to gain a foothold in its negotiation with Sony, Pandora requested a list of Sony's tracks so that it would know which songs would need to be removed from the service should a rate not be agreed to in time. No such list was forthcoming. According to Judge Cote, "Sony had a list readily at hand," but "understood that it would lose an advantage in its negotiations with Pandora if it provided the list of works and deliberately

77. *Id.* at 59.
78. *Id.*
79. *Id.*
80. *See id.* at 61.
81. *Id.* at 62.
82. *Id.* at 62–63.
83. *Id.* at 62. Nonetheless, in the fall of 2012, the FTC announced that it would not challenge the merger. As discussed in the sections below, this counterintuitive determination is most likely the result of the FTC's mandate under the antitrust laws, which call for intervention in any merger that would "substantially lessen competition." *See* U.S. DOJ & FTC, HORIZONTAL MERGER GUIDELINES ¶¶4–6 (2010) (hereinafter HORIZONTAL MERGER GUIDELINES). In this case, there was already a breakdown in structural competition, so that the proposed merger—while not creating or protecting competition—also did not worsen it.

chose not to do so."[84] Pandora turned next to ASCAP, making the same request for a list of Sony's tracks, but Sony (unsurprisingly) would not give ASCAP permission to release the list.[85]

On January 17, 2013, Sony and Pandora agreed to an undisclosed advance and a rate 25% above ASCAP's going rate.[86] In violation of extant confidentiality agreements, Sony shouted this rate from the rooftops, crediting its size for the dramatic rate increase it achieved, and calling the rate "quite reasonable. When you compare it to the rate record companies are getting, it was really miniscule."[87]

Instead of proffering an efficiency rationale—namely, that digital plays of a song are easily tracked via readily available technologies, and that moving the administration of those rights in-house saves the company royalty shares that it would otherwise have to pay to ASCAP—Sony cited dissatisfaction with the disparity between the publishing royalty rate and the sound recording royalty rate: "We were struck by the vast disparity between what the record companies received from digital music services for the sound recording rights that they conveyed and what was paid for the [musical composition] performance right."[88] Historically, the royalty rate for sound recordings has always been higher. This disparity reflects the significantly higher overhead costs involved in granting artist advances, hiring studio time, and pressing and delivering a physical product. In contrast, music publishing does not require investment in a physical product, and little in the way of advances, thereby reducing the overall risk as well. In addition, publishing enjoys a royalty on the terrestrial performance side that does not extend to recordings at all.[89] Nonetheless, Sony determined that, given its size and market power, it could "really push Pandora and get a much better settlement as a result . . . [Pandora] will pay more, a lot more than they originally intended . . . ."[90]

And Sony was right. Sony's boast prompted Universal to begin its negotiations by demanding even more. In February 2013, Universal

84. *Id.* at 65–66.

85. *Id.* at 68.

86. *Id.* at 69; *see also, e.g.*, *Sony Negotiates 25% Royalty Increase from Pandora: Report*, BILLBOARD (Jan. 17, 2013), http://www.billboard.com/biz/articles/news/publishing/1510421/sonyatv-negotiates-25-royalty-increase-from-pandora-report [http://perma.cc/3SPQ-5ZNS].

87. *See* Order, *supra* note 9, at 71.

88. *Id.* at 40 (testimony of Martin Bandier).

89. For a full discussion of the legislative history behind terrestrial performance rights, *see* García, *supra* note 15.

90. Order, *supra* note 9, at 57.

announced its withdrawal of new media rights from ASCAP and began its private negotiations with Pandora.[91] Universal's Horowitz knew well the rate his recording counterparts were receiving, as he previously ran that side of the business for Universal. Following Sony's lead, Horowitz opened negotiations with Pandora by saying "we want Pandora to survive," followed by "how did you get Marty [Bandier] at Sony to agree to such a low payment?"[92]

In response to Universal's prompt demand for an effective rate 50% higher than the prevailing ASCAP rate, Pandora repeated the request it had made of Sony—a request for a list of Universal content for removal from the Pandora service.[93] Unlike Sony, Universal provided Pandora with the list, but subject to a non-disclosure agreement (NDA) such that Pandora could not use the list for the purposes of removing any content (because to do so would require sharing it with programmers). As a result, Pandora's options were to either accept Universal's proffered rate, or face a flurry of copyright infringement claims.[94]

On July 1, 2013, the parties provisionally "agreed" to a rate of 7.5% (just under double the ASCAP rate) for a six-month period (i.e., enough time to allow for a rate court decision).[95] By way of comparison, Universal charged iHeartRadio—a competitor of Pandora, and subsidiary of radio conglomerate Clear Channel—a rate of 1.7%.[96] This rate is both lower than ASCAP's going rate and nearly a quarter of the rate Universal demanded of Pandora. Like Sony, Universal refused Pandora's request that the provisional agreement not be submitted as evidence of a "market rate" at the rate court proceeding.[97] Indeed, ASCAP ultimately presented, among other things, both the Sony and the Universal rates as benchmarks for determining a market rate. Meanwhile, Pandora presented 1.70%, or slightly less than the ASCAP rate.[98]

4. *The Rate Court Determination*

After a three-week bench trial that included direct testimony, deposition testimony, and a variety of submitted affidavits, Judge Cote, writing on behalf of the rate court, held that "ASCAP has . . . failed to

91. *Id.* at 72.
92. *Id.* at 74.
93. *See id.* at 74–75.
94. *Id.* at 76–77.
95. *Id.* at 79.
96. *Id.* at 22.
97. *Id.* at 80.
98. *Id.* at 7.

demonstrate that Pandora's direct licenses with Sony and [Universal] constitute fair market benchmarks."[99] Specifically, the rate court determined that "Sony and [Universal] each exercised their considerable market power to extract *supra*-competitive prices," and that "the evidence at trial revealed troubling coordination between Sony, [Universal], and ASCAP."[100] Importantly, "ASCAP, Sony, and [Universal] did not act as if they were competitors with each other in their negotiations with Pandora. Because their interests were aligned against Pandora, and they coordinated their activities with respect to Pandora, the very considerable market power that each of them holds individually was magnified."[101]

Judge Cote called the Universal-Pandora rate the result of "virtually no meaningful negotiations," and noted that because Universal "control[s] roughly 20% of the music market, [it] began with and insisted upon a demand that bore no relation to the then-existing market price," and as such "this license rate cannot be said to represent a bargain arrived at by a willing buyer and seller."[102] As to Sony's rate, the S.D.N.Y. found that even if it represented a plausible market valuation, it could not be used as a benchmark because of "the coercive process by which it was negotiated."[103]

In the end, the rate court set a rate of 1.85% of revenues—the same rate currently available under ASCAP's 5.0 form license—for every year of the license term (from 2011 through 2015). An interim determination by the rate court additionally granted Pandora's motion for partial summary judgment by holding that the major publishers' purported withdrawals of new media rights—and, by extension, ASCAP's amended Compendium allowing them to do so—violates the consent decree.[104]

Specifically, the court noted that Section IV(C) of the AFJ2 prohibits ASCAP from licensing a composition to some services (i.e., smaller digital, and also non-digital) and not others (i.e., larger digital services like

99. *Id.* at 94.
100. *Id.* at 97.
101. *Id.* at 98–99.
102. *Id.* at 105–06.
103. *Id.* at 104.
104. *See In re* Petition of Pandora Media, No. 12 Civ. 8035, 2013 WL 5211927, at 1 (S.D.N.Y. Sept. 17, 2013). The court held:

> Because the language of the consent decree unambiguously requires ASCAP to provide Pandora with a license to perform all of the works in its repertory, and because ASCAP retains the works of 'withdrawing' publishers in its repertory even if it purports to lack the right to license them to a subclass of New Media entities, Pandora's motion for summary judgment is granted.

Pandora).[105] The court also interpreted "repertory" as used in the consent decree to include all of the rights pertaining to a work.[106] In other words, the rate court held that publishers wishing to withdraw their digital rights must withdraw all of their rights (i.e., digital and analog). This effectively invalidated Sony and Universal's attempted withdrawal of digital rights only, putting to the publishers the more difficult determination of whether to withdraw analog rights as well, and how to administer them.

On appeal, the Second Circuit affirmed the rate court's decision in its entirety.[107] The appeals court confirmed as to rate, finding that "ASCAP failed to carry its burden of proving that its proposed rate was reasonable."[108] With regard to the preclusion of withdrawals by the consent decree, the Second Circuit confirmed that "[t]he partially withdrawn works at issue remain in the ASCAP repertory pursuant to the plain language of the consent decree."[109]

5. *The Consent Decree*

The Second Circuit's interpretation of ASCAP's consent decree was supported by a statement from the DOJ confirming "the consent decree governing the licensing activities of [ASCAP] does not permit ASCAP to accept partial grants of public performance rights."[110] In the face of mounting criticism of the consent decrees as outdated, the Senate Judiciary Committee has undertaken a review of the consent decrees.[111] As part of this review, the Committee has solicited public comments on, among other things, whether if "partial or limited grants of licensing rights to ASCAP and BMI are allowed, should there be limits on how such grants are structured?"[112]

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105. *Id.* at 4 ("AFJ2 also contains a provision preventing ASCAP from discriminating in pricing or with respect to other terms or conditions between similarly situated licensees.")

106. *Id.* at 12–14.

107. Pandora Media, Inc. v. ASCAP et al., 785 F.3d 73 (2d Cir. 2014).

108. *Id.* at 78.

109. *Id.*

110. Brief for U.S. Department of Justice, Pandora Media, Inc. v. ASCAP et al., 785 F.3d 73 (2d Cir. 2014) (No. 14-1158-cv(L)), http://www.justice.gov/atr/cases/f312700/312748.pdf [http://perma.cc/N6FV-TPT9].

111. *See Antitrust Consent Decree Review*, DOJ http://www.justice.gov/atr/ascap-bmi-decree-review [http://perma.cc/Z3Y2-3KAV].

112. *Antitrust Consent Decree Review—ASCAP and BMI 2014*, DOJ, http://www.justice.gov/atr/cases/ascap-bmi-decree-review.html [http://perma.cc/4Q8G-HCDS]. For a review of public comments submitted in response to this, and other, inquiries, see *ASCAP and BMI Consent Decree Review Public Comments*, DOJ, http://www.justice.gov/atr/public-comments [http://perma.cc/GUE3-9HCV].

On March 10, 2015, the Senate Judiciary Committee held a hearing on the consent decrees. In what is undoubtedly a first for the music industry, comments from such traditionally opposed parties as the National Association of Broadcasters and Public Knowledge (i.e., everyone except ASCAP and the music publishers) reached a common conclusion: The consent decrees are necessary to protect against anticompetitive behavior and to promote competition in online music distribution.[113] The question remains whether this conclusion is true without application to the individual publishers.

C. COLLECTIVE LICENSING V. PRIVATE ORDERING

The mass exodus of the major publishers from ASCAP begs the question: Why would a company who voluntarily joins a collective to handle the difficult and time-consuming work of royalties collection suddenly want to withdraw and do all of the work itself? This question can be answered in two parts: In the first instance, by considering the decline in advantages afforded by collective action in the digital age; and second, by detailing the gains to be had from private over collective action. The final subsection will address potential drawbacks to withdrawing from the collective, including adverse selection, manipulation of market rates, and access concerns.

1. Diminished Advantages of Collective Action

The fact that the major music publishers withdrew their digital rights from ASCAP challenges the conventional wisdom that lauds collective rights management as the optimal means of licensing copyrighted content.[114] Despite the potential for anticompetitive harm stemming from the aggregation of copyrights,[115] collectives like ASCAP have traditionally

113. *Hearing on "How Much for a Song? The Antitrust Decrees that Govern the Market for Music" Before the S. Subcomm. On Antitrust, Competition Policy and Consumer Rights*, 114th Cong. (2015) (statement of Mike Dowdle, Bonneville International Corporation) http://www.judiciary.senate.gov/imo/media/doc/Dowdle%20Testimony.pdf [http://perma.cc/9PLE-ZLXP].

114. *See, e.g.*, Merges, *supra* note 5. To some extent, the existence of the consent decrees further cuts against the notion of collective licensing as an optimal solution to the transaction cost problem. *See* DiCola & Sag, *supra* note 31 at 208. *See also* Ariel Katz, *The Potential Demise of Another Natural Monopoly: Rethinking the Collective Administration of Performance Rights*, 1 J. COMPETITION L. & ECON. 541 (2005) (challenging the traditional case for PROs).

115. Some scholars have gone so far as to call collectives' blanket licenses "illegal restraints of trade" insofar as they fix prices for a product that cannot be obtained elsewhere. *See* Ivan Reidel, *The Taylor Swift Paradox: Superstardom, Excessive Advertising and Blanket Licenses*, 7 N.Y.U. J.L. & BUS. 731, 737 (2011) (declaring blanket licenses to

been justified on the same bases as other collective bargaining models. First, they minimize transaction costs associated with identification of, and negotiation with, multiple contracting partners. In his seminal work on property rules and IP licensing, Professor Robert Merges explains that "[i]t is the high transaction costs associated with the initial [rights] entitlements that lead the parties to establish the [collective]—an organization that then dramatically lowers the costs of exchanging the rights."[116] In other words, collectives "conserve on transaction costs by either making it easier to identify and locate rightholders, or by creating the occasion for repeat-play, reciprocal bargaining."[117]

In her Order, Judge Cote explains how those costs are lowered for both licensees and licensors:

> Employing ASCAP to perform these [licensing] functions is efficient for music users and copyright holders. A music user can license an enormous portfolio of copyrighted music through the execution of a single license without having to contact each copyright holder. Copyright holders benefit from ASCAP's expertise and resources in policing the market, negotiating licenses, and distributing the revenue from a vast array of licenses promptly and reliably among the multiple owners of the public performance copyrights in each work. The ability of ASCAP and other performing rights organizations . . . to grant licenses covering a large number of compositions creates significant economies of scale in the market for music licensing.[118]

Second, collectives help level the playing field in negotiations by concentrating bargaining power and by setting (and enforcing) a collective valuation.[119] In an industry like digital music licensing—whose inception came after the establishment of the collectives and for which there is not, and never has been, a real market—collectives have a lot of power in setting the "market" rate. Indeed (with the exception of cases that go to

be "illegal restraints of trade" and calling for urgent reform of DOJ enforcement practices). While this Article recognizes the growing strength of these (and other) arguments, they do not negate the valuable role that collectives serve in ensuring access to content, and in funneling royalties to artists. *See infra* Part V.B.4.

116. *See* Merges, *supra* note 5, at 1302–03.

117. *Id.* at 1294. Unfortunately, this doesn't mean that collectives fare any better than statutory licenses at differentiating amongst individual content valuations. *See* García, *supra* note 15, at 1128–29. In the collectives' defense, however, it may be the case that tailoring is not worth the effort in the bundled licensing context.

118. Order, *supra* note 9, at 11.

119. *See* Merges, *supra* note 5 at 1294 (noting that CROs function by "promulgat[ing] rules and procedures for placing a monetary value on members' property rights.")

the rate court), ASCAP sets the rate for the content that it administers. But this can hardly be called a "market rate" in the absence of a market. To the extent opt-out speaks to inefficiency, we need look no further than the private "success" of publishers like Sony and Universal for a challenge to the current system.

Technological development and concomitant changes in consumer behavior and business models have challenged the traditional justifications for collectives. For example, searchable online databases have made identifying content owners easier, greatly reducing the transaction costs associated with pairing licensees and licensors. For better or for worse, industry consolidation has decreased the number of smaller, independent content owners that stand to benefit from pooling their content and bargaining power.

With respect to digital content, audio matching technologies have made it both possible and cost-effective for content owners to track their repertoire's usage themselves. As more traditional analog outlets—for example, brick-and-mortar retail stores and restaurants—transition to digital streaming, the proportion of royalties attributed to analog sources continues to shrink, eventually allowing a licensor to administer most of its rights itself. In short, the need for collectives is waning in the digital world. Additionally, as Professor Daniel Gervais has put it: "Initially, CMOs developed out of necessity; it was not feasible for authors and publishers to maintain a direct relationship with users. With the advent of new technologies, however, authors and publishers are increasingly able to initiate and maintain a direct relationship with users."[120]

2. Advantages of Private Ordering

To be clear, the partial withdrawal of rights from ASCAP by the major music publishers is a form of private ordering. One interpretation of the events described in the Pandora–ASCAP proceeding is consistent with a functioning free market in which a powerful party (or parties) naturally emerges, through ingenuity and hard work, and in which a market rate reflecting supply and demand is eventually established. In other words, proof positive of free market economics.

Under this view, Sony came to a position of market power through decades of diligent content acquisition and strategic consolidation. Also under this view, the rate achieved in private negotiation with Pandora reflects the value of Sony's content to Pandora's Internet radio service.

120. Gervais, *supra* note 31, at 27.

Otherwise, Pandora would simply take its business elsewhere or shut down its service.

Another (admittedly oversimplified) reason a company might choose to withdraw from a collective to negotiate privately is that the company may be able to do better in the private market (where "better" means that they can make more money). Previous scholarship examined the potential advantages of private ordering around an inefficient statutory regime, and this is arguably another example of improvement on the status quo. There, the potential gains from private deal making include a higher rate, the ability to tailor terms to a specific piece of content, use, or partner, and the flexibility to more easily and readily adjust deal terms in response to new technologies or business models.[121]

In the music industry, these advantages have already been observed on the sound recordings side of the business, where private ordering around a statutory license initially emerged in 2012. When iHeartMedia[122]—a large media conglomerate and owner of hundreds of radio stations nationwide—and Big Machine—a relatively small record label and home of recording artist Taylor Swift—circumvented § 114 in favor of private ordering, the parties benefited in several ways. First, Big Machine gained the right to be paid on terrestrial plays (a nonexistent right under current laws), while iHeartMedia secured a lower-than-statutory rate on digital plays. This scheme was far better tailored (pun intended!) for a radio-friendly artist like Taylor, and its short, renewable term allowed the parties to make easy adjustments in the future. Finally, and happily for the parties, circumvention and private ordering vis-à-vis one partner did not necessitate private negotiation across the board with all partners. In addition to lowering the risk associated with circumvention, private ordering allowed for greater specificity as to the content and uses contemplated by the parties.

3. *Potential Drawbacks to Private Ordering*

Despite its purported advantages, private ordering in the shadow of a collective, and particularly in the context of a highly regulated market like music publishing, presents a variety of concerns—including adverse

121. *See* García, *supra* note 15, at 1146–51.

122. Formerly, Clear Channel Communications, Inc. On September 16, 2014, the company changed its name to reflect a new commitment to digital media. *See* Andrew Hampp, *Clear Channel Changes Name to iHeartMedia*, BILLBOARD (Sept. 16, 2014), http://www.billboard.com/articles/business/6251599/clear-channel-changes-name-iheartmedia [http://perma.cc/A3V2-F3ZM].

selection, misrepresentation of market rates, and denial of access to content.

a) Adverse Selection

As noted in Part II.B.2 *supra*, not everyone at ASCAP was on board with the amendments to ASCAP's governing documents that permitted selective withdrawal of new media rights. Notably, the individual songwriter-members expressed concern about the loss of transparency in the accounting and distribution of royalties to songwriters if the individual publishers took over those functions. Specifically, "[t]hey were concerned . . . that the publishers would not manage with as much care the difficult task of properly accounting for the distribution of fees to multiple rights holders, and might even retain for themselves certain monies, such as advances, in which writers believed they were entitled to share."[123] Moreover, ASCAP's writer-members recognized that a withdrawal of digital rights represented a withdrawal of cash (i.e., lost royalty shares) from the collective, leaving the small, independent songwriters and publishing companies footing a larger share of the cost of daily operations at ASCAP.[124]

Resistance intensified with introduction of the second amendment allowing for selective withdrawal. The independent songwriter members were unhappy with the monies that ASCAP was losing as a result of the new media withdrawals and did not want to allow the majors to continue to weaken the ASCAP organization.[125] They were also upset by what they viewed as a bait-and-switch by the major publishers who had promised to go out into the market and secure for the industry a higher "market rate." Instead, Sony directly licensed DMX (a company that provides digital music services for retail stores) at a rate considerably lower than the going ASCAP rate, in exchange for a hefty advance.[126] DMX then took that

123. *See* Order, *supra* note 9, at 42.

124. *See id.* at 45. These costs include administrative, litigation, and advocacy expenses. As the bulk of administrative costs stem from the analog side of the business (which rights were retained by ASCAP), withdrawal of digital rights did little to reduce overhead costs while dramatically reducing revenue.

125. *See id.* at 51.

126. *See* Steve Gordon, *Direct Licensing Controversy: Will Publishers Be Able To License Public Performing Rights To Digital Music Services Directly (Instead of through the PROs) and What Are the Consequences for Songwriters?* FUTURE OF THE MUSIC BUSINESS (May 27, 2014) http://www.futureofthemusicbusiness.biz/2014/05/direct-licensing-controversy-will.html [http://perma.cc/4DPR-WPE4] ("In 2007 Sony negotiated a direct deal with DMX, the digital background music service. In doing so, it received an advance payment

rate—sans mention of the advance—to the rate court to secure a lower rate for itself across the board.[127] The primary proponent of this second amendment to ASCAP's Compendium was Sony, who pushed for its passage despite receiving legal advice raising "antitrust concerns with the carve-out proposal."[128]

As a result of the major publisher withdrawals, ASCAP's remaining members—the songwriters themselves, and the smaller, independent publishers who lack the ability to demand private negotiation—were left with a weaker organization. Not only was ASCAP left touting a less robust and less valuable blanket license, but it was also collecting less in royalty shares. This put the full burden of covering the costs of operation—including litigation, lobbying, and advocacy—on the smaller members left behind.

Prior work has examined the phenomenon of private ordering around an unpalatable statutory license, or "penalty default license," as the inevitable result of inherent inefficiencies and bounded uncertainty.[129] The proliferation of private ordering in the market for collectively licensed IP rights challenges the conventional view of collectives as the optimally efficient licensing mechanism, and instead demonstrates that they suffer many of the same inefficiencies as statutory licenses.[130] Specifically, it shows that in some cases, an individual party can privately negotiate a higher rate than a collective can command. As a consequence, dominant market players who are opt out of the collectives, leave behind weaker players with a weaker organization and set off a downward spiral that has

of 2.7 million dollars. It is doubtful whether Sony's writers received any portion of this money.").

127. *See id.*; Order, *supra* note 9, at 51 n.36.

128. *Id.* at 53 n.37.

129. *See* García, *supra* note 15.

130. N.B.: ASCAP has argued that these inefficiencies stem from the consent decrees themselves:

> It is clear that the legal and regulatory restrictions imposed on ASCAP by the Consent Decree and the Copyright Act severely limit ASCAP's members from achieving competitive rates for their works. Indeed, as the Copyright Office noted in its recent report on Copyright and the Music Marketplace, '[t]here is substantial evidence to support the view that government-regulated licensing processes imposed on publishers and songwriters have resulted in depressed rates.'

Hearing on Performance Rights Organization Consent Decrees, 114th Cong. 14 (2015) (statement of Elizabeth Matthews, ASCAP (citing U.S. COPYRIGHT OFFICE, COPYRIGHT AND THE MUSIC MARKETPLACE (2015)), http://www.judiciary.senate.gov/imo/media/doc/Matthews%20Testimony.pdf [http://perma.cc/HD4C-BMFG].

negative overall welfare consequences despite the apparent benefits to early-departers.

Adverse selection—the term used herein to describe this defection of powerful members from their respective collectives—decreases the efficiency and efficacy of the abandoned collective. These consequences stem, in large part, from the fixed costs associated with collective rights administration and enforcement. In addition to leaving collectives with reduced income from membership fees, adverse selection may leave remaining members to suffer reduced royalties as a result of a diminished catalog, reduced bargaining power, and weaker enforcement capabilities.

These fixed costs are difficult to amortize and may result in a system with higher gross transaction costs—including litigation and lobbying expenses—that must be borne by the remaining members. It is true that a publishing company has no legal or economic obligation to forego increased revenues in order to avoid making things more difficult for individual writer-members. Nonetheless, there are potential trickle-down effects for the entire system. Where the financial burden of sustaining the collective becomes unsustainable for the weaker members, adverse selection can lead to diminished distribution of content to consumers. It also affords defecting members the opportunity for anticompetitive behavior to the detriment of innovation in both the creation and dissemination of content.

b) Manipulation of "Market" Rate

The promised upside of this adverse selection—the notion that the higher rate negotiated by the majors would go on to be adopted as the "market" rate to the benefit of all—not only proved false, but actually went the other way when DMX presented its *lower* rate (sans advance) for adoption instead.[131] The DMX example illustrates how circumvention of a collective in favor of private can lead to misrepresentation of "market" rates. This is especially true in an industry like music publishing, where no

131. *See* Broad. Music, Inc. v. DMX, Inc., 683 F.3d 32, 49 (2d Cir. 2012) (confirming adoption of DMX's proposed rate); and Steve Gordon, *DMX v. BMI Demonstrates that Digital Services May Use Direct Licensing to Reduce Their Payments to the PROs but the Decision May Be Reversed on Appeal*, THE FUTURE OF THE MUSIC BUSINESS (July 12, 2011), http://www.futureofthemusicbusiness.biz/2011/07/dmx-vs-bmi-demonstrates-that-digital.html [http://perma.cc/72T3-6HPR] (discussing DMX's successful rate reduction campaign based on the negotiated Sony rate and asking "how can 550 direct licenses [the number held by Sony] be a benchmark for the true value of the [collective's] blanket licenses when those 550 licenses represent, in probability, only a tiny fraction of the songs represented by the [collective]").

real market exists outside of the collectives that have operated more or less since the industry's inception.

It is unclear whether the rates obtained by Sony and Universal are "right" or whether they are supracompetitive (as Pandora has alleged). The going ASCAP rate may not be "right" either--it may well be, as the music publishing industry has alleged, the result of Pandora's manipulations. Indeed, in a move labeled "cynical and shameless," Pandora recently purchased a small, terrestrial radio station in South Dakota in an unabashed effort to take advantage of the lower statutory rate offered Internet radio services owned by broadcast radio stations.[132]

In the context of the ASCAP withdrawals, the major music publishers also enjoy a first-movers advantage. As first to withdraw their digital rights and first to go out into the "market" to negotiate a private rate, they are able to set a baseline rate that subsequent private deals are most likely to adopt, either by example or by peer pressure. In other words, if Pandora agrees to a rate double that of ASCAP's, so too might their competitors (if they want to remain competitors). This can lead to the establishment of an industry norm or custom that is based on little more than coercion and desperation as other digital distribution services are pressured to pay the same rates or shut down.[133]

c) Collectives' Role in Ensuring Access To Content

With all of their faults and potential drawbacks, collectives like ASCAP serve an important function that private ordering might otherwise foreclose: access to content for all prospective licensees willing to pay an agreed-upon rate and meet agreed-upon terms. This access is enforced by consent decree. The AFJ2 directs ASCAP to "grant to any

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132. David Israelite, *Statement of National Music Publishers Association (NMPA) CEO David Israelite*, NMPA http://www.billboard.com/articles/news/6553964/pandora-radio-station-fcc-approval-kxmz [http://perma.cc/5U68-6262]. For more on the radio station purchase, see Glenn Peoples, *Pandora Buys Terrestrial Radio Station in South Dakota, Aims for Lower ASCAP Royalties*, BILLBOARD (June 11, 2013), https://www.billboard.com/biz/articles/news/radio/1566479/pandora-buys-terrestrial-radio-station-in-south-dakota-aims-for [https://perma.cc/AM4F-FKB8]. The very existence of a different, lower rate structure for an Internet radio station owned by a broadcast radio station versus a free-standing Internet radio station illustrates the byzantine nature of the heavily lobbied music industry.

133. For a critique of the influence of custom on law in the IP context, see Jennifer E. Rothman, *The Questionable Use of Custom in Intellectual Property*, 93 VA. L. REV. 1899 (2007). For the same critique in other contexts, see, for example, Lisa Bernstein, *The Questionable Empirical Basis of Article 2's Incorporation Strategy: A Preliminary Study*, 66 U. CHI. L. REV. 710 (1999) (criticizing the incorporation of commercial customs into Article 2 of the UCC).

music user making a written request therefor a non-exclusive license to all of the works in the ASCAP repertory."[134] As a result, ASCAP cannot license its repertory to one Internet radio service and refuse to license another. Individual music publishers like Sony and Universal can make such refusals, however. This is particularly concerning where the major publishers effectively control an asset essential to any music streaming service: music.[135]

The concern about access to content is nothing new. Congress has long recognized the importance of access to the maintenance of competition in the content industries. For example, the cable industry operated for many years under so-called "program access rules," which required owners of cable programming to make that content available to rival distributors.[136] The program access rules were promulgated as a central part of the Cable Television Consumer Protection and Competition Act of 1992 (the "Cable Act"), and have been credited with driving the growth of the satellite television industry.[137]

When the program access rules were enacted, lawmakers were concerned that content owners would refuse to license content to competitors.[138] As a result of these rules, satellite companies like Dish and

134. United States v. ASCAP, No. 41-1395, 2001 WL 1589999, § VI (2001).

135. It may be reasonably argued that while *some* music is essential to a music streaming service, one publisher's content is largely interchangeable with another's. After all, if Honey Nut Cheerios suddenly refused to sell its product to Grocery Store A (and it is allowed to do so), Grocery Store A could simply sub in generic Nutty O's. Diehard fans of the original may balk, but would hardly view Grocery Store A as being competitively disadvantaged. Part IV.B.2.c *infra* will attempt to show that, for a variety of reasons, it's a bit more complicated than that in the music context.

136. *See* 47 U.S.C. § 548 (2012).

137. *See, e.g.*, Comments of the Satellite Broadcasting and Communications Association Before the Federal Communications Commission at 17 (July 29, 2002), http://www.sbca.com/PublicAffairsdocs/Competition_2002Comments.pdf ("Industry observers credit the program access rules . . . as one of the most important factors in the rise of DBS as a successful consumer service and competitor to cable.") [http://perma.cc/V3MY-NNZK]; Joe Flint, *FCC lets program access rules expire*, L.A. TIMES (Oct. 5, 2012), http://articles.latimes.com/2012/oct/05/entertainment/la-et-ct-fcc-program-access-20121005 [http://perma.cc/EN3L-FJFG].

138. *See* JONATHAN E. NUECHTERLEIN AND PHILIP J. WEISER, DIGITAL CROSSROADS: TELECOMMUNICATIONS LAW AND POLICY IN THE INTERNET AGE 343–47 (2d ed. 2013) [hereinafter DIGITAL CROSSROADS]. Nuechterlein and Weiser note:

> The concern underlying these requirements is that a cable incumbent, left to its own devices, might withhold affiliated programming from its MVPD [multichannel video program distributor] rivals in the hope that the programming is so indispensable to the television experience of

DirecTV grew and proved to be viable competitors. With the growth of these companies, moreover, the FCC has retained these rules, but now questions how much longer the rules will stay in place.[139]

Unfortunately, the music publishing industry does not currently enjoy robust competition, and collectives play a valuable role in providing—though not necessarily guaranteeing—access. As Part V *infra* will discuss, only a mandatory, compulsory license can guarantee access. But first, the next Part discusses a final, paradoxical category of concern stemming from the withdrawal, and private negotiation, of public performance rights: anticompetitive behavior.

III. AN ANTITRUST PARADOX

A. ANTICOMPETITIVE BEHAVIOR

Perhaps the most unexpected development highlighted by the Pandora–ASCAP rate proceeding is the growing anticompetitive threat posed not by ASCAP, but by the individual music publishers acting in loose coordination to demand more money, or, failing that, to deny access to their content altogether—something that ASCAP, per the consent decree, cannot do. The coordination of effort among the major music publishers and ASCAP went beyond written "encouragement" during negotiation—Universal's Horowitz emailed both LoFrumento at ASCAP and fellow publishing heads at Sony and Warner/BMG, urging them to "[b]e strong . . . . You can really push Pandora and get a much better settlement as a result. They are reeling. They will pay more, a lot more than they originally intended" to include public announcement of terms afterward, even where such disclosure was in clear contravention of extant

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many viewers that they will forgo the rivals' service in favor of the cable incumbent's service.

139. In the Matter of Revision of the Commission's Program Access, 27 FCC Rcd. 12605, No. 12-123, at 4 (2012) ("[A] preemptive prohibition on exclusive contracts is no longer 'necessary to preserve and protection competition and diversity in the distribution of video programming.'") (quoting Cablevision Systems Corp. v. F.C.C., 597 F.3d 1306, 1308 (D.C. Cir. 2010)). In *Cablevision*, the court went on to note that "We anticipate that cable's dominance in the MVPD [multichannel video program distributor] market will have diminished still more by the time the Commission next reviews the prohibition, and expect that at that time the Commission will weigh heavily Congress's intention that the exclusive contract prohibition will eventually sunset." *Id.* at 1314. *See also* DIGITAL CROSSROADS, *supra* note 138, at 344 ("In October 2012, the FCC denied a third five-year extension, allowed the flat ban on exclusive contracts to expire, and announced that it would continue to review such exclusive contracts on a case-by-case basis under section 628(b).")

NDAs.[140] "By mid-January 2013, and despite the existence of a confidentiality agreement, Sony leaked the key terms of the Pandora license to the press. . . . [Sony's] Bandier was quoted as saying that '[a]t the end of the day, we got a terrific deal for our songwriters. Our thinking has been vindicated.'"[141]

This announcement by Sony not only informed the other publishers of the rate Sony had achieved, but also informed the songwriters that those publishers compete for. In other words, if Universal were to obtain less, its songwriters could simply go over to Sony, making Sony's announced rate the *de facto* floor. Together with a demand that Pandora remove the respective publishers' content, coupled with a refusal to identify that content, and amid threats of massive copyright litigation,[142] this low-level, coordinated effort is referred to herein as "tacit collusion."[143]

A highly concentrated industry like music licensing is especially vulnerable to this form of anticompetitive conduct. The more concentrated the market, the greater risk to competition posed by coordination.[144] Some industries—like telecommunications, or utilities—face a set of circumstances in which multi-firm production is more costly than single-firm production, and so are said to tend toward "natural monopoly," an economic condition in which optimal efficiency is reached with only one firm in the market.[145] The typical natural monopoly industry faces very high start-up costs. A prospective entrant in such an industry would be forced (at prohibitive cost and great inefficiency) to recreate necessary infrastructure already put into place by the dominant firm.[146]

An oligopoly, on the other hand, is found where a few large, powerful firms dominate a market, so that the actions of each firm impact the other firms, and in which each firm recognizes a strategic interdependence with

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140. Order, *supra* note 9, at 57.

141. *Id.* at 71.

142. *See supra*, Part II.B.3.

143. As discussed in detail in Part III.B *infra*, tacit collusion is distinct from explicit collusion in that the former is not a violation of antitrust law.

144. *See, e.g.*, Carl Shapiro, *Theories of Oligopoly Behavior*, in THE HANDBOOK OF INDUSTRIAL ORGANIZATION 329 (R. Schmalensee & R.D. Willig, eds. 1989); George Stigler, *A Theory of Oligopoly*, J. POL. ECON., 72:1 (1964).

145. *See generally*, William J. Baumol, *On the Proper Cost Tests for Natural Monopoly in a Multiproduct Industry*, AM. ECON. REV. 67 (1977).

146. *See generally* LOUIS KAPLOW & STEVEN SHAVELL, MICROECONOMICS 42 (2004) (noting, for example, that in a natural monopoly, "the competitor's profit would likely not be sufficient to cover the cost of building another network")

the other firms.[147] As these firms' combined market share increases, their strategic interdependence increases. When the minimum efficient scale—defined as the lowest level of output at which a firm can operate at minimum cost per unit—is a relatively large percentage of the market, smaller firms cannot compete, and the market becomes a natural oligopoly.[148] This is the case in music publishing: An industry comprised of only three firms, each with double-digit market share, demonstrates a willingness and ability to tacitly collude with respect to price. The oligopoly condition allows for "a group of firms to reach a collusive outcome without overt acts of detectable communication. Such tacit collusion results from a 'meeting of the minds,' whereby competitors recognize that it is in their collective best interests to set price or quantity equal to the collusive level."[149] This behavior is commonly known as parallel pricing. While not technically illegal—indeed, and as discussed further in the next Part, "application of the antitrust laws [in this context] becomes challenging"[150]—parallel pricing is nonetheless problematic precisely because it is difficult to monitor and enforce against.[151]

Network effects have further exacerbated the effects of consolidation in the music industry by removing the threat of meaningful competition from the marketplace. Network effects (also called "network externalities") describe the phenomenon—especially prevalent in technology companies—of an increased value to a consumer deriving from an increase in the number of other consumers enjoying the same product or service. One is not likely to choose a laundry detergent based on which brand his closest friends use, for example, nor is he likely to begin getting more out of his laundry detergent if his neighbors adopt the same brand. In the case of a video game console, however, people are more likely than not to adopt the brand—for example, the Xbox—that their friends are using, as this allows them to play with together on the same platform. As more and more people also purchase an Xbox, individual enjoyment of the device grows,

147. *See generally* HAL R. VARIAN, INTERMEDIATE MICROECONOMICS: A MODERN APPROACH 468–91 (5th ed. 1999) (discussing oligopoly and oligopolistic pricing behavior).

148. *See id.* at 427 (defining minimum efficient scale as "the level of output that minimizes average cost, relative to the size of demand")

149. Alan Devlin, *A Proposed Solution to the Problem of Parallel Pricing in Oligopolistic Markets*, 59 STAN. L. REV. 1111, 1112–13 (2007).

150. *Id.* at 1113.

151. *Cf.* RICHARD A. POSNER, ANTITRUST LAW 94 (2d ed. 2001) (arguing the antitrust laws ought to be able to identify and regulate parallel pricing). This view has not been adopted.

both in terms of new game development and a community to play with. This is an example of network effects.

In music, network effects play a role on both the content and the distribution side. In distribution, as in the Xbox example, consumers are more likely to join the music streaming platform that their friends are on so that they can share playlists, for example. When it comes to the songs themselves, network effects have been shown to have a significant influence on consumer tastes and preferences, leading to what this article will term psychological, as opposed to technological, lock-in. For example, a 2007 study of over 14,000 listeners took a unique approach to measuring what types of things influence whether a song will become a "hit."[152] The authors created an experiment in which the first set of listeners heard a series of songs and—without any information other than the name of the artist and title of the song—were asked to rank them in order of preference. The second set of listeners heard the same series of songs, only this time they were also given the number of times each song had been downloaded by others in their social circle. With the second group, listeners showed a clear preference for songs that others had preferred. The study concluded that "social influence played as large a role in determining the market share of successful songs as differences in quality."[153]

For this reason, songs are not truly substitutable. Listeners are as locked-in to the songs their social group listens to as they are to the gaming platform their social group plays on. As a result, a fledgling streaming service cannot compete without a catalog of popular songs. This enables the owners of popular songs (i.e., the major music publishers)—acting alone or in tacit collusion with similarly situated entities—to act anticompetitively by threatening to withhold their content from a service or by offering favorable rates to one service over another.[154]

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152. See Salganik et al., *Experimental Study of Inequality and Unpredictability in an Artificial Cultural Market*, 311 SCIENCE 854 (2006).

153. Duncan J. Watts, *Is Justin Timberlake a Product of Cumulative Advantage?*, N.Y. TIMES (April 15, 2007), http://www.nytimes.com/2007/04/15/magazine/15wwlnidealab.t.html [http://perma.cc/S8GR-U898].

154. In a slightly different context, Francesco Parisi and Ben Depoorter have suggested that in the case of complementary inputs to a derivative work, "price coordination and monopolistic pricing do not in all circumstances produce inefficient equilibria." *The Market for Intellectual Property: The Case of Complementary Oligopoly*, *in* THE ECONOMICS OF COPYRIGHT: DEVELOPMENTS IN RESEARCH AND ANALYSIS 25, (W. Gordon & R. Watt, eds., 2003). This suggests that the welfare effects of price coordination and competition may depend on the type and nature of the goods involved, and that structural competition doesn't necessarily solve the problem either.

In the case of music publishing, Sony and Universal tacitly colluded to charge Pandora a higher rate than other Internet radio services were paying through ASCAP. Given the publishers' combined market share of roughly 50%, a prospective entrant into the music streaming space could be easily blocked by the major publishers' joint refusal to deal.[155]

B. CONSEQUENCES OF ANTICOMPETITIVE BEHAVIOR

There are a variety of reasons to care about anticompetitive behavior on the part of music publishers. First, it represents a very real threat to innovation in both the creation and distribution of content. If publishers go after the most successful companies in a given space—as they did with Pandora in the music streaming space—that risks a situation in which the companies that control an essential input (in this case, music) in one industry, can threaten to stifle innovation in another, related industry (in this case, streaming distribution). To be clear, this is not an argument in favor of Pandora's preservation, but rather for the preservation of multiple distribution options.

These content owners can also block access to content altogether. Without a statutory license, there is no longer guaranteed access to content, and nothing to stop a content owner who wishes to start its own streaming service from withholding its content from potential competitors. Instead of requiring thousands of individual negotiations, a digital radio service today can obtain upward of 80% of all of the music publishing rights that they need from a mere three companies. And if those three companies cooperate on rate, explicitly or tacitly, the remaining rights holders will eventually be forced to take that rate in order to remain competitive. Again, this is not an argument in favor of ASCAP's preservation necessarily, but rather an argument against the foreclosure of access to content that enables new entry into the market.

155. This is so despite the fact that most streaming customers actually consume a mere 5% of the content offered by a typical music service. *See, e.g.*, Paul Resnikoff, *95 Percent of Streaming Music Catalogs Are 'Irrelevant' to Consumers, Study Finds*, DIGITAL MUSIC NEWS (Sept. 10, 2015), http://www.digitalmusicnews.com/2015/09/10/95-percent-of-streaming-music-catalogs-are-irrelevant-to-consumers-study-finds [http://perma.cc/53XV-TZTU]. Rather, it is consumers' perspective of what they're getting that matters: a user simply feels better paying $9.99 for "millions of songs" than for what they actually use, which is probably closer to "tens of songs." For an intriguing argument against more content for the sake of more content, see Michael Abramowicz, *An Industrial Organization Approach to Copyright Law*, 46 WM. & MARY L. REV. 33, 37–38 (2004) (suggesting that "changes along the edges of copyright law that lead to slight reductions in the number of works produced but greater dissemination of other works could increase social welfare")

Some may argue that this behavior is not a real cause for concern. After all, free market theory tells us that if a company like Sony or Universal is indeed over-pricing its product or otherwise behaving badly, the market will correct such behavior by taking its business elsewhere, by admitting new entrants, and/or by otherwise reacting in such a way as to drive the price back to a mutually agreeable level. In that case, the argument could be made that concerns about tacit collusion or parallel pricing are unwarranted For example, in the IP context the very purpose of IP rights is to protect copyright owners from competition for a limited period of time. To the extent competition is suppressed, then, this is nothing more than the system at work.[156]

These arguments based on the free market theory assume a competitive market, and the problem is that the protection from competition afforded content owners by copyright law does not extend (or, is not intended to extend) to distributors of that content. For example, as a content owner, Sony could decide to favor a particular distribution company (whether by affiliation, or by contractual agreement, or for kicks) and charge other distribution companies a different amount or decline to license its content to other distribution companies altogether. This protects Sony's favored distributor via an unintended extension of its lawful copyright protections. Notably, under the AFJ2, ASCAP is specifically prohibited from exhibiting such favoritism, while no such restriction applies to Sony as an individual publisher. In other words, the problem with the free market theory as applied to music licensing is that there is no competitive market.

While economic theory is not generally hostile to price discrimination in a competitive marketplace,[157] where structural competition has been compromised such discrimination can cut against innovation by shrinking the field of competitors. In other words, the problem is not the price itself, but rather the lack of competition. If a music publisher like Sony decides to go after Pandora, the most successful distribution company in the Internet radio space, the result is a situation in which a company with control over a necessary input—in this case, music—can drive a leading

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156. Indeed, Professor Lydia Pallas Loren has suggested that "[t]he entire structure of the sound recording digital public performance right is statutorily geared to protect incumbents." *The Dual Narratives in the Landscape of Music Copyright*, 52 HOUS. L. REV. 537, 577 (2014).

157. *See* Joseph Farrell & Philip J. Weiser, *Modularity, Vertical Integration, and Open Access Policies: Towards a Convergence of Antitrust and Regulation in the Internet Age*, 17 HARV. J.L. & TECH. 85, 108–09 (2003).

innovator out of the market. After all, together Sony and Universal own roughly half of all digital music copyrights. A digital music service would be hard pressed to compete effectively without this content.[158]

Indeed, this threat has arisen before. In the wake of Napster's shut down in 2001, the major labels formed MusicNet and PressPlay with the intent of distributing their own content. At that time, there were five major labels: AOL Time Warner, Bertelsmann and EMI formed MusicNet, and Vivendi Universal and Sony formed PressPlay. Together, the five labels—through the newly-formed MusicNet and PressPlay entities—controlled over 80% of all commercial music.[159] This consolidation of market power predictably led to a DOJ investigation of allegations from small online music services that the companies "refused licenses . . . because they did not pony up hundreds of thousands of dollars for negotiations," and that "MusicNet and Pressplay could potentially exclude them from online distribution deals."[160] Although the inquiry ended in 2003 without further action on behalf of the DOJ, both companies were promptly broken up and sold off.[161]

In the short term, Pandora suffers the most obvious injury in the form of higher licensing costs resulting from a higher royalty rate—to be clear, a rate both higher than Pandora was previously paying and higher than that faced by its peers. Importantly, this is not strictly a private harm vis-à-vis Pandora, but rather a harm that extends to the broader market for music licensing. Some music consumers can expect to see higher subscription rates and/or more advertising as Pandora passes along some of its increased costs, thereby reducing consumer welfare. Other consumers,

158. Collectively, the withdrawal of new media rights by Sony (with the acquisition of EMI) and Universal reduced ASCAP's revenues by half. *See* Order, *supra* note 9, at 342.

159. *See* Kelly Donohue, *MusicNet & PressPlay: To Trust or Antitrust*?, 1 DUKE L. & TECH. REV. 1, 2 (2001) (noting, in addition, that since "the labels have either bought or sued remaining competitors, MusicNet and PressPlay virtually control the online music industry through the use of its copyrights").

160. *Justice Dep't Begins Probe into MusicNet, PressPlay*, BILLBOARD (Aug. 7, 2001) http://www.billboard.com/articles/news/78850/justice-dept-begins-probe-into-musicnet-pressplay [http://perma.cc/X7TF-D5E3].

161. *See, e.g.*, Jon Healey, *N.Y. Firm Buys Out MusicNet*, L.A. TIMES (Apr. 13, 2005) http://articles.latimes.com/2005/apr/13/business/fi-musicnet13 ("A New York venture capital firm said Tuesday that it had taken over MusicNet, an online music service formed in 1999 by three major record companies and RealNetworks Inc.") [http://perma.cc/4RHY-F6ME]; and *Roxio Rebranding Pressplay As Napster*, BILLBOARD (May 20, 2003), http://www.billboard.com/articles/news/70995/roxio-rebranding-pressplay-as-napster ("Roxio has acquired online music service Pressplay from Universal Music Group (UMG) and Sony Music Entertainment and plans to revive it under the Napster name before March 2004.") [http://perma.cc/8A2S-PXXL].

unable to afford the higher subscription rates, may find themselves forced either into the ad-supported environment or out of the market altogether.

In the long term, tacit price collusion may reduce allocative efficiency by affording the coordinating companies the opportunity to engage in parallel pricing so as to raise prices supracompetitively[162] or discriminatorily. The societal harm resulting from parallel pricing takes several forms. First, as seen previously, some consumers may be priced out of the market. Second, innovation may decrease if prospective licensees cannot afford the new "market" rate, and so are deterred from entering in the first place.

In a functioning market, one might expect that this harm would be short-lived since a truly supracompetitive rate will eventually adjust downward. In a highly regulated market like music licensing, however, this adjustment is far from guaranteed.[163] Those entrants who do manage to enter the market will face tacitly collusive pricing in the form of a so-called "price umbrella." A price umbrella allows a dominant firm (or tacitly colluding dominant firms) to set a price which all prospective competitors must either meet or beat (but not exceed) in order to attract buyers.[164] Finally, returning to the example, Pandora was targeted for being the largest, most commercially successful digital licensee in the space. Collusion of this sort can stifle innovation as potential market entrants decline to make themselves the new target of powerful content owners.[165]

In addition to the potentially negative impact on consumers and innovation, there are also consequences for ASCAP, ASCAP's writer-members, and smaller licensees. In the interest of self-preservation, ASCAP was pressured into amending its governing documents in ways that were not clearly in the interest of the organization as a whole. As a result, ASCAP's writer-members are left bearing the lion's share of

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162. Any argument to the effect that the resulting price increase was merely adjusting for a "below market" price is rebutted first by the lack of a competitive marketplace (required for such an adjustment to take place); and second, by the fact that if this were true, there would have been no reason for the companies to work together to raise the price; the (competitive) market would have self-corrected.

163. Although this isn't the case in the Pandora–ASCAP example, the publishing companies could alternately tacitly collude to depress prices in order to bolster a favored entrant (or entrants), thereby potentially misleading new entrants with artificial price signals.

164. *See* AM. BAR ASSOC., PROVING ANTITRUST DAMAGES: LEGAL AND ECONOMIC ISSUES 227 (2d ed. 2010).

165. *See generally, e.g.*, Kevin M. Lemley, *The Innovative Medium Defense: A Doctrine to Promote the Multiple Goals of Copyright in the Wake of Advancing Digital Technologies*, 110 PA. ST. L. REV. 111, 112 (2005) (extending innovation from a patent law concern to a copyright one, and considering the ways in which "copyright owners may stifle innovation in ways never before contemplated")

ASCAP's costs. If and when the withdrawing majors take their privately negotiated rate—nearly twice that of the going ASCAP rate—to the rate court for adoption as the new "market rate," smaller licensees (mostly start-ups and regional services) will face even higher costs of entry.

This is not just an efficiency argument: Unequal treatment of services also offends freedom of speech principles. Differential treatment of certain services "harms consumers by delaying the rollout of new distribution technologies."[166] The greater this differential, the greater the threat to "the very existence of newer technologies for music distribution."[167] It is further a disservice to assume that economic effect is the only goal of antitrust, when in fact antitrust regulation is in significant part an "exercise in judgment."[168] This judgment includes consideration of both mathematical and social values.

Another consequence of this breakdown in structural competition is the potential for technological lock-in. Technological lock-in "is made possible when a critical mass of interdependent users accepts a standard."[169] Specifically, "[w]hen switching costs are sufficiently high and technology-specific network externalities strong, the market may be subject to excess inertia, or 'lock-in' to a particular technology."[170]

Closely related to the concept of network effects, technological lock-in occurs when the incentive to improve an existing technology or to innovate is diminished by the degree of coordination between users of an existing technology. In music licensing, the major music publishers can effect a lock-in to an inferior technology by offering it a better rate than that offered to other technologies, or by denying access to their content to other companies altogether. In this way, for example, consumers may be stuck with a single clunky, outdated music streaming service favored by the major music publishers, while the developers of superior technology are either discouraged or pushed out.[171]

A final, oft-overlooked consequence of this brand of anticompetitive behavior is the loss of revenues for artists. Without a statutory license that

166. Peter DiCola, *Copyright Equality: Free Speech, Efficiency, and Regulatory Parity in Distribution*, 93 B.U. L. REV. 1837, 1839 (2013).

167. *Id.*

168. Allensworth, *supra* note 10 at 1, 53–54.

169. Clayton P. Gillette, *Lock-in Effects in Law and Norms*, 78 B.U. L. REV. 813, 817 (1998).

170. Catherine Fazio & Scott Stern, *Innovation Incentives, Compatibility, and Expropriation as an Antitrust Remedy: The Legacy of the Borland/Ashton-Tate Consent Decree*, 68 ANTITRUST L.J. 45, 52 (2000).

171. *See id.*

guarantees artists a share of royalties,[172] creators are potentially denied a portion of revenues stemming from private deals, with predictable consequences for the disincentivization of creation. In addition to reducing transaction costs and consolidating bargaining power, collectives (in the absence of a statutory license) frequently serve in the role of "protector" for artists whose interests diverge from those of the distribution intermediary to whom they have assigned their copyrights.

Previous work has noted, for example, that SoundExchange—as the designated collective for public performance royalties for sound recordings—enforces § 114(g)(2) of the Copyright Act's mandatory royalties distribution to recording artists (a distribution that does not necessarily occur under privately negotiated deals).[173] Without this statutory protection, artists are left to whatever distribution they negotiated in their contract. More often than not, for recording artists signing onto deals before making a name for themselves, this amount (where extant) will be significantly lower than the statutory rate.

Similarly, a composer may never receive a share of public performance royalties paid directly to her music publisher (as opposed to paid through a collective) as standard music publishing contracts typically deny songwriters a share in royalties stemming from privately negotiated licenses.[174] ASCAP, on the other hand, offers transparent royalties collection and administration to all of its members, be they music publishing companies or individual songwriters. Together, the potential for diminished economic incentives for both content creators and content distributors, coupled with a reduction in, or even elimination of access to that content, represent a real threat to innovation.

IV. CONVENTIONAL SOLUTIONS & THEIR DISCONTENTS

The Pandora–ASCAP example demonstrates the potential for unchecked anticompetitive behavior to stifle innovation and to lock consumers into existing technology while potentially denying artists their fair share of revenues. There are a few possible options for avoiding these outcomes. This Part discusses two: First, we can do nothing, and allow the

172. For example, 17 U.S.C. § 114(g)(2) mandates a 50/50 split of royalties earned on digital performance of sound recordings between artists and copyright assignees. 17 U.S.C. § 114(g)(2) (2012). See *infra* Part III.B for more detail on this oft-overlooked consequence of statutory circumvention.

173. *See* García, *supra* note 15, at 1151–52; *infra* Part V.B.4.

174. *See* PASSMAN, *supra* note 65 at 264 ("[A]ll songwriter contracts say the writer doesn't share in any performance monies received by the publisher.").

market to correct itself. Alternately, we can turn to antitrust law. As detailed herein, neither of these options is particularly effective in the music licensing context, nor, indeed, in highly regulated industries generally.

A. THE FREE MARKET APPROACH

Classic free market theory, or economic liberalism theory, suggests one possible response to anticompetitive behavior: Do nothing, and allow the market to correct itself.[175] Starting from basic supply and demand, the free market theory tells us that with little to no government intervention, producers and consumers will come together in the marketplace to set optimal prices. The general rule is that profit-maximizing firms will ultimately settle on the price where marginal cost (the cost of producing one additional unit) equals marginal revenue (the additional revenue that can be earned on the sale of one additional unit).

Under this theory, where a firm has over- or under-shot the equilibrium price, consumers will respond by moving toward the firm, or toward its competition, until eventually the equilibrium price is reached. In a two-entity market for widgets, for example, if Company A prices its widgets too high, free market theory says that consumers will purchase their widgets from Company B, unless and until Company A lowers its price (or, alternately, differentiates its widgets in some way). Company B may respond by further lowering its price, and so on, but neither company will go below the equilibrium price.[176] Similarly, if Company B refuses to sell its widgets to a downstream entrant, Company A can step in and fill the order. In this way, a market can correct itself, and anticompetitive behavior is avoided.

Unfortunately, this self-correction is only possible in a workably competitive market, or one with low to no barriers to entry (such that the monopoly won't be sustainable). What we have instead in the music publishing industry is a highly concentrated market, with high barriers to

175. *See generally* MILTON FRIEDMAN, CAPITALISM AND FREEDOM (2002) (making the case for competition capitalism).

176. Some companies will engage in so-called "loss leading" behavior, where they may actually sell at a loss for some period of time, or for certain product lines, in an effort to build interest in some other product line, or in the company generally. Amazon's Prime delivery service—grossly underpriced, but catering to the company's biggest spenders—is a good example of this. *See, e.g.*, Greg Bensinger, *Amazon's Spending Leads to Biggest Quarterly Loss in 14 Years,* WALL ST. J. (Oct. 23, 2014), http://www.wsj.com/articles/amazons-spending-leads-to-another-loss-1414095239 [http://perma.cc/BF37-8NT4].

entry. In his testimony to the Copyright Royalty Board (CRB)[177] on behalf of Pandora, Professor Carl Shapiro notes that:

> A moderately or highly concentrated market in which the leading suppliers tacitly collude is not workably competitive. For example, if the leading suppliers have settled into some form of coordinated interaction, e.g., by refraining from competing actively to poach each other's customers, the market will fail to be workably competitive. More generally, if the leading suppliers are colluding—either expressly or tacitly—the market is not workably competitive.[178]

This is precisely what exists in music licensing—leading suppliers of public performance rights tacitly colluding to demand higher royalty rates. Applying these principles directly to interactive music streaming services, Shapiro continues:

> If interactive streaming services indeed 'must carry' the music from each of several major record companies to be competitive, and if these services have a limited ability to control the mix of music played by their customers because customers pick which songs to listen to, the market for recorded music licensed to interactive streaming services is *not* workably competitive.[179]

Notwithstanding the efforts of Congress, the DOJ, and the relevant courts, consolidation in the music industries has only intensified. Currently, a mere three record labels constitute 65% of the music found on Pandora,[180] while the three largest music publishers control roughly 65% of the market for musical compositions.[181] Notably, the cooperation

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177. The CRB consists of three judges appointed by the Librarian of Congress. The Board determines and adjusts statutory rates under the Copyright Act. *See Copyright Royalty Judges*, LIBRARY OF CONGRESS, http://www.loc.gov/crb/background/ [http://perma.cc/KA8Q-XBDV].

178. *In re* Determination of Royalty Rates and Terms for Ephemeral Recording and Digital Performance of Sound Recordings, 14-CRB-001-WR, at 11 (U.S.C.R.B. Oct. 6, 2014) (Written Direct Testimony of Carl Shapiro), http://www.loc.gov/crb/rate/14-CRB-0001-WR/statements/Pandora/14_Written_Direct_Testimony_of_Carl_Shapiro_with_Appendices_PUBLIC_pdf.pdf [http://perma.cc/4RQ6-7Y3L].

179. *Id.* at 12. Pandora, on the other hand, is not an interactive music streaming service because its consumers aren't able to choose specific songs to listen to. Shapiro goes on to differentiate Pandora's service from the interactive services for the purposes of suggesting that any rate reached vis-à-vis the interactive services should not be extended to Pandora, which he argues *is* able to steer consumers toward or away from certain songs.

180. *See* Shapiro Written Testimony, *supra* note 178, at 13 n.19.

181. *See* Christman, *supra* note 46 (offering first quarter 2015 rankings for music publishing).

among the major music publishers that Judge Cote in her Order calls "collusion" happened in spite of extant antitrust laws and multiple opportunities for antitrust review. Without a workably competitive market, the forces of supply and demand are not able to correct a supracompetitive price, nor check such anticompetitive practices as refusal to deal. The anticompetitive behavior revealed by the Pandora–ASCAP proceeding occurred in a highly regulated industry, in the shadow of a consent decree, and under the auspices of a rate court and two different regulatory agencies: the DOJ and the FTC. This points to an extensive breakdown in structural competition.

B. ANTITRUST LAW

The significance of a loss of structural competition is that antitrust, the usual go-to solution for checking anticompetitive behaviors, doesn't work well (if at all) without it. In the absence of a workably competitive market, antitrust law is largely ineffective, for the reasons described in this section. This is especially true when, as here in music licensing, there is a highly regulated market with a differentiated good, like songs.

1. *Inapplicability*

The biggest challenge for antitrust in this context is the inapplicability of its usual arsenal: the Sherman Act, merger review, and consent decrees.

a) Limitations of the Sherman Act

The most significant challenge for antitrust in the content licensing context is that neither of the concerning behaviors at issue—i.e., neither tacit collusion nor parallel pricing—rise to the level of a Sherman Act violation, yet both carry significant competitive downsides. Section 1 of the Sherman Act forbids all contracts and business combinations made "in restraint of trade," while § 2 prohibits monopolization and attempts to monopolize.[182] Unlike explicit collusion, tacit collusion is not a violation of § 1.[183]

182. 15 U.S.C. §§ 2, 3 (2012).

183. *See, e.g.*, William H. Page, *A Neo-Chicago Approach to Concerted Action*, 78 ANTITRUST L.J. 173, at Part I (2012) (concluding that "Section 1 does not reach tacit collusion"). *Cf.* Richard A. Posner, *Oligopoly and the Antitrust Laws: A Suggested Approach*, 21 STAN. L. REV. 1562, 1598–605 (1968) (arguing that tacit collusion *should* violate § 1). Judge Posner's position has not been adopted, however, as he himself has acknowledged. *See, e.g.*, *In re* High Fructose Corn Syrup Antitrust Litigation, 295 F. 3d 651, 654 (2002) (acknowledging that "it is generally believed . . . that an express, manifested agreement, and thus an agreement involving actual, verbalized communication, must be proved in order for a price-fixing conspiracy to be actionable under the Sherman Act"). This piece

In their treatise on antitrust law, Professors Areeda, Hovenkamp and Elhauge write that "[t]he courts are nearly unanimous in saying that mere interdependent parallelism does not establish the contract, combination, or conspiracy required by Sherman Act § 1."[184] The Supreme Court confirmed this interpretation:

> Because § 1 of the Sherman Act "does not prohibit [all] unreasonable restraints of trade . . . but only restraints effected by a contract, combination, or conspiracy," . . . "[t]he crucial question" is whether the challenged anticompetitive conduct "stem[s] from independent decision or from an agreement, tacit or express[.]" . . . While a showing of parallel "business behavior is admissible circumstantial evidence from which the fact finder may infer agreement," it falls short of "conclusively establish[ing] agreement or . . . itself constitut[ing] a Sherman Act offense."[185]

The Court went on to hold that "[e]ven 'conscious parallelism,' a common reaction of 'firms in a concentrated market [that] recogniz[e] their shared economic interests and their interdependence with respect to price and output decisions' is 'not in itself unlawful.'"[186] Unfortunately for antitrust regulators, the coordination between Sony and Universal is precisely this sort of "conscious parallelism" that can be contributed to "shared economic interests" and "interdependence."

Parallel pricing similarly does not constitute an antitrust violation. While parallel pricing is not technically illegal, it is indicative of a highly concentrated market.[187] In *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, the Supreme Court considered a case that American television producers brought against their Japanese counterparts in which they alleged that the Japanese firms:

> had illegally conspired to drive American firms from the market by engaging in a scheme to fix and maintain artificially high prices for television sets sold by petitioners in Japan and, at the

takes no position on whether or not these behaviors *should* fall under the auspices of the Sherman Act, but rather takes their exclusion as well-established.

184. AREEDA ET AL., ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION ¶ 1433(a) (2003).

185. Bell Atlantic Corp. v. Twombly, 550 U.S. 544, 553–54 (2007) (alterations in original; internal citations omitted).

186. *Id.*

187. *See generally,* Donald F. Turner, *The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusals to Deal*, 75 HARV. L. REV. 655 (1962) (discussing parallel behavior among firms); *infra* Part III.A.

> same time, to fix and maintain low prices for the sets exported to and sold in the United States.[188]

There, the Court concluded that "conduct as consistent with permissible competition as with illegal conspiracy does not, standing alone, support an inference of antitrust conspiracy."[189]

As with tacit collusion, the difficulty with parallel pricing lies in its ambiguity. The question remains whether Sony and Universal could have independently decided to withdraw and demand a higher rate from Pandora. Arguably—and herein lies the rub for antitrust: it is inapplicable to some instances of anticompetitive behavior. While a colorable argument could be made that Sony and Universal's conduct with regard to the partial withdrawals goes beyond mere parallel pricing and tacit collusion into actionable anticompetitive behavior, the fact remains that the DOJ and the FTC have both declined to act.

b) Limitations of Merger Review

Both the DOJ and the FTC enforce the antitrust laws as laid out in three distinct, but related, acts: the Sherman Act,[190] the Clayton Antitrust Act of 1914 (the "Clayton Act"),[191] and the Robinson-Patman Act of 1936 (the Robinson-Patman Act").[192] Broadly speaking, the Sherman Act prohibits all combinations "in restraint of trade" and makes it unlawful to monopolize an industry.[193] The Clayton and Robinson-Patman Acts focus specifically on price discrimination.[194]

The DOJ and the FTC typically allocate merger reviews according to their relative expertise in different subject matter areas. Most recently, the FTC has handled merger review for the music industry. In the case of Sony's acquisition of EMI—a move that took the already concentrated music publishing industry from four firms to three—the FTC declined to challenge the merger. While approval of 4-to-3 mergers is not unique in the antitrust context, it is unusual to see a merger approved despite explicit concerns voiced about the majors' ability to influence pricing: In the wake of the FTC's 2012 review of the proposed Sony-EMI merger, Pandora

188. 475 U.S. 574, 574 (2012).
189. *Id.* at 588.
190. 15 U.S.C. §§ 1–7 (2012).
191. 15 U.S.C. §§ 12–27.
192. 15 U.S.C. § 13.
193. 15 U.S.C. §§ 1–2. For more on the legislative history behind its enactment, *see* Robert H. Bork, *Legislative Intent and the Policy of the Sherman Act*, 9 J.L. & ECON. 7 (1966).
194. *See Bork*, supra note 193.

filed an opposition cautioning that "the combination of the Sony and EMI catalogs would give Pandora 'no choice' but to enter into a direct license for the content. While Pandora 'could survive without access to Sony's musical content,' it 'could not survive without access to the combined Sony and EMI catalogues.'"[195]

At the same time Sony was looking to acquire EMI's publishing catalog, Universal sought to acquire EMI's recorded music business. In that case too, the FTC declined to intervene.[196] Because the FTC only publishes its findings when a merger is challenged, the agency's decision-making process is not fully transparent in either case. The most likely explanation for the agency's decision lies in its mandate that calls for intervention in any merger that would "substantially lessen competition."[197] In the music publishing industry, there was already a breakdown in structural competition, such that the proposed merger—while neither creating nor protecting competition—also did not worsen it. The FTC most likely approved Sony's acquisition of EMI's catalog because it didn't make matters worse: The competitive environment in music licensing was dismal before the Sony-EMI merger and remained dismal afterward. In other words, "the FTC was not able to establish that the merger would lessen competition in the market . . . because of a lack of evidence of pre-merger competition."[198]

Another possible explanation for the agency's decision is that the companies' catalogs were viewed as complements, rather than substitutes. In that case, a music streaming service would require both companies' catalogs, such that the FTC did not view the combination as a horizontal merger.[199] With a mandate allowing for intervention only where a

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195. Order, *supra* note 9, at 62.

196. Notably, the European Union's antitrust regulators also approved both mergers, but only with divestitures. In the case of Universal/EMI, this included divestiture of 60% of EMI's European business. *See* Vanessa Mock et al., *Universal to Win EMI – After Selling Key Assets*, WALL ST. J. (Sept. 20, 2012), http://www.wsj.com/articles/SB10000872396390444032404578006343033008694 [http://perma.cc/W5BA-594F]. The FTC required no such divestitures.

197. *See* HORIZONTAL MERGER GUIDELINES, *supra* note 83 at ¶¶ 4–6.

198. Shapiro Written Testimony, *supra* note 178, at 13 n.17 (referring to the Universal/EMI merger approval).

199. *See id.* at n.15 (calling it obvious that "the FTC saw the repertoires of Universal and EMI as complements, not substitutes, for interactive streaming services. Therefore, for this group of buyers, the Universal/EMI merger was not a horizontal merger, and the normal loss of direct competition that occurs in a horizontal merger was not present.").

combination will worsen competition, antitrust can do little in an industry that has lost its structural competition.[200]

While it is too late for the music licensing industry—antitrust law cannot institute structural competition once it is lost—an important lesson may be gleaned for antitrust law and industry consolidation going forward: Where antitrust fails to prevent consolidation up front, it may be powerless to "fix" the problem afterward. The music industry offers a powerful cautionary tale as to why structural competition matters, and why the structural presumption does not always apply.

c) Limitations of Consent Decrees

One of antitrust's most effective tools, the consent decree, has likewise proven ineffective in the music licensing space. As discussed at Part I(A)(2) *supra*, the DOJ first imposed a consent decree on ASCAP in 1941.[201] That decree, last amended in 2001, required ASCAP "to grant to any music user making a written request therefor a non-exclusive license to perform all of the works in the ASCAP repertory."[202]

Prompted by anticompetitive concerns about ASCAP's consolidation of content, the consent decree restricts how ASCAP licenses content in a variety of ways. Among other things, it makes a copyright owner's grant of licensing authority to ASCAP non-exclusive—which means that a rights holder can always license its own content—and requires that ASCAP charge all similarly-situated entities the same rate.[203] These requirements were intended to assuage concerns about anticompetitive behavior in music licensing. But the consent decree acts only on ASCAP, and not on ASCAP's individual members, thus limiting its ability to thwart anticompetitive behavior on the part of individual entities.

The FTC, through its repeated determination not to intervene in the series of mergers that have reduced the music publishing industry to a mere three entities, has effectively foreclosed a finding of worsened competition stemming from anticompetitive behavior on behalf of the individual publishers: ASCAP's consent decree requires all grants from rights holders be made on a non-exclusive basis, thereby allowing a party to opt out and negotiate privately. This assumes that the individual

200. As Part IV.B.2.c *infra* explains, music goods are complementary and not substitutable, making this situation different from the standard 4-to-3 merger.

201. *See supra* note 33 and accompanying text.

202. *See* United States v. ASCAP, No. 41-1395, 2001 WL 1589999, § VI (S.D.N.Y. 2001).

203. *Id.* § IV(B)–(C).

publisher, acting alone, does not have the ability to act anticompetitively. Unfortunately, this assumption is wrong. Sony, the nation's largest music publisher, currently enjoys a market share of roughly 30%, and may well be able to exercise unilateral monopoly power in some circumstances. When working in tacit collusion with Universal, the combined market share is raised to nearly 50%.

Antitrust law does not provide a remedy for breaking up monopolist (or oligopolist) firms unless and until they engage in predatory conduct. Even if one firm is not found to be monopolistic on its own, two or more firms may tacitly collude to set prices or to bar entry to a new service by withholding content altogether. It is well established that antitrust law does not address the oligopolist problem of tacit collusion.[204] This is why the maintenance of structural competition is so important. Where it is not maintained—as in the case of the music industry—it cannot be rebuilt.

In light of the discontent stemming from the attempted withdrawals by Sony and Universal, the Senate Judiciary Committee has begun a review of ASCAP's consent decree.[205] In his request for comments, Senator Leahy called for "renewed attention to the consent decrees" in order to "ensure the decrees' purposes are still being met."[206] By and large, the publicly available comments received to date recognize the role and import of a consent decree for the purposes of creating and protecting competition in the music licensing space.

In its written comments, ASCAP focuses on three overarching suggestions for changes to its consent decree: First, an expedited rate-setting process to replace the rate court.[207] Second, ASCAP seeks a congressional blessing to allow for partial digital withdrawals, claiming that "this approach would result in competitive market transactions that would then provide informative benchmarks for the rate-setting tribunal."[208] Unfortunately for ASCAP, "competitive market transactions" between "truly willing buyers and willing sellers" is not possible without a competitive market.[209] Finally, ASCAP asks for permission to license not only public performance rights, but also mechanicals, synchronization, and

204. *See id.* (proposing that tacit collusion is not—and should not—constitute a violation of the antitrust laws).

205. *See* discussion *supra* Part II.B.5.

206. *How Much For A Song?: The Antitrust Decrees That Govern the Market for Music*, 114th Cong. (2015) (statement of Senator Patrick Leahy), http://www.judiciary.senate.gov/imo/media/doc/03-10-15LeahyStatement.pdf [http://perma.cc/HYC2-ASEN].

207. *See* Matthews, *supra* note 129 at 19.

208. *Id.* at 19–20.

209. *Id.* For further rebuttal of this claim, *see supra* Part II.C.3.b.

print rights. This would arguably create a "'one-stop shop' for musical work rights."[210] While this would undoubtedly improve upon the labyrinth that potential music licensees currently navigate, it could also exacerbate the potential for anticompetitive behavior on behalf of the collective.

Pandora and ASCAP agree that the consent decrees aren't working, but for different reasons. Pandora's comments, not surprisingly, urge caution and note several judicially recognized instances of "egregious misconduct" on behalf of the music publishers and collectives.[211] In addition to Judge Cote's finding of "troubling coordination" in the Pandora–ASCAP proceeding, Pandora references a December 2013 proceeding between Pandora and BMI in which the judge held that "BMI cannot combine with [music publishers] by holding in its repertory compositions that come with an invitation to a boycott attached."[212] Notably, both of these findings occurred under extant consent decrees. So long as the consent decrees do not apply to individual entities, and those entities are allowed to withdraw, the consent decrees are powerless to correct anticompetitive behavior arising from private ordering of the type seen here. For this reason, the consent decrees no longer function to curb anticompetitive behavior.[213]

2. *Challenges*

Even where antitrust is applicable, it is an ex post review—that is, the review is conducted only when the alleged harm is already evident.[214] At that point, both the review and enforcement of a remedy—if one is even

210. *See* Matthews, *supra* note 129 at 20.

211. *See How Much For A Song?: The Antitrust Decrees That Govern the Market for Music*, 114th Cong. 4 (2015) (statement of Christopher S. Harrison, Pandora Media, Inc.) http://www.judiciary.senate.gov/imo/media/doc/Harrison%20Testimony.pdf [http://perma.cc/47KJ-BU4W].

212. *Id.*

213. The problem of anticompetitive behavior unchecked by antitrust is not exclusive to music publishing. Sound recordings have also devolved into a natural oligopoly situation, with a mere three entities controlling nearly all sound recordings copyrights. *See supra* Part III.A. In the case of sound recordings, however, piracy serves as a check on most anticompetitive behavior. Unlike music publishers, the record labels are at all times arguably "competing with free," which keeps them honest in a way that music publishers don't face.

214. This is not to say that antitrust cannot have *ex ante* effects as well. *See, e.g.*, Parisi & Depoorter, *supra* note 154 at 21 (discussing the effect of antitrust rulings on competition between direct and intermediary licensors).

available—are notoriously cumbersome, time-consuming, and costly.[215] Antitrust cases are also notoriously difficult to prove. Even if there was conduct rising to the level of an antirust violation, antitrust is ill-suited to high-tech industries like music licensing where antitrust enforcers' ability to understand and predict industry evolution is especially limited.[216] In addition to the inapplicability of antitrust law to certain anticompetitive behaviors and its procedural shortcomings, antitrust faces particular challenges in the context of highly-regulated industries, in the IP field, and music in particular.

a) In the Regulatory Context

Regulation frequently works to encourage investment in an industry by protecting the firms within it. This is especially true in industries with high start-up costs, or with high risks of failure, and for companies that rely on a distribution system. Public utilities, for example, face all of these challenges, and new entry into these markets requires substantial investment. In the early years of electricity generation, "companies saw clearly the advantages of a regulated marketplace to protect their investments from unbridled competition."[217]

Extensive regulatory regimes tend to undermine antitrust by giving firms an implied immunity from antitrust review.[218] For this reason,

215. *See, e.g.*, Comment of the Staff of the Federal Trade Commission, FERC Docket No. RM11-14-000 at 1 (2011) (noting that "[i]nconsistent approaches may make the antitrust review process longer, more confusing, and more costly than necessary").

216. *See, e.g.*, Ronald A. Cass, *Antitrust for High-Tech and Low: Regulation, Innovation, and Risk*, 9 J.L. ECON. & POL'Y 169, 169–70 (2013) (claiming that "[t]raditional problems of regulation generally, and of antitrust enforcement specifically, are exaggerated in high-technology sectors, where antitrust enforcers' abilities to understand and predict industry evolution are most limited and where enforcement actions are most likely to rest on debatable predicates about the effects of specific conduct."). *Cf. United States v. Microsoft*, 253 F. 3d 34 (D.C. Cir. 2001) (offering an example of sophisticated antitrust analysis in a high-tech context).

217. *See* MARY M. TIMNEY, POWER FOR THE PEOPLE: PROTECTING STATES' ENERGY POLICY INTERESTS IN AN ERA OF DEREGULATION 47 (2004).

218. *See, e.g.*, Stacey L. Dogan & Mark A. Lemley, *Antitrust Law and Regulatory Gaming*, 87 TEX. L. REV. 685, 686 (2009) (asserting that "antitrust laws are impliedly repealed by government regulation of a particular industry"); Daniel F. Spulber & Christopher S. Yoo, *Mandating Access to Telecom and the Internet: The Hidden Side of* Trinko, 107 COLUM. L. REV. 1822, 1851 (2007) ("Courts have long recognized that the enactment of a federal regulatory scheme can immunize particular conduct from antitrust scrutiny."); *see also* Credit Suisse Sec. (USA) LLC v. Billing, 551 U.S. 264, 276 (citing four conditions that the court will consider in determining whether a regulatory regime precludes antitrust, and determining that "the securities law impliedly precludes the application of the antitrust laws").

regulation is frequently considered to have anticompetitive consequences, and to work at odds with antitrust. Music's regulatory regime—comprising an entire Act[219] and meriting congressional reconsideration[220]—likewise reduces the role of antitrust, not least of all because IP regulation protects creators and inventors from competition (albeit for a limited period of time).[221]

b) In the Intellectual Property Context

An important challenge for antitrust in the music industry is its juxtaposition to the intellectual property context. IP law necessarily contravenes antitrust law insofar as it grants limited "monopolies" to inventions, content, and brands via property rights afforded by patent, copyright, and trademark law, respectively. In each case, these legally sanctioned monopolies are limited in both scope and duration, and are traditionally justified by the proposition that on balance, they produce enough social utility—by encouraging creation and dissemination of new content—to offset the societal costs of deterring competition.[222]

Of course, the exclusive rights granted by copyright do not a true economic monopoly make. For example, most novels are copyrighted, but no one novel is considered to have a monopoly on the genre as a whole. This is because while imperfect, content is generally considered

219. *See* The Copyright Act, 17 U.S.C. §§ 101–1332 (1976).

220. *See, e.g.*, Maria A. Pallante, *The Next Great Copyright Act*, 36 COLUM. J.L. & ARTS 315 (2013) (calling for "comprehensive review and revision of U.S. copyright law").

221. *See, e.g.*, Herbert Hovenkamp, *Antitrust and the Regulatory Enterprise*, 2004 COLUM. BUS. L. REV. 335, 341 (2004) ("One consequence of regulation is a reduced role for the antitrust laws. When the government makes rules about price or output, market forces no longer govern. To that extent antitrust is shoved aside.").

222. Professors Hovenkamp, Janis and Lemley explain the justification this way:

> Because intellectual property rights impose costs on the public, the intellectual property laws can be justified by the public gods argument only to the extent that the laws on balance encourage enough creation and dissemination of new works to offset those costs. One of the reasons that intellectual property rights are limited in scope, in duration, and in effect is precisely in order to balance these costs and benefits . . . . The key to economic efficiency lies in balancing the social benefit of providing economic incentives for creation and the costs of limiting the diffusion of knowledge.

HERBERT HOVENKAMP ET AL., IP AND ANTITRUST: AN ANALYSIS OF ANTITRUST PRINCIPLES APPLIED TO INTELLECTUAL PROPERTY LAW § 1.3 (2002) (hereinafter TREATISE).

substitutable.[223] If a bookstore doesn't have a title that a friend recommends, or if it is selling a comparable title for half the price, the customer may choose to purchase the comparable title. This consolation purchase may not prevent the customer from purchasing the recommended book in the future, but the choice demonstrates the limited power of copyright's "monopoly" grant. Most individual copyrights (for example, a copyright to a single song) are not viewed as conferring market power on individual owners, but in the aggregate they may—for example, a music publisher with rights to millions of songs.

The highly technical nature of many IP-related disputes challenges antitrust still further. Some commentators suggest that antitrust's impotence in the IP context owes further to its overly narrow analysis that ignores this "marketplace of ideas."[224] Academics, industry, and legislators have all lamented the difficulties of policing the so-called "marketplace of ideas," defined as "a sphere in which intangible values compete for acceptance," and also as "a form of nonprice competition."[225] The idea underlying this push for expanded merger review is to recognize that technologically inclined firms compete on a number of dimensions other than price such as the pace and breadth of innovation, customer service, and overall quality.[226]

Much of the emphasis in case law at the intersection of antitrust and IP has been on compulsory licensing as a theoretical equitable remedy for the anticompetitive exploitation of IP rights. For example, 17 U.S.C. § 115 contains a compulsory cover license, under which licensees willing to pay the statutory rate may license the use of a musical composition for the purpose of creating a sound recording. This represents an exception to the copyright holder's general right to exclude. In this sense, compulsory licenses reflect a balance between exclusive rights for copyright owners and ensure access to creative works. Notably, this balance stems from a regulatory, and not an antitrust, solution.

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223. *See, e.g.*, Michael Abramowicz, *An Industrial Organization Approach to Copyright Law*, 46 WM. & MARY L. REV. 33, 37 (2004) ("Copyrighted works can serve as imperfect substitutes for one another . . . .").

224. *See* Maurice E. Stucke & Allen P. Grunes, *Antitrust and the Marketplace of Ideas*, 69 ANTITRUST L.J. 249, 249 (2001) (arguing for antitrust merger review to be expanded "to include its impact on the 'marketplace of ideas'").

225. *Id.* at 251, 297. For another example of antitrust's impotence in the IP context, see Aaron K. Perzanowski, *Rethinking Anticircumvention's Interoperability Policy*, 42 U.C. DAVIS L. REV. 1549 (2009) (suggesting that in lieu of antitrust, the DMCA's interoperability exemption be expanded)

226. *Id.* at 279.

c) In the Music Context

One of the biggest challenges to the application of the free market theory to the music publishing industry is that free market economics assumes a competitive marketplace for rival and excludable goods. Unfortunately, that is not the state of affairs for the music industry, which instead touts a single, public good—songs—in a marketplace that is not workably competitive.[227] As a noncompetitive market, music is uniquely susceptible to anticompetitive concerns.[228]

First, music is a differentiated product—that is, each song is unique, and consumers of music value variety. This demonstrates that the model of perfect competition does not apply because that model "assume[s] that many suppliers offer a homogenous product."[229] This is not the case in music, where no one song is a perfect substitute for another. Sellers of differentiated products, like songs, can typically demand a price above marginal cost and how much above depends on the buyer's elasticity of demand.

In music, an interactive service—one that allows consumers to select specific songs to play—is said to have nearly inelastic demand, and so typically faces higher prices than noninteractive services in which consumers can merely guide the song selection by dictating genre, or indicating "sounds like" choices. This is because, as Professor Shapiro describes in detail in his written testimony, a noninteractive service like Pandora has the ability to "steer" playlists toward some songs and away from others.[230] This makes non-interactive services' demand largely elastic, thereby lowering the price they can demand.

In addition, in the music-licensing context, one publisher's catalog is frequently complementary with—and not substitutable for—another's.[231]

227. Unlike standard goods—including those traditionally protected by property rights, like a house—songs, once released, are not excludable, nor is their worth diminished through their use by others. N.B.: Professor Yoo has persuasively argued that copyrighted goods are more accurately viewed as "impure public goods," or goods that are non-rival but excludable, or non-excludable but rival. Christopher S. Yoo, *Copyright and Public Good Economics: A Misunderstood Relation*, 155 U. PA. L. REV. 635, 635 (2007).

228. *See, e.g.*, Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 1 (1984) (stating that "[t]he goal of antirust is to perfect the operation of *competitive* markets.") (emphasis added).

229. Shapiro Written Testimony, *supra* note 178, at 4.

230. Shapiro Written Testimony, *supra* note 178, at 5–7 ("[T]he more easily a music service can steer listeners toward or away from specific sound recordings, the lower will be the price that music service will be able to negotiate.").

231. *See supra* note 179 and accompanying text.

This circumstance cuts to the heart of the conflict between IP and antitrust in the form of unilateral refusals to license.[232] In the absence of a compulsory license, IP owners are generally under no obligation to license the intellectual property, nor, indeed, to use it at all.[233] This is problematic from an economic perspective because licensing (at least in theory) allows the market to transfer IP to its most productive use.[234] Meanwhile, the DOJ Antitrust Division's Intellectual Property Guidelines take the position that content licensing is essentially pro-competitive:

> Licensing, cross-licensing, or otherwise transferring intellectual property . . . can facilitate integration of the licensed property with complementary factors of production. This integration can lead to more efficient exploitation of the intellectual property, benefiting consumers through the reduction of costs and the introduction of new products. Such arrangements increase the value of intellectual property to consumers and to the developers of the technology. By potentially increasing the expected returns from intellectual property, licensing also can increase the incentive for its creation and thus promote greater investment in research and development.[235]

In other words, licensing is the most efficient means of extracting value from an IP right, and circumstances that allow for lower levels of licensing, such as withdrawals and refusals to deal, may lead to lower value levels as well.[236]

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232. *See* TREATISE, *supra* note 222, § 13.1 (stating that "[u]nilateral refusal to license cases . . . cut to the heart of the intellectual property owner's right to exclude others from practicing the intellectual property" and noting that "[a]s such, efforts to invoke antitrust law in this context deserve special scrutiny.").

233. *Id.* § 13.2a (stating that "an intellectual property owner has no obligation to use its right at all."); *id.* § 13.2b (adding that the "'right' to refrain from using intellectual property would be a hollow thing indeed if the intellectual property owner could not prevent others from infringing the right."). Indeed, the common justification for compulsory licenses is their role as a point of guaranteed access. While outside the scope of the immediate Article, future work will consider the theory and practice of this type of engineered access.

234. *Id.* § 13.2 ("Economic theory encourages licensing because it allows the market to transfer the intellectual property right to the most productive user of that right.").

235. U.S. DOJ & FTC, *Antitrust Guidelines for the Licensing of Intellectual Property*, JUSTICE.GOV, § 2.3 (Apr. 6, 1995), http://www.justice.gov/atr/antitrust-guidelines-licensing-intellectual-property (hereinafter *Antitrust Guidelines for IP*) [http://perma.cc/ZL8A-GXGV].

236. The courts have also recognized the importance of licensing, primarily through the doctrine of copyright misuse. Copyright misuse is an affirmative defense akin to "unclean hands." *See, e.g.*, *In re* Napster, Inc. Copyright Litigation, 191 F.Supp.2d 1087, 1102 (2002) ("Copyright misuse as a defense to an infringement action finds its origins in

Congress has recognized the special situation of the music industry as a peddler of complimentary, but differentiated goods. It is also susceptible to refusals to license. Concern over the latter in particular is reflected in the compulsory license scheme prevalent in copyright law as it applies to music specifically. For example, § 115—the compulsory license for cover songs—recognizes a conflict between the societal value inherent in the creation of different versions of a song and the propensity for copyright owners to deny the realization of this value. The compulsory license resolves this conflict by limiting the copyright holder's ability to refuse to license in exchange for money in the form of the statutory rate. Professor Jane Ginsburg has written:

> [T]he real purpose of a compulsory license is to reduce the extent to which copyright ownership of the covered work conveys monopoly power, so that the copyright owner must make the work available to all who wish to access and exploit it.[237]

The existence of a compulsory license also supports the claim that in the absence of a workably competitive market, some form of regulation is called for. In copyright, regulation already exists and can be fairly readily augmented to make up for the short reach of antitrust in the music context. In other words, a market that is not workably competitive cannot self-correct, and antitrust cannot curb behaviors outside its purview, but regulation can. The next Part suggests that contrary to the conventional view of regulation as competition-reducing, "remedial regulation" can encourage competition in a way that antitrust cannot.

V. FACILITATING COMPETITION THROUGH REGULATION

There is a third option for checking anticompetitive behavior, maintaining competition, encouraging innovation, preventing technological lock-in, and ensuring payment to artists: regulation. The conventional view of regulation is as a system that works against competition; one that thwarts new entry and protects incumbents.[238] Indeed, the Telecommunications Act of 1996—intended to mark the deregulation of the telecommunications industry—proclaims as its

the equitable defense of unclean hands and is similar to the patent law defense of the same name.")

237. Jane C. Ginsburg, *Creation and Commercial Value: Copyright Protection of Works of Information,* 90 COLUM. L. REV. 1865, 1926 (1990).

238. *See, e.g.*, *supra* Part IV.B.2.a.

purpose: "To promote competition and *reduce regulation* in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies."[239] The goal of this Part is to challenge the conventional view and to present regulation as potentially pro-competitive.

Conventional thinking about how to approach the competition problem, or bargaining breakdown, in content generally falls into two divergent points of view: There are those who would reduce dependence upon (or in some cases do away with altogether) the current statutory licensing regime in favor of private ordering and/or other, preferable mechanisms such as fair use, patent pools, and collectives;[240] and those who favor compulsory licensing over private deal making for avoiding bottlenecks and for more robust information exchange.[241] The former view ignores the important role compulsory licenses play in ensuring access to content; the latter ignores the potential informational value derived from private rate setting. Both of these perspectives ignore the competitive market.

This Article departs from both of these perspectives, proposing instead a new model for maintaining competition in the licensing of intellectual property rights. This proposal calls for adherence to a mandatory, compulsory license by default, but embraces private ordering where (and

239. Title page of 47 U.S.C. (1996) (emphasis added).

240. *See, e.g.*, Wendy J. Gordon, *Fair Use as Market Failure: A Structural and Economic Analysis of the Betamax Case and its Predecessors*, 82 COLUM. L. REV. 1600, 1613 (1982) ("In extreme instances, Congress may correct for market distortions by imposing a regulatory solution such as a compulsory licensing scheme," but maintaining that "the broad brush of this regulatory solution is too sweeping for most cases."); Mark A. Lemley, *The Economics of Improvement in Intellectual Property Law*, 75 TEX. L. REV. 989, 1061–67, 1068–83 (1997) (pushing for new rules around derivative works and fair use as preferable to compulsory licensing for avoiding bargaining breakdowns in copyright); Merges, *supra* note 5, at 1295–96 (arguing against compulsory licensing as subject to "legislative lock-in" and instead favoring such devices as patent pools and collectives like ASCAP for overcoming bargaining obstacles); Robert P. Merges, *Intellectual Property Rights and Bargaining Breakdown: The Case of Blocking Patents*, 62 TENN. L. REV. 75, 75–76 (1994) (arguing for expanded use of reverse doctrine of equivalents over compulsory licensing for the avoidance of bargaining breakdowns in patent law).

241. *See, e.g.*, Ian Ayres & Eric Talley, *Solomonic Bargaining: Dividing a Legal Entitlement to Facilitate Coasean Trade*, 104 YALE L.J. 1027, 1092–94 (1995) (arguing that compulsory licensing can induce parties to reveal their "truthful revelation," thereby overcoming bargaining breakdown); *see also* Neil Weinstock Netanel, *Copyright and a Democratic Civil Society*, 106 YALE L. J. 283 (1996), 334–35 nn.247–48 (discussing Ayres & Talley's theory).

only when) real competition can be shown to exist between rival content licensors. This proposal, referred to herein as the "remedial regulation model," utilizes existing mechanisms—specifically, statutory licenses, a collective administrator, and existing regulatory authorities—to correct anticompetitive behavior at minimal cost.

The current competition policy for the licensing of intellectual property assumes robust competition, and so allows for private ordering in the shadow of the statutory license. For example, § 114 of the Copyright Act allows copyright owners to *either* use the statutory license, *or* to negotiate their own royalty rates and license terms for the public performance of sound recordings.[242] As a result, conventional antitrust mechanisms—like ASCAP's consent decree—are wholly ineffective against anticompetitive behavior perpetrated by individuals, who can merely opt-out.

The remedial regulation model updates copyright's competition policy by reversing this assumption. Instead, it assumes monopolistic (or oligopolistic) market power, thereby converting the existing, circumventable statutory licenses into mandatory, compulsory licenses under which parties may petition for permission to deal privately. Requiring only minimal statutory amendment and utilizing existing regulatory agencies and collectives, the remedial regulation model offers licensors and licensees a compromise: Continued access to content for all at a predictable rate and the flexibility to negotiate private terms, so long as industry consolidation has not reached a point so as to call into question the arms-length nature of any such transactions. This proposal builds, in part, on the existing literature on penalty defaults and altering rules. After a brief review of default theory, this Part will show its application in the regulatory context and will detail a remedial regulatory solution to copyright's competition problem.

A. PENALTY DEFAULTS, ALTERING RULES & COMPETITION

1. *Default Theory*

A "penalty default" is an undesirable fall back option designed to penalize those who, through failure to do or to not do some thing (be it negotiate, or share information), do not otherwise negotiate around it. The concept of "penalty default rules" was first introduced by Professors

242. *See* 17 U.S.C. § 114(e) (2012).

Ian Ayres and Robert Gertner,[243] who described them as unpalatable fallback options in contract law that kick in unless the parties negotiate their own terms. Such rules, they argue, induce more knowledgeable parties to "reveal information by contracting around the default penalty."[244] Prior work has extended this concept to licensing and demonstrates that "penalty default *licenses* encourage[] more efficient deal making among otherwise unequal parties by motivating them to circumvent an inefficient statutory license in favor of private ordering."[245]

In other words, penalty defaults are a mechanism by which regulators can encourage or discourage a certain behavior without regulating that behavior directly. This is particularly useful where the behavior sought to be modified is not easily regulated, such as to encourage retirement savings, organ donation, and to curb pollution.[246] The next section argues that penalty defaults might also prove especially useful for regulating behavior that is not readily ameliorated by existing legal regimes, such as the anticompetitive behavior of the individual music publishing companies whose tacit collusion and parallel pricing activities are not checked by antitrust.

Altering rules establish the "necessary and sufficient conditions for altering default legal consequences."[247] "Impeding" altering rules aim to "deter opt-out by artificially increasing its difficulty."[248] This is effectively what remedial regulation does: By requiring a showing of sufficient competition before private ordering is permitted, the statutory license is made "quasi-mandatory" or sticky.[249]

243. Ian Ayres & Robert Gertner, Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules, 99 YALE L. J. 87, 91 (1989).

244. *Id.* at 94. In other words, where a penalty default rule results in an undesirable outcome for Party A (possessor of information unknown to Party B), Party A may be incentivized to negotiate around the default term, thereby revealing his information not only to Party B, but also to the legislature, which can use that information to draft better rules, default and otherwise.

245. García, *supra* note 15, at 1122 (emphasis added).

246. *See generally* RICHARD H. THALER & CASS R. SUSSTEIN, NUDGE (2008) (identifying areas in which behavior modification via incentive or encouragement might be best received).

247. Ian Ayres, *Regulating Opt-Out: An Economic Theory of Altering Rules*, 121 YALE L.J. 2032, 2114 (2012).

248. *Id.* at 2084.

249. *Id.* at 2087.

2. *Application to Regulation*

In the regulatory context, the remedial concept behind impeding altering rules works to penalize an undesirable behavior in hopes of encouraging a different behavior. Here, it does so by mandating compliance with a statutory rate—thereby foreclosing private ordering with all of its potential benefits—unless and until sufficient competition can be shown in the relevant marketplace.

There is precedent for this approach. In wholesale electricity, for example, the Federal Energy Regulatory Commission (FERC) sets the applicable rates for energy transmission. A utility company is allowed to charge a "market-based tariff only if [the company] demonstrates that it lacks or has adequately mitigated market power, lacks the capacity to erect other barriers to entry, and has avoided giving preferences to its affiliates."[250]

Varying in procedure, but similar in spirit, are patent pools, or the pooling of patents between two or more companies. Patent pooling is generally acceptable, even favored, unless "(1) excluded firms cannot effectively compete in the relevant market for the good incorporating the licensed technologies and (2) the pool participants collectively possess market power in the relevant market."[251] Where these conditions exist, the DOJ or the FTC will review the licensing arrangement for anticompetitive effect before determining whether the parties will be allowed to engage in the pooling activity. In both of these examples, a competitive marketplace is not assumed, but must first be shown.

B. REMEDIAL REGULATION

In lieu of antitrust, this Article advocates utilizing remedial regulation—or, regulation that discourages industry consolidation—in

250. Morgan Stanley Capital Group Inc. v. Public Utility Dist. No. 1 of Snohomish County, Wash., 554 U.S. 527, 537 (2008); *see also* Market-Based Rates For Wholesale Sales of Electric Energy, Capacity And Ancillary Services by Public Utilities, Order No. 697, 119 FERC ¶ 61,295, at ¶ 7 (2007), http://www.ferc.gov/whats-new/comm-meet/2007/062107/E-1.pdf [https://perma.cc/T36A-BAVL], which cites the development of a 4-prong analysis for determining whether a seller can engage in private ordering:

> (1) [W]hether the seller and its affiliates lack, or have adequately mitigated, market power in generation; (2) whether the seller and its affiliates lack, or have adequately mitigated, market power in transmission; (3) whether the seller or its affiliates can erect other barriers to entry; and (4) whether there is evidence involving the seller or its affiliates that relates to affiliate abuse or reciprocal dealing.

251. *Antitrust Guidelines for IP*, *supra* note 235, § 5.5.

order to open the market and maintain competition. This model assumes a baseline that tends toward oligopoly, natural or otherwise, and so allows for private ordering only where sufficient competition can first be shown. Otherwise, regulation operates to ensure ongoing access to the relevant input(s) for all prospective consumers or licensees able and willing to meet the statutory requirements and to pay the statutory rate. Because this regulation does not necessarily represent a market rate—nor, indeed, as high a rate as private ordering might obtain—this Article labels it "remedial." It punishes the lack of a competitive marketplace.

If a company wants to engage in private ordering to obtain a higher rate or better terms, it must first petition to show the existence of sufficient competition in the relevant market. While such "remedial regulation" cannot create a robust competitive market where none exists, it can prevent a few powerful firms from unilaterally controlling the price for an input, or from barring new entry to the market altogether to the detriment of both consumers and innovators in the space. As is the case with other highly regulated industries, the underlying assumption here is that the government has a greater responsibility for checking anticompetitive behavior in the music licensing space owing to its role in the granting of exclusive property rights via copyright.

As with the wholesale electricity example, remedial regulation places the burden of proving a competitive marketplace on the party seeking to get out from under the statutory regime. This resets the baseline assumption and brings competition policy in line with positive market conditions, while at the same time establishing a "safe harbor" that allows for private ordering (and its concomitant advantages) when, and only when, sufficient competition can be shown. The next section outlines one possible path toward implementation of remedial regulation in the music licensing context.

1. Logistics

In the music licensing context, remedial regulation does three things. First, it removes the authority for negotiation found in certain statutory licenses,[252] thereby converting them into mandatory (i.e., non-

252. For example, 17 USC § 114(e) permits:

> [A]ny copyright owners of sound recordings and any entities performing sound recordings affected by this section [to] negotiate and agree upon the royalty rates and license terms and conditions for the performance of such sound recordings and the proportionate division of

circumventable) statutory licenses. Specifically, transition to a remedial regulatory regime begins with the conversion of existing non-mandatory statutory licenses—like § 114[253]—into a mandatory, statutory license. There is precedent for this in the Copyright Act itself: Both § 111 (for broadcast cable) and § 119 (for satellite television)[254] are mandatory, compulsory licenses that do not allow for circumvention and private ordering.

Next, remedial regulation also establishes a new compulsory license for the public performance of musical compositions. Currently, these rights are negotiated in the market, allowing for the types of anticompetitive conduct seen in the music licensing space. The establishment of a compulsory license provides a guaranteed point of access by removing the threat of unilateral refusals to license. As with other compulsory licenses—such as § 115's cover license—this statutory infringement on the exclusionary rights of copyright owners is justified by the societal benefit of avoiding anticompetitive behavior that threatens to stifle innovation in the distribution space. These compulsory licenses serve as impeding altering rules, or sticky defaults, intended to make opt-out difficult.

These newly mandatory compulsory licenses can be administered by a governmentally authorized collective. As it did with SoundExchange in the context of public performance rights for sound recordings, the government could likewise designate one of the existing collectives—such as ASCAP or BMI—or elect to form an entirely new collective to be charged with the administration and distribution of royalties for these newly-created licenses. In any case, the CRB retains rate-setting authority for all statutory licenses.

Finally, a remedial regulatory regime establishes a procedure through which a rights holder wishing to forego the statutory license and engage in private ordering may petition to do so via a showing of sufficient competition in the market for music licensing. A party wishing to circumvent the statutory license files a petition with the regulatory body (most likely the FTC, given both its institutional competence and specialization in the music industry).[255] This designation would require a

> fees paid among copyright owners, and [to] designate common agents on a nonexclusive basis to negotiate, agree to, pay, or receive payments.

17 U.S.C. § 114(e) (2012).

253. 17 U.S.C. § 114.

254. 17 U.S.C. §§ 111, 119.

255. One might also suggest that the additional workload for the FTC is its just desert for allowing the market concentration in music licensing to reach its current levels.

congressional delegation of authority to the FTC for petition review.[256] The FTC then either accepts the petition, allowing parties to circumvent and engage in private negotiation, or rejects it, in which case the parties must proceed under the statutory rates set by the CRB. Importantly, this ensures continued access to content regardless of the state of competition, while simultaneously eliminating adverse selection concerns resulting from opt-out of the most powerful parties.

A petition to circumvent mandatory statutory licenses must show real and sufficient competition in the relevant market. In the wholesale electricity context, FERC requires a company seeking authorization to engage in "market-based rates" or "MBRs" file an application under § 205 of the Federal Power Act.[257] Borrowing liberally from that application's guidelines, a petition in the music-licensing context might require any or all of the following:

- A letter explaining the basis for the petition, and containing contact information and a description of the petitioning entity's business.
- A description of the specific type of license to be negotiated for by petitioner.
- A description of any affiliates of the petitioner and their business activities. Or, if the petitioner has no affiliates, the application should include a representation to that effect. Affiliates can be defined as, but not limited to, upstream owners and wholly or partially owned entities.
- Representations of how the petitioner satisfies the reviewing agency's concerns with regard to horizontal market power.
- Representations of how the petitioner satisfies the reviewing agency's concerns with regard to vertical market power.
- Representations of how the petitioner satisfies the reviewing agency's concerns with regard to barriers to entry and unilateral refusals to license.

Congress might consider an appeals process to allow for dispute resolution in the event of dissatisfaction regarding a determination by the

256. For an excellent analysis of the various government institutions that participate in the making and enforcement of copyright law, and the pros and cons of each, *see* DiCola & Sag, *supra* note 31.

257. *See* 16 U.S.C. § 12 (2014).

reviewing agency, or disagreement about the sufficiency of evidence presented. Should an appeals option present too heavy a burden for the reviewing agency, it should be noted that FERC has successfully defended the lack of an appeals process in the MBR context.

In sum, the remedial regulation model establishes a regulatory regime that punishes a lack of competition by prohibiting private ordering, and all of the benefits that it brings, until sufficient competition can be shown. This discourages incumbents from amassing market power, since increased market share will only limit their ability to engage in private negotiation and deal making. It also mitigates some of the potential drawbacks of private ordering, such as the misrepresentation of "market" rates, and adverse selection consequences borne by smaller licensors when their larger counterparts withdraw.

2. *Applicability*

Certain features make an industry particularly well suited for remedial regulation. The first is lack of a functioning market. In the music licensing context, the concern is anticompetitive behavior such as tacit collusion and parallel pricing, but breakdowns in market function are found in other places as well, for example, in industries specializing in differentiated and/or complementary products; i.e., products which do not face perfect competition. A regulatory scheme that punishes dominance by denying dominant players the freedom to negotiate privately is a scheme that discourages such convergence in the first place.

Second is the inapplicability of another legal regime, such as the inapplicability of antitrust law to the anticompetitive behavior exemplified by the individual music publishing companies. Where an extant set of laws is unable to modify unwanted or undesirable behavior, remedial regulation may be able to achieve the desired result with minimal statutory amendment and lowered costs by utilizing existing regulatory bodies and agencies.

Remedial regulation is particularly well suited to industries already subject to extensive regulation. In those cases, the regulatory regime is likely already working at cross-purposes with a more hands-off approach—such as the inherent conflict between copyright's limited monopoly grant and antitrust law. The existence of an extensive regulatory regime also makes remedial regulation an easy transition: First, the industry players are accustomed to regulation; second, many of the statutory terms that will come to constitute the remedial regulation are likely to already be in place. The same is true of existing agencies, giving remedial regulation an advantageous starting point, and lowering the cost of implementation.

Finally, remedial regulation can also be useful in certain contexts—such as highly technical fields, like IP—where lawmakers and administrators are unlikely to fully understand the nuances in a field, and/or where the industry players have a distinct advantage over lawmakers in their ability to anticipate and respond to new developments. In those markets, remedial regulation places the burden on the parties to make a case for themselves and the market in which they operate. This puts the informational demands on the party best equipped to provide the relevant information, and at the least cost.

3. Challenges

The suggestion to implement additional regulation, remedial or otherwise, in an already highly regulated environment such as music licensing, is not made lightly. As a general matter, regulation begets regulatory gaming, or "private behavior that harnesses procompetitive or neutral regulations and uses them for exclusionary purposes."[258] In their seminal article on this topic, Professors Dogan and Lemley suggest that while regulatory gaming cannot generally be avoided ex ante, it may be checked by continued antitrust oversight of regulated markets.[259] While not a wholesale fix, the fact that the DOJ and the FTC would continue to have jurisdiction over the music publishing companies should assuage gaming concerns here.

Another concern is the fact that remedial regulation would shift some of the antitrust oversight from the auspices of the Sherman Act to that of the Copyright Act; or, from Title 15 to Title 17. This opens competition policy up to the potentially negative influences of lobbying. Copyright—with its concentrated market power and disparate interests—is particularly susceptible to the influence of lobbyists.

Further, by mandating statutory licensing, remedial regulation forecloses the opportunity for a true market to develop. Without a real market, it is difficult to know whether the statutory rates set are economically efficient. This concern may be mitigated, however, by the uniform application of the rate across all parties.

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258. Dogan & Lemley, *supra* note 218 at 687.

259. *See id.* at 688 (While "[r]egulatory agencies and even Congress cannot normally prevent gaming ex ante . . . some level of antitrust enforcement . . . provides a necessary check on behavior like product hopping that has no purpose but to exclude competition.")

In his classic work on organizational discontent, Albert Hirschman describes a dichotomy of reactions from an unsatisfied player: The entity can either continue as a member and voice its complaints, or it can exit the organization and do business elsewhere.[260] In the absence of sufficient competition, a remedial regulatory regime removes the exit option. This leaves disgruntled publishers to use their voices within ASCAP (or other designated collective), and/or under the compulsory license, where they may be able to wield their considerable market power to unfair advantage.

Part II.C.2 *supra* described the advantages of private ordering, including the ability to achieve a higher royalty rate, to negotiate licenses tailored to a particular piece of content and use, and to enjoy increased flexibility to respond to changes in technology and consumer preferences. It follows that another downside to remedial regulation is that it makes private ordering and the benefits it brings more difficult, time-consuming, and costly. In some instances, it may discourage private deal making altogether. This cost is arguably offset, however, by the societal gains from the elimination of anticompetitive behavior. Importantly, private ordering is not eliminated, but rather regulated. Abuses are checked, and access to content for all comers—established firms and prospective entrants alike—is ensured.

In addition, the remedial regulation model utilizes an existing regulatory agency, the CRB, for rate setting. To the extent that the existence of, and exercise of rate-setting authority by, the CRB poses separation of power issues, so too would a remedial regulation scheme that assigns rate setting to that agency.[261] Whether the CRB's functions should be moved to the executive branch, or vested elsewhere, however, is outside the scope of this Article, and not specific, nor limited, to the remedial regulation model.

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260. *See* ALBERT O. HIRSCHMAN, EXIT, VOICE, AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES (1970).

261. Writing on administrative agencies generally, Professor Jody Freeman has summarized the concern this way:

> The combination of executive, legislative, and adjudicative functions in administrative agencies appears to violate the separation of powers principles embodied in the Constitution. Worse yet, despite their considerable discretionary power to impact individual liberty and property rights, allocate benefits and burdens, and shape virtually every sector of the economy, agencies are not directly accountable to the electorate.

Jody Freeman, *The Private Role in Public Governance*, 75 N.Y.U. L. REV. 543, 545–46 (2000).

Finally, and perhaps most importantly, regulatory price setting of the sort advocated herein "has been plagued by complicated valuation, allocation and second-best pricing problems that have bordered on insurmountable."[262] Further, as noted in prior works, the default nature of compulsory licenses makes the set rates sticky, and parties may come to feel entitled to the regulatory rate regardless of its efficiency or appropriateness.[263] But regulatory price setting is already status quo for the music licensing industry, such that its further encouragement does not worsen the situation therein. To the contrary, to the extent that remedial regulation can work to eliminate anticompetitive behavior, its benefits may well outweigh any costs. If the model works—i.e., if it indeed discourages consolidation of market power and entities' petitions for private ordering are granted—the market will eventually move away from regulatory price setting altogether.

4. Advantages

The most obvious advantage of the remedial regulation model is that it discourages anticompetitive behavior. The possibility of private ordering is also preserved, so long as some do not reap its advantages at the expense of others. Importantly, remedial regulation maintains a point of access for content by leaving existing statutory licenses and a collective in place.

The additional costs borne by a party wishing to petition for private ordering are justified by the potential upside of private licensing over licensing under the statute, and are further excused by the optional nature of petition: No one has to petition, and the statutory license is always available as a point of access. Utilizing the FTC for regulatory review makes further use of an existing regulatory body readily possessed of all necessary authority for so doing. Review of petitions for circumvention can also help to further inform the reviewing agency of current market conditions. This information can lead to better merger reviews in the future.

The remedial regulation model is cost-effective in that it requires only minimal statutory amendment to remove the non-mandatory default from existing statutory licenses. The establishment of a new compulsory license for public performance rights likewise imposes minimal legislative burden as it models itself after the existing compulsory license for digital public

262. Christopher S. Yoo, *The Economics of Network Access*, 28 ADMIN. & REG. L. NEWS 5 (2003). In the music context specifically, the history of webcasting royalty determinations is arguably an unmitigated disaster. *See* DiCola & Sag, *supra* note 31 (suggesting the problems owe to flawed institutional design).

263. *See* García, *supra* note 15 at 1157–59.

performance of sound recordings, including the designation of a sole collective—quite possibly one already in existence—for royalties administration.

In the long-term, implementing a penalty default regulatory scheme will encourage innovation by ensuring a competitive environment in which new entrants are not discouraged from starting new services by the threat that their success might be punished with rate coercion. In essence, the remedial regulation model calls for a policy of facilitating the emergence and continuation of rival content providers and distributors. Where a robust number of providers cannot exist—owing to market conditions or otherwise—the remedial regulation model ensures all players face the same market conditions. As detailed in previous work, private ordering offers a number of benefits over the statutory regime, but a statutory rate is still better overall than an artificial "market" rate imposed by a single dominant firm.[264]

The remedial regulation model's use of mandatory statutory licenses also works to ensure payment to artists. For example, the statutory license for sound recordings contains a section calling for mandatory distribution of royalties to artists.[265] Section 114(g)(2) mandates a 50/50 split of incoming royalties between the creator herself and the intermediary to whom the copyright is assigned:

- 50% of receipts shall be paid to the copyright owner;
- 2.5% of receipts shall be deposited in an escrow account for distribution to non-featured musicians;
- 2.5% of receipts shall be deposited in an escrow account for non-featured vocalists; and
- 45% of receipts shall be paid to the featured recording artist on the sound recording.[266]

Such assurances for artists aren't limited to statutory licenses. Article XVII(1)(c) of ASCAP's Articles of Association likewise specifies the distribution of royalties as "one-half thereof to be distributed among the 'Music Publisher' members, and one-half among the 'Composer and

264. *See generally* García, *supra* note 15 (discussing the potential for manipulation of "market" rates).
265. 17 U.S.C. § 114(g) (2012).
266. 17 U.S.C. § 114(g)(2)

Author' members, respectively."[267] Article XX, Section 4 further notes that "[t]he royalties, or the right to participate in the royalties, and the rights of the members in the Society, shall not be sold or otherwise disposed of . . . ."[268] When either § 114, or ASCAP (or both) is circumvented, so too is this guaranteed payment to the artist, who becomes subject to whatever portion their contract with the intermediary allows for (which, in the case of many songwriters, is nothing).

Remedial regulation's newly established compulsory license for the public performance of musical compositions could offer similar payment guarantees that cannot be circumvented unless and until a successful petition is filed. Even then, a minor statutory amendment could dictate that the artist protection portions are not circumventable.[269] These artist protections can be made inalienable, such that where a firm successfully petitions circumvention by a showing of sufficient competition, the artist distribution portion of the circumvented statutory license remains in force.

This comports with legislative intent in setting up these protections in the first place: "The Committee intends the language of section 114(g) to ensure that a fair share of the digital sound recording performance royalties goes to the performers according to the terms of their contracts."[270] According to Representative Conyers, this provision was adopted to "ensure[] that musicians, vocalists, and artists receive their royalties from digital music directly from the collection agent instead of through other intermediaries."[271] The concern is obvious: In the absence of statutory protection for those musicians, vocalists, and artists, the intermediary record labels and music publishers might cut them out of their share of royalties, as indeed has been the case in recent deals.

VI. CONCLUSION

Despite the existence of more content now than ever before, there are far fewer *legal* distribution and licensing channels for that content. The dearth of competition in the licensing space is bad for users, artists, and

267. AM. SOC'Y OF COMPOSERS, AUTHORS, AND PUBLISHERS, ARTICLES OF ASSOCIATION OF THE AM. SOC'Y OF COMPOSERS, AUTHORS, AND PUBLISHERS 19–20 (2002), http://www.ascap.com/~/media/files/pdf/members/governing-documents/articles-of-association.pdf [http://perma.cc/S54Q-CE4N].

268. *Id.* at 22.

269. *See* García, *supra* note 13, at 8 (proposing "a fidelity clause requiring parties who circumvent the compulsory license to adhere to the statutorily mandated distributions in order to obviate circumvention of statutory protections for non-parties").

270. H.R. Res. No. 104-274, at 24 (1995).

271. 148 Cong. Rec. H7047 (2002) (statement of Rep. Conyers).

innovators alike. By recognizing the value of private ordering in content licensing and aiming to facilitate it when competition is robust, remedial regulation works to maintain and encourage competition where antitrust law does not.

The question of how to best manage emerging technologies and the challenges they present has never been more pressing. The debate around net neutrality, for example, is essentially a debate about whether antitrust law or regulation is the better means of ensuring competition in the broadband Internet space. Some lawmakers have argued that "vigorous application of the antitrust laws can prevent dominant Internet service providers (ISPs) from discriminating against competitors' content or engaging in anticompetitive pricing practices."[272]

Others have pointed out that application of antitrust laws to ISPs requires an expansive interpretation of antitrust's jurisdiction. These critics have expressed concern that antitrust, unlike regulation, "does not address the non-economic goals of net neutrality, including the protection of free speech and political debate."[273] Remedial regulation may well prove a sustainable option for the maintenance of competition among Internet service providers.

Acknowledging the potential for remedial regulation to maintain and encourage competition in industries, like music licensing, where antitrust has failed is only a starting point. Recognition of regulation as a tool for checking anticompetitive behavior offers lawmakers a means of ensuring continued growth and innovation in high tech sectors that have proven resistant to traditional antitrust enforcement. By shifting the burden of maintaining competition to the firms that wish to get out from under regulation, remedial regulation harnesses the power of private industry in order to serve public goals.

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272. *Net Neutrality: Is Antitrust Law More Effective Than Regulation in Protecting Consumers and Innovation?*, 113th Cong. (2014) (statement of Hon. Bob Goodlatte, Chairman House Judiciary Committee), http://judiciary.house.gov/index.cfm/hearings?Id=CCF704C2-E445-4D9A-8B84-26F6B9A59CC6&Statement_id=4CB6551B-8469-48C7-A155-8F62D9D172A6 [http://perma.cc/VT76-QDVL].

273. *Net Neutrality: Is Antitrust Law More Effective Than Regulation in Protecting Consumers and Innovation?*, 113th Cong. (2014) (statement of Ranking Member John Conyers, Jr.), http://democrats.judiciary.house.gov/opening-statement/ranking-member-conyers-statement-net-neutrality-hearing [http://perma.cc/YB74-DNJG].

APPENDIX

Music Copyrights Reference Grid