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## Private Copyright Reform

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# PRIVATE COPYRIGHT REFORM

*Kristelia A. García\**

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*The government is not the only player in copyright reform, and perhaps not even the most important. Left to free market negotiation, risk averse licensors and licensees are contracting around the statutory license for certain types of copyright-protected content, and achieving greater efficiency via private ordering. This emerging phenomenon, herein termed “private copyright reform,” presents both adverse selection and distributive justice concerns: first, circumvention of the statutory license goes against legislative intent by allowing for the reduction, and even elimination, of statutorily mandated royalties owed to non-parties. In addition, when presented without full term disclosure, privately determined royalty rates can lead to industrial and statutory adoption of inaccurate “market” valuations. Finally, private copyright reform can exacerbate market inequalities by leaving smaller, less powerful parties with a weaker, less effective statutory regime. These concerns could be addressed by comprehensive copyright reform, an ambitious and lengthy process at best. The concerns might also be eliminated by making compliance with the statutory license mandatory, thereby eliminating private copyright reform as an option. Recognizing the efficiency-enhancing value of private copyright reform, however, this Article leaves the option to circumvent in place, and instead suggests two modest statutory amendments to alleviate the adverse selection and distributive justice concerns presented. Private copyright reform also challenges traditional intellectual property doctrine; specifically, it questions the efficiency of statutory licenses and collective rights organizations, while also raising questions of fairness around the ability of*

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*private parties to make law. While resolution of these doctrinal questions is outside the scope of this Article, the recent proliferation of private copyright reform suggests they are ripe for reconsideration.*

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#### INTRODUCTION

James Taylor is an American singer and songwriter, and the recipient of five Grammy awards. Over the span of his 45-year career, he has sold nearly 100 million albums.<sup>1</sup> Best known for hits like “Fire and Rain” and “You’ve Got a Friend,” Taylor was inducted into the Rock and Roll Hall of Fame in 2000.<sup>2</sup> He was awarded the National Medal of Arts by President Obama in 2011, and performed at the presidential inauguration in January 2013.<sup>3</sup>

In 2007, an audit performed on Taylor’s royalty statements from his long-time record label, Warner Brothers, uncovered a deficiency of \$1,692,726 alleged to constitute amounts owed for creative and inaccurate

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1. *Biography*, JAMES TAYLOR.COM (Aug. 2012), <http://www.jamestaylor.com/about/>.  
 2. *Id.*  
 3. *Id.*

accounting—and that only dates back to 2004.<sup>4</sup> A second audit, conducted in 2010, found an additional deficiency of \$1,147,591 covering just the three years since the first audit.<sup>5</sup> So far, Warner Brothers has owned up to \$764,056 (later adjusted downward to \$147,278), and has paid only \$97,857.<sup>6</sup> The alleged underpayment stems primarily from uncertainty surrounding royalties owed from relatively new technologies and business models, including digital streaming and subscription services. In the music industry, the lag between the introduction of a new technology like digital streaming, and the statutory license's ability to accommodate it, allows for guesswork to fill in the gaps. This guesswork is often proven inaccurate by eventual legislation,<sup>7</sup> but corrections, when made, are slow.

As one among many, this example serves as a reminder that rapid technological development and concomitant changes in consumer behavior can adversely affect not only copyright holding intermediaries and their business models, but also, and importantly, the underlying creators—even those as successful and well-advised as James Taylor—that the copyright laws are tasked with protecting.<sup>8</sup> While a recording artist at odds with his record label is nothing new, the ever-changing and highly unstable music industry has now produced an entirely new concern for artists and other non-parties: “private copyright reform.”

As introduced herein, “private copyright reform” refers to private licensing in the shadow of a statutory license. A statutory license is a common mechanism in copyright that serves as an open offer that may be accepted by any prospective licensee willing to pay the statutory rate and meet the statu-

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4. Paul Resnikoff, *52 Ways to Screw an Artist, by Warner Bros. Records*, DIGITAL MUSIC NEWS (Sept. 19, 2012), <http://www.digitalmusicnews.com/permalink/2012/120919jamestaylor> (citing omissions stemming from, among other sources, underpayment of mechanical royalties, misallocation of recording expenses, nondisclosure of terms with third-party licensees, non-payment for various synchronization uses, failure to pass-through performance royalties, unauthorized compilation licenses, failure to apply proper tax credits, and interest).

5. *Id.*

6. *Id.*

7. For example, ad-supported internet services such as Pandora were not anticipated when the Digital Performance Right in Sound Recordings Act was passed in 1995. 17 U.S.C. §§ 106(6), 114 (2012). As a result, Internet radio services whose users paid a subscription fee were subject to a compulsory royalty, while Internet radio services whose users watched ads (in lieu of subscribing) were exempt from paying any royalties at all. This inadvertent result led to a series of post-legislation arbitration sessions, beginning in 1998 with the session commonly known as Webcasting I. *See In re Digital Performance Right in Sound Recordings & Ephemeral Recordings*, Nos. 99-6 CARP DTRA, 2000-3 CARP DTRA (Dec. 4, 2000), *available at* <http://www.copyright.gov/carp/114schedule.html>.

8. Article I, Section 8, Clause 8 of the U.S. Constitution authorizes Congress to “promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.” Notwithstanding the fact that many songwriters and, to an even greater degree, recording artists, assign their rights to an intermediary publishing company or record label, the task of copyright arguably remains the encouragement of creators themselves.

tory terms.<sup>9</sup> These private content licensing agreements circumvent both the statutory license and relevant collective rights organization (“CRO”),<sup>10</sup> and in so doing, alter not only the rights and obligations under the law of the parties themselves, but also potentially alter the rights and entitlements of non-parties in several significant ways.

First, private copyright reform may deny artists royalty payments to which they are legally entitled. Second, parties may misrepresent privately negotiated valuations as representative of the market. Rate misrepresentation (*i.e.*, the introduction of a privately determined valuation as the “market” rate, when in fact it represents only the specific parties’ interests) is problematic insofar as these misrepresentations are frequently adopted by the industry, either formally through the Copyright Royalty Board’s (“CRB”) or rate court’s rate setting processes, or informally through evolving industry norms and customs.<sup>11</sup> Finally, the adverse selection that leads larger, stronger companies to opt out of the statutory license leaves smaller, less powerful parties with a weaker, less effective statutory regime.

Unlike industries such as broadcast cable and satellite television,<sup>12</sup> which operate under a mandatory statutory license that requires parties to operate solely under the statute and to pay royalties directly to the Register of Copyrights, the sound recording industry is governed by Section

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9. The terms “statutory license” and “compulsory license” are often used interchangeably. In this context, the descriptor “compulsory” can be misleading since it refers to the inability of a licensor to refuse to license to a licensee who complies with the statutory terms; it does not mean that compliance with the license is mandatory, as some such licenses—17 U.S.C. § 114 for the compulsory licensing of sound recordings, for example—explicitly authorize circumvention, as detailed herein.

10. A collective rights organization (CRO) is an entity tasked with the collection and administration of statutory royalties. In the sound recording industry, the sole CRO is SoundExchange. The music publishing industry has specialized CROs, often referred to as “performing rights organizations” or PROs (because they administer performing rights). The three largest PROs, which together constitute the majority of the industry, are ASCAP, BMI, and SESAC. Both ASCAP and BMI operate under consent decrees. *See, e.g.*, *United States v. Am. Soc’y of Composers, Authors, Publishers*, No. 41-1395 (WCC), 2001 WL 1589999 (S.D.N.Y. June 11, 2001) (renewing ASCAP’s consent decree).

11. The argument made herein—that industry norms are not necessarily efficient for non-parties—builds upon a literature critiquing the use of norms and customs generally, both within, and outside of, the intellectual property context. *See, e.g.*, Lisa Bernstein, *The Questionable Empirical Basis of Article 2’s Incorporation Strategy: A Preliminary Study*, 66 U. CHI. L. REV. 710 (criticizing the use of custom in the UCC context); Jennifer E. Rothman, *The Questionable Use of Custom in Intellectual Property*, 93 VA. L. REV. 1899 (2007) (critiquing the influence of custom on intellectual property law).

12. 17 U.S.C. § 111(d)(1) (establishing, in the case of broadcast cable, that “a cable system whose secondary transmissions have been subject to statutory licensing . . . shall, on a semiannual basis, deposit with the Register of Copyrights . . . [a] statement of account . . .”); *id.* § 119(b)(1) (establishing, in the case of satellite transmissions, that “[a] satellite carrier whose secondary transmissions are subject to statutory licensing . . . shall, on a semiannual basis, deposit with the Register of Copyrights . . . [a] statement of account”).

114(e)(1) of the Copyright Act of 1976<sup>13</sup> (the “Copyright Act”). This section specifically contemplates an opt-out for licensors and licensees by authorizing “copyright owners of sound recordings” and “any entities performing sound recordings” to alternately “negotiate and agree upon the royalty rates and license terms and conditions for the performance of such sound recordings and the proportionate division of fees paid among copyright owners, and may designate common agents on a nonexclusive basis to negotiate, agree to pay, or receive payments.”<sup>14</sup> This gives parties a choice: they can utilize the compulsory licensing, or they can opt to engage in a private licensing deal.

Similarly, Section 115(c)(3)(B) of the Copyright Act authorizes voluntary negotiations for determining royalty rates and terms for musical compositions under the mechanical compulsory license: “[n]otwithstanding any provision of the antitrust laws, any copyright owners of nondramatic musical works and any persons entitled to obtain a statutory license . . . may negotiate and agree upon the terms and rates of royalty payments under this paragraph and the proportionate division of fees paid. . . .” Sound recordings and musical compositions are therefore unique under the copyright laws in that both operate under a circumventable compulsory license. Once circumvented, the statute’s terms no longer apply to the parties in any way. This compulsory alternative, coupled with rampant instability and uncertainty both as to royalty rates and business models in these industries, provides the ideal setting for risk averse parties to experiment with private copyright reform.

While Sections 114(e)(1) and 115(c)(3)(B) have allowed circumvention in these industries for decades, parties have not taken advantage of the opportunity until now. Instead, licensors and licensees have always operated under the respective compulsory license, and paid and collected their performance royalties through a designated collective rights organization, like the American Society of Composers, Authors and Publishers (“ASCAP”) for musical compositions, or SoundExchange for sound recordings. One explanation for this adherence to the statutory license is simple: the negotiation of individual content licenses with many different parties requires extensive, and in many cases prohibitive, time and effort. In this way, compulsory licenses and CROs are generally understood to be efficient, and even necessary, in industries that license intellectual property.

A primary impetus behind the establishment of Section 114, for example, was the avoidance of high transaction costs associated with negotiation

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13. Copyright Act of 1976, Pub. L. No. 94-553, 90 Stat. 2541 (codified as amended in scattered sections of 17 U.S.C.).

14. 17 U.S.C. § 114(e)(1).

of many individual content licensing deals.<sup>15</sup> While the negotiation of individual content licensing agreements is no less burdensome today than it was twenty years ago, the music industry has changed drastically. It is unclear whether the “facilitation of bulk licensing” explanation is wholly applicable in the new, digital age where consumers are more concerned with access than catalog.<sup>16</sup> Instead, modern digital content services emphasize “curating an ultimately limited selection,”<sup>17</sup> a task best accomplished through private ordering. This emphasis too may be a contributing factor to the emergence of private copyright reform. Advances in technology, changes in consumer behavior, failing business models, diminished profits, uncertainty surrounding future royalty rates, unpredictability around pending legislation and litigation, and a propensity toward risk aversion all serve as impetuses for private copyright reform.

Eager for stability, licensees and licensors in these industries are utilizing for the first time a statutory authorization for private deal making to alter not only their own rights and responsibilities under the law via the establishment of private royalty valuations, but also those of non-parties. For the parties involved, these private deals better align incentives, save lobbying costs, and encourage cooperation and growth in a way that the existing compulsory licensing regime does not. This private copyright reform includes both the creation of new rights and royalty obligations where none currently exist, and the reduction or elimination of rights and royalty obligations otherwise owed. This Article will focus on the latter.<sup>18</sup>

Part I highlights the volatile and unpredictable nature of copyright protection for music, and the music industry’s preference for risk avoidance, as dual impetuses to private copyright reform. This reform, and the terms and rights allocations that it establishes, suggest that the government is not the only player in copyright reform, and perhaps not even the most important. Left to free market negotiation, risk averse licensors and licensees are contracting around compulsory licensing regimes and opting instead for pri-

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15. See, e.g., Richard A. Posner, *Utilitarianism, Economics, and Legal Theory*, 8 J. LEGAL STUD. 103 (1979) (finding that defaults, like a statutory license, minimize transaction costs by mimicking what the parties would have wanted).

16. In other words, “[m]any consumers will say they want everything, but they actually don’t.” Paul Resnikoff, *If Only People Cared About ‘Comprehensive Catalogs’ and Millions of Songs*, DIGITAL MUSIC NEWS (May 14, 2013), <http://www.digitalmusicnews.com/permalink/2013/20130514care>; see also, e.g., Portia Krebs, *Digital Music Sales Soaring, Thanks to Streaming and Downloads*, US TELECOM (Sept. 18, 2012), <http://www.ustelecom.org/blog/digital-music-sales-soaring-thanks-streaming-and-downloads> (comparing Spotify’s 16 million songs to Pandora’s 1 million songs, and explaining Pandora’s greater commercial success: “Pandora argues it’s quality, not quantity, that distinguishes their collection.”).

17. *Id.*

18. While certainly not limited to intellectual property, the field is rife with examples of new rights creation in areas such as terrestrial broadcasting. This private rights creation is the subject of a forthcoming piece that will examine this particular phenomenon and its implications for compulsory licensing.

vately determined valuations. By so doing, they gain terms tailored to their specific content and use, with greater flexibility and responsiveness than possible under the current statutory licensing regime.

By permitting circumvention of not only the statutory license, but also of the statutorily mandated distributions to artists, private copyright reform raises serious distributive justice concerns by allowing for the reduction, and even circumvention, of royalties to which songwriters, recording artists, musicians and vocalists are legally entitled. Unlike royalties collected and distributed by a CRO under 17 U.S.C. §§ 114-15, monies collected under privately negotiated deals are not subject to the statutory distribution, and so they are not required to be paid directly to artists or songwriters. The loss of this income could have significant, immediate financial impact for recording artists and songwriters, as well as long-term negative impact on creative output.

Private copyright reform can also result in the misrepresentation of a privately determined valuation as a “market” rate. This misrepresentation is especially worrisome in industries such as sound recording and music publishing, where private values are often adopted by the industry—either formally through the rate court’s or CRB’s rate setting procedure, or informally through evolving industry norms. As a result, the private valuation of larger, more powerful parties may come to dominate.

Thus, the potential for adverse effect on non-parties is not limited to individual creators and consumers of content; smaller industry players and potential new entrants are adversely affected as well. One of the driving forces behind private copyright reform in the sound recording and music publishing industries is the desire for a cooperative business partner. Proliferation of these private deals among larger industry players will place smaller parties and potential new entrants at a distinct disadvantage. Unable to strike private deals, these smaller players will be left behind to operate under the (arguably less desirable) compulsory licensing regime, or peer pressured into acquiescing to unsustainable terms. At the same time, the loss of administrative fees by CROs whose services are no longer being utilized could severely cripple their ability to effectively serve the smaller members and new entrants dependent upon them for collection of royalties and administration.

Part II considers two examples of private copyright reform from each of the sound recording and music publishing industries as case studies to motivate an analysis of the significant move away from statutory copyright law toward a privately determined and administered regime. This Part attempts to explain this transition, to point out its shortcomings, to evaluate whether it bolsters or undermines the current thinking around intellectual property rights and copyright policy goals, and to raise awareness around the potential for abuse. In so doing, Part II offers a brief overview of what digital performance rights are, how they work, and the challenges they present.



Part III considers the normative implications of private copyright reform. These implications include both the adverse selection and distributive justice concerns presented by statutory circumvention and private valuation, as well as private copyright reform's contribution to our broader doctrinal understanding of intellectual property rights, compulsory licenses, and CROs.

While not without its drawbacks, private copyright reform can bring greater efficiency to content licensing in the form of tailored and responsive deal terms. In recognition of the potential efficiency advantages, this Article leaves the right to circumvent in place, but suggests that copyright's goal of promoting creation requires immutable artist protection. To this end, I propose a series of statutory amendments to address the distributive justice challenges presented by private copyright reform. First, I suggest the addition of 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. Second, I recommend the inclusion of a full disclosure requirement for all private valuations presented to the CRB or rate court for adoption as a means of avoiding misrepresentation of a private valuation as a "market" rate. As detailed in Part III, these amendments, if adopted, would also serve to ameliorate the impact of adverse selection.

Beyond distributive justice and misrepresentation in rate setting, recent examples of private copyright reform in the sound recording and music publishing industries challenge the traditional understanding of compulsory licenses and CROs as optimally efficient mechanisms for content licensing, and they build upon literature suggesting that the existence of a compulsory license may in fact encourage private negotiation.<sup>19</sup> The phenomenon of private copyright reform also expands upon scholarship suggesting that risk aversion creates extralegal intellectual property right entitlements<sup>20</sup> by showing that circumvention of statutory artist protections can alternately diminish, or even eliminate, such entitlements, while raising questions of fairness around the ability of private parties to make law. While the resolution of doctrinal questions about efficiency and private law making are outside the scope of this Article, the proliferation of private copyright reform suggests they may be ripe for reconsideration.

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19. See Ian Ayres & Eric Talley, *Solomonic Bargaining: Dividing a Legal Entitlement to Facilitate Coasean Trade*, 104 YALE L.J. 1027, 1033 (1995) (asserting that "liability rules may induce both *more contracting* and *more efficient contracting* than property rules.").

20. These "entitlements" come about where parties are unsure whether they need a license or not, and so secure one "just in case," resulting in an industry custom to license content where no such legal obligation exists. See James Gibson, *Risk Aversion and Rights Accretion in Intellectual Property Law*, 116 YALE L.J. 882, 884 (2007) (discussing how "doctrinal gray areas" and "risk aversion . . . pervade[ ] key copyright industries" where the "result is a practice of securing copyright licenses even where none is needed. Better safe than sued.").

## I. IMPETUSES FOR PRIVATE COPYRIGHT REFORM

While there are many possible explanations for the emerging private copyright reform phenomenon, the three most likely impetuses include: (i) increasing change and instability in the sound recording and music publishing industries; (ii) legislative uncertainty about statutory rates and standards, and resulting litigation; and (iii) the efficiency gains enjoyed by parties who circumvent the statutory license in favor of private ordering.

A. *Industrial Instability*

Advances in technology and resultant changes in consumer behavior—the shift from buying records to subscribing to music streaming services, for example—have decimated traditional music industry business models. The presentation and passage of the Digital Performance Right in Sound Recordings Act of 1995<sup>21</sup> (hereinafter, the “DPRA”) stemmed primarily from fear of harm to record sales resulting from the availability of new digital music services.<sup>22</sup> Section 114(d)(2) of the DPRA calls for statutory licensing of public performance rights for certain digital audio transmissions.<sup>23</sup> To this end, the Librarian of Congress has tasked the CRB with determining and adjusting “reasonable terms and rates of royalty payments.”<sup>24</sup> The CRB holds hearings every five years to set the royalty rates for the subsequent five-year period.<sup>25</sup> While intended to improve responsiveness to ongoing technological change, a royalty rate set to change every five years has done nothing to lend stability or predictability to an industry already in turmoil.

To make matters worse, the CRB applies different standards in establishing digital performance royalty rates for different types of digital music services. The Digital Millennium Copyright Act of 1998,<sup>26</sup> (the “DMCA”) establishes four categories of digital audio services: (1) preexisting subscrip-

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21. Digital Performance Right in Sound Recordings Act of 1995, Pub. L. No. 104-39, 109 Stat. 336 (codified as amended at 17 U.S.C. §§ 106, 114-15).

22. See *Statement of Marybeth Peters, The Register of Copyrights Before the Subcomm. on Courts and Intellectual Property Comm. on the Judiciary*, H.R. 1509, 104th Cong., (1st session June 28, 1995) (noting that “[i]f record producers must risk having sales of phonorecords displaced by digital delivery direct to the consumer’s home from a ‘celestial juke-box,’ those whose livelihoods depend on mechanical royalties on those phonorecords face the same risk.”), available at <http://www.copyright.gov/docs/regstat062895.html>.

23. 17 U.S.C. §114(d)(2) (2012) holds, in relevant part, that “[t]he performance of a sound recording publicly by means of a subscription digital audio transmission not exempt under paragraph (1), an eligible nonsubscription transmission, or a transmission not exempt under paragraph (1) that is made by a preexisting satellite digital audio radio service shall be subject to statutory licensing.”

24. *Id.* § 801(b)(1).

25. *Id.* § 804(b)(1).

26. The Digital Millennium Copyright Act of 1998, Pub. L. No. 105-304, 112 Stat. 2860 (codified as amended in scattered sections of 17 U.S.C.).

tion digital audio services, such as Music Choice;<sup>27</sup> (2) preexisting satellite radio services, such as Sirius XM;<sup>28</sup> (3) non-subscription digital audio services, such as Pandora’s ad-supported radio service;<sup>29</sup> and (4) subscription digital audio services, such as Spotify’s premium tier service.<sup>30</sup>

The two categories of preexisting digital audio services are subject to the standard set forth in Section 801(b)(1) of the Copyright Act (hereinafter, the “801(b) standard”). The 801(b) standard considers the following factors when setting a rate: maximization of availability of creative works to the public; fair return to the copyright owner and fair income to the copyright user; relative and technological contribution, capital investment, cost and risk; and minimization of disruptive impact on the industries involved.<sup>31</sup> By contrast, the two categories of subscription and non-subscription digital audio services, which include Internet radio services like Pandora, are subject to rates set by the CRB under a standard intended to emulate fair market value by looking at what a willing buyer and a willing seller would agree to in a hypothetical marketplace<sup>32</sup> (hereinafter, the “willing buyer, willing seller” standard).

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27. 17 U.S.C. § 114(j)(11) defines a “preexisting subscription service” as “a service that performs sound recordings by means of noninteractive audio-only subscription digital audio transmissions, which was in existence and was making such transmissions to the public for a fee on or before July 31, 1988. . . .” For information about Music Choice and a description of service offerings, see MUSIC CHOICE, <http://www.musicchoice.com/> (last visited February 26, 2013).

28. 17 U.S.C. § 114(j)(10) defines a “preexisting satellite digital audio radio service” as “a subscription satellite digital audio radio service provided pursuant to a satellite digital audio radio service license issued by the Federal Communications Commission on or before July 31, 1998. . . .” For information about Sirius XM and a description of service offerings, see SIRIUS XM, <http://www.siriusxm.com/> (last visited February 26, 2013).

29. 17 U.S.C. § 114(j)(6). For information about Pandora and a description of service offerings, see PANDORA, <http://www.pandora.com/> (last visited February 26, 2013).

30. 17 U.S.C. § 114(j)(14). For information about Spotify and a description of service offerings, see SPOTIFY, <https://www.spotify.com/> (last visited February 26, 2013).

31. 17 U.S.C. § 801(b)(1)(A)-(D).

32. 17 U.S.C. § 114(f)(2)(B) defines the “willing buyer, willing seller” standard as follows:

In determining such rates and terms, the Copyright Royalty Judges shall base their decision on economic, competitive and programming information presented by the parties, including—

(i) whether use of the service may substitute for or may promote the sales of phonorecords or otherwise may interfere with or may enhance the sound recording copyright owner’s other streams of revenue from its sound recordings; and

(ii) the relative roles of the copyright owner and the transmitting entity in the copyrighted work and the service made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, and risk.

In establishing such rates and terms, the Copyright Royalty Judges may consider the rates and terms for comparable types of digital audio transmission services and comparable circumstances under voluntary license agreements. . . .

Under the “willing buyer, willing seller” standard, Internet radio providers like Pandora currently pay more than 50% of their revenues in digital performance royalties.<sup>33</sup> The 801(b) standard, on the other hand, currently yields royalty rates approaching 8% of revenues for satellite and cable audio providers like Sirius XM and Music Choice,<sup>34</sup> or roughly 1/6 of the total reached under the “willing buyer, willing seller” standard:

PERFORMANCE ROYALTY RATES FOR SOUND RECORDINGS

Type of service	Standard	Rate as an average percentage of revenue
Preexisting (e.g., SiriusXM)	801(b)	7-8%
Post-1995 (e.g., Pandora)	“willing buyer, willing seller”	50-70%

B. Legislative Unpredictability & Fallout Litigation

This inequality has led to the drafting and introduction of several pieces of legislation, most recently the Internet Radio Fairness Act of 2012<sup>35</sup> (hereinafter, the “Fairness Act”) and the Interim Fairness in Radio Starts Today (FIRST) Act (hereinafter, the “Interim Act”).<sup>36</sup> Introduced in September 2012, the Fairness Act seeks, among other things, to resolve the six-fold disparity in digital performance royalty rates between preexisting services and others by essentially replacing the “willing buyer, willing seller” stan-

17 U.S.C. § 112(e)(4) also contains the “willing buyer, willing seller” language with regard to ephemeral recordings.

33. See, e.g., Tim Westergren, *Internet Radio Fairness Act*, PANDORA, <http://www.pandora.com/static/ads/irfa/irfa.html> (last visited Dec. 16, 2012) (“In 2011, Pandora paid over 50% of revenues in performance royalties.”).

34. See, e.g., David Oxenford, *Copyright Royalty Board Oral Argument on Sirius XM SoundExchange Royalties – A View of the Application of the 801(b) Standard Proposed for Internet Radio*, BROADCAST LAW BLOG (Oct. 25, 2012), <http://www.broadcastlawblog.com/tags/sirius-xm-music-royalties/> (discussing the debate between Sirius XM and SoundExchange regarding whether the rate should increase or decrease from “the 8% of revenue that the service now pays. . .”).

35. Internet Radio Fairness Act of 2012, H.R. 6480, 112th Cong. § 2 (2d Sess. 2012), available at <https://www.govtrack.us/congress/bills/112/hr6480/text> (“To adopt fair standards and procedures by which determinations of Copyright Royalty Judges are made with respect to webcasting, and for other purposes”).

36. Interim Fairness in Radio Starts Today Act of 2012, 112th Cong. (2d Sess. 2012), [http://nadler.house.gov/sites/nadler.house.gov/files/documents/NADLER\\_153\\_xml.pdf](http://nadler.house.gov/sites/nadler.house.gov/files/documents/NADLER_153_xml.pdf) (discussion draft).

dard currently applied to Internet radio with the 801(b) standard currently applied to cable and satellite providers.<sup>37</sup>

Proponents of the Fairness Act argue that because there is no true market for Internet radio,<sup>38</sup> the “willing buyer, willing seller” standard is not only unfair, but also highly subjective. In a statement before the Senate Judiciary Committee, the Digital Media Association, a trade association representing technology companies in the digital music space, explained the “market” for digital performance licenses as a “fiction” and noted that “there is no market for licensing these [digital performance] rights other than under the statutory license itself,” because the performance right for sound recordings and the statutory license were created simultaneously.<sup>39</sup> In response to concerns about lowering royalties, proponents suggest that any initial decrease in revenue would be compensated by long-term growth in the industry.<sup>40</sup> There is also an antitrust argument: at current rates, proponents claim that smaller webcasters will be driven out of business, leaving large broadcasters to dominate the digital radio market as they have with terrestrial radio.<sup>41</sup> As proof, the Fairness Act’s supporters make the historical case: lacking the diversified portfolio of the large broadcasters, many small webcasters were pushed from the market after a 2007 CRB rate hike.<sup>42</sup>

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37. See Internet Radio Fairness Act of 2012 § 3(a)(2) (suggesting removal of the “willing buyer, willing standard” and replacement with “the objectives set forth in section 801(b)(1) . . .”).

38. The industry has operated under a compulsory scheme since its inception.

39. See *Supplemental Statement of the Digital Media Association Senate Judiciary Committee Hearing on “Music and Radio in the 21st Century: Assuring Fair Rates and Rules across Platforms”*, DIGITAL MEDIA ASS’N (July 29, 2008), [http://www.digmedia.org/component/docman/doc\\_download/89-dimasupplemental-testimony](http://www.digmedia.org/component/docman/doc_download/89-dimasupplemental-testimony); see also Senator Ron Wyden, *Summary of Internet Radio Fairness Act of 2012*, U.S. SENATOR RON WYDEN (Sept. 21, 2012), <http://www.wyden.senate.gov/download/summary-of-internet-radio-fairness-act-of-2012> (noting “[t]here is no functioning market for these licenses . . .” and that therefore the CRB judges have “very little information to make reasonable conclusions.”).

40. Internet webcaster Pandora is one such company which has promised increased investment if granted a lower royalty rate. See, e.g., Tim Westergren, *Pandora and Artist Payments*, PANDORA (Oct. 9, 2012), <http://blog.pandora.com/pandora/archives/2012/10/pandora-and-art.html> (“Making performance fees fair for internet radio will drive massive investment in the space, accelerating the growth of the overall sector, and just as importantly accelerating the development of new technology that leverages the incredible power of the internet to build and activate new audiences. . . . The short-term reduction in revenue would be rapidly swamped by the overall growth of the sector.”).

41. See, e.g., Hiawatha Bray, *Internet Radio Firms Say Royalties Limiting Choices*, BOSTON GLOBE (Mar. 14, 2008), available at [http://msl1.mit.edu/furdlog/docs/b\\_globe/2008-03-14\\_bglobe\\_internet\\_radio\\_royalties.pdf](http://msl1.mit.edu/furdlog/docs/b_globe/2008-03-14_bglobe_internet_radio_royalties.pdf) (“[Critics] warn of an online music industry dominated by the same giant media companies that presently dominate traditional radio broadcasting.”).

42. See *id.* (describing the closure of Internet radio start-up Mobile Beat Radio following the CRB rate hike in January 2007 and warning of a repeat of terrestrial radio’s domination in Internet radio by “the same giant media companies,” who will “push all of us [small broadcasters] out of business.”).

Opponents insist the existing rates are fair and accuse proponents of the Fairness Act of seeking to take money away from artists. They argue that moving Internet radio providers from a “willing buyer, willing seller” rate to an 801(b) rate would effectively result in a government-mandated subsidy that would enrich the Internet radio providers at the expense of artists, and suggest it is the Internet radio business model, and not the digital performance royalty rate, that needs to change.<sup>43</sup> Through the Recording Industry Association of America (“RIAA”), the recording industry has been particularly vocal in its opposition to the Fairness Act and instead supports the Interim Act supported by Congressman Nadler (D) from New York.<sup>44</sup> The draft Interim Act asks the CRB to take into consideration the fact that terrestrial broadcasters don’t pay a performance royalty on sound recordings when determining the rate broadcasters should pay digitally.<sup>45</sup> In other words, it seeks compensation for the lack of a terrestrial performance right<sup>46</sup> through an increase in the digital performance rate. To that end, the bill would move preexisting services from an 801(b) standard to a “willing buyer, willing seller” standard.<sup>47</sup>

Opponents are quick to point out the hypocrisy of the recording industry in seeking a different standard as licensors than they enjoy as licensees. Mechanical license royalties under Section 115 of the Copyright Act are set according to the 801(b) standard. Thus, as licensees of musical compositions, record labels paying royalties to a songwriter or publisher benefit from the lower rate determined under 801(b), while at the same time, as licensors of sound recordings, they seek to benefit from the higher rate determined under the “willing buyer, willing seller” standard.<sup>48</sup>

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43. See, e.g., *Songwriters and Music Publishers Call Foul on Pandora’s Efforts to Further Lower Songwriter Compensation*, NAT’L MUSIC PUBLISHERS ASS’N (Nov. 6, 2012), <https://www.nmpa.org/media/showwhatsnew.asp?id=74> (statement of NMPA CEO David Israelite) (“It’s outrageous Pandora would try to reduce the already nominal amount they pay songwriters and music publishers, when Pandora’s business model is based entirely on the creative contributions of those songwriters.”).

44. Interim Fairness in Radio Starts Today Act of 2012, 112th Cong. (2d. Sess. 2012), [http://nadler.house.gov/sites/nadler.house.gov/files/documents/NADLER\\_153\\_xml.pdf](http://nadler.house.gov/sites/nadler.house.gov/files/documents/NADLER_153_xml.pdf).

45. See *id.* § 2, cl. 8–21 (discussion draft).

46. A terrestrial performance right gives a rights holder the right to collect royalties for plays of a song on traditional FM/AM format radio, also known as “terrestrial” radio. As discussed further herein, under the current copyright regime, only digital radio pays for plays; FM/AM radio does not.

47. Interim Fairness in Radio Starts Today Act of 2012, cl. 8–21 (discussion draft).

48. See *Internet Streaming of Radio Broadcasts: Balancing the Interests of Sound Recording Copyright Owners with those of Broadcasters: Hearing Before the Subcomm. on Courts, the Internet and Intellectual Property of the H. Comm. on the Judiciary*, 108th Cong. (2004), available at <http://www.judiciary.house.gov/Legacy/potter071504.htm> (testimony of Jonathan Potter, Executive Director, Digital Media Association) (“There is also no principled basis why the recording industry utilizes the traditional four-factor § 801(b) rate-setting standard when it is a licensee in proceedings to set songwriters’ royalties, but benefits from the more favorable willing buyer-willing seller standard when it is licensor in the Internet radio context.”).

In support of the Interim Act, SoundExchange has looked to digital performance royalty rates negotiated in the marketplace to suggest that rates should in fact be higher.<sup>49</sup> Citing the value of its talk programming and hardware as “additional considerations” under an 801(b) standard evaluation, preexisting satellite radio providers like Sirius XM counter that their rate should in fact be lowered, and have pushed back with figures culled from recent, direct licensing deals completed with over ninety artists and labels.<sup>50</sup> SoundExchange has dismissed those deals as non-representative because they were completed with small, independent labels and do not involve any of the major label groups.<sup>51</sup> Sirius XM has responded to those allegations with a lawsuit alleging that interference from SoundExchange has prevented them from negotiating with the major record labels.<sup>52</sup>

Sirius XM isn't the only industry player utilizing lawsuits to endorse pending legislation. In a suit recently filed in New York federal court, Pandora has sued performance rights organization ASCAP for setting mechanical royalty rates that are alleged to be “ill suited and not reasonable.”<sup>53</sup> In its complaint, Pandora insists that ASCAP's current performance royalty rate for musical compositions is based on an experimental form license from 2005 that was never intended to apply long-term.<sup>54</sup> The parties have attempted to negotiate a new rate for over a year without success.<sup>55</sup> A deal was reached, however, between ASCAP and the Radio Music Licensing Committee, an organization that includes among its members Pandora competitor iHeart Radio,<sup>56</sup> a division of media conglomerate Clear Channel. That deal sets a blanket license rate of 1.7% of gross revenues, less a standard deduction from the applicable revenue base of 25% for new media offerings (which includes Internet radio).<sup>57</sup> Pandora's complaint alleges that ASCAP has refused to extend them the same terms.<sup>58</sup>

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49. See Oxenford, *supra* note 34 (“SoundExchange contended that the rates should go up significantly from the 8% of revenue that the service now pays.”).

50. *Id.*

51. *Id.* Interestingly, no one has questioned the presentation of a mere ninety deals (in a pool of thousands) as representative of the market.

52. See Complaint Jury Trial Demanded at 32-33, *Sirius XM Radio Inc. v. SoundExchange, Inc.*, (No. 12-CV-2259) (S.D.N.Y. Mar. 27, 2012).

53. Petition of Pandora Media, Inc. for the Determination of Reasonable License Fees at 3, *Pandora Media, Inc. v. United States*, (No. 12-8035 (DLC) (MHD)) (S.D.N.Y. Nov. 5, 2012). In accordance with the consent decree under which ASCAP functions, the federal district court for the Southern District of New York currently functions as the rate court for setting performance royalties for musical compositions. See *United States v. Am. Soc'y of Composers, Authors, Publishers*, No. 41-1395 (WCC), 2001 WL 1589999, at \*6 (S.D.N.Y. June 11, 2001).

54. See Petition of Pandora Media, Inc., *supra* note 53, at 3.

55. *Id.* at 4.

56. iHEARTRADIO, <http://www.iheart.com> (last visited Feb. 27, 2013).

57. Petition of Pandora Media, Inc., *supra* note 53, at 4-5.

58. *Id.* at 6; see also Don Jeffrey, *Pandora Media Sues ASCAP Seeking Lower Songwriter Fees*, BLOOMBERG (Nov. 5, 2012), <http://www.bloomberg.com/news/2012-11-05/pandora-media-sues-ascap-seeking-lower-songwriter-fees>.

Pandora further asserts that a lower rate is appropriate now that ASCAP's largest music publisher client—the newly-combined EMI and Sony/ATV—is withdrawing its content from ASCAP, making ASCAP's catalog inherently less valuable, and requiring Pandora to expend additional time and money to directly license that content.<sup>59</sup> Sony/ATV has justified its withdrawal from ASCAP by making the same rate disparity argument that Pandora is making in its support of the Fairness Act. According to a top publishing executive at Sony/ATV, “Pandora pays record labels \$12.50 for every \$1 paid to songwriters and music publishers. . . . It is the worst division of content payments for songwriters in any form of the music business. Sony/ATV is attempting to improve that horrible ratio.”<sup>60</sup> In other words, Sony/ATV believes it can negotiate a better rate than ASCAP,<sup>61</sup> despite the fact that ASCAP is being simultaneously sued for having a rate that is both “ill-suited” and “unreasonable.”<sup>62</sup>

In the face of all of this uncertainty and unpredictability surrounding digital performance royalty rates, some industry players have (unsurprisingly) opted out of the compulsory regime altogether. Part II will consider the structure of this private copyright reform, and potential concerns arising from it, through consideration of two examples, one from each of the sound recording and music publishing industries.

### C. Efficiency Gains

Perhaps the strongest impetus for private copyright reform is its ability to improve upon the inefficiencies of the statutory license. This includes improved cooperation and incentive alignment, tailored and predictable rate setting, rapid accommodation of changes in technology and consumer preferences, and value differentiation for different content and uses.

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dora-media-sues-ascap-seeking-lower-songwriter-fees.html (“This year Ascrap [sic] negotiated a fee agreement with the Radio Music Licensing Committee, which represents large broadcasters such as . . . Clear Channel. They will pay 1.7 percent of gross revenue minus deductions based on advertising commissions. Pandora said in its lawsuit that Ascrap [sic] refused to offer it the same terms. Clear Channel operates the iHeartRadio Internet service, a direct competitor to Pandora.”).

59. See Petition of Pandora Media, Inc., *supra* note 53, at 6-9.

60. Paul Resnikoff, *Pandora Is Now Suing ASCAP to Lower Songwriter Royalties*, DIGITAL MUSIC NEWS (Nov. 6, 2012), <http://www.digitalmusicnews.com/permalink/2012/121105ascap>.

61. So far, Sony/ATV appears correct in this belief. On January 17, 2013, they signed a direct licensing deal with Pandora for a digital performance rate 25% higher than ASCAP's going rate. See, e.g., *Sony/ATV Negotiates 25% Royalty Increase from Pandora: Report*, BILLBOARD BIZ (Jan. 17, 2013), <http://www.billboard.com/biz/articles/news/publishing/1510421/sonyatv-negotiates-25-royalty-increase-from-pandora-report>.

62. Glenn Peoples, *Pandora Sues ASCAP for Lower Rates*, BILLBOARD BIZ (Nov. 6, 2012), <http://www.billboard.biz/bbbiz/industry/legal-and-management/pandora-sues-ascap-for-lower-rates-1008003232.story>.



The statutory license for sound recordings, 17 U.S.C. § 114, sets a per-play rate that misaligns incentives between licensees and licensors. In the case of sound recordings, for example, record labels want as much airtime as possible to promote their artists and boost album sales, while a per-play royalty encourages broadcasters to minimize costs by playing as little music as possible.<sup>63</sup> In contrast, a rate set as a share of revenues—common in private copyright deals, as discussed in Part II *infra*—encourages more plays, which in turn induces more listeners, which ultimately leads to a higher per-ad rate since advertisers will pay more for ads they believe will reach a bigger audience.<sup>64</sup>

Unlike the statutory license, private copyright reform also encourages a mutually cooperative relationship between the parties involved. This is a challenging time for copyright holders in the content industries<sup>65</sup> as piracy continues to rise, and revenues continue to fall.<sup>66</sup> A terrestrial broadcaster looking to expand into digital radio, and to grow its market share there, for example, stands to benefit from a cooperative relationship with digital content owners. These relationships may afford broadcasters early and exclusive content, with which they can use to attract both advertisers and listeners. A revenue share also allows both parties to share in the upside and downside of a business venture. This marks a significant departure from, and improvement on, the music industry's standard digital model consisting of either an equity requirement<sup>67</sup> or an exorbitant advance for the licensor, with no consequence from—or responsibility for—the fate of the licensee.<sup>68</sup>

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63. See Ed Christman, *Exclusive: Clear Channel, Big Machine Strike Deal to Pay Sound-Recording Performance Royalties to Label, Artists*, BILLBOARD BIZ (June 5, 2012, 7:00 AM), <http://www.billboard.com/biz/articles/news/1094776/exclusive-clear-channel-big-machine-strike-deal-to-pay-sound-recording> (quoting broadcasting CEO Bill Pittman as saying: “I don’t want to try and guess how much advertising I can sell. . . . It encourages us to try and play as little music as possible.”).

64. There is a trade-off: Each additional play reduces the time available for running paid advertising. The key in this model is to charge more for less; *i.e.*, to charge more per ad, but run fewer ads.

65. The “content industries” typically include music, television, film, and publishing.

66. See, *e.g.*, Paul Resnikoff, *Album Sales Sink to Their Lowest Levels Since 1991 . . .*, DIGITAL MUSIC NEWS (Nov. 1, 2013), <http://www.digitalmusicnews.com/permalink/2013/11/01/weeklyalbum>; Mark Sweney, *Global Recorded Music Sales Fall Almost \$1.5bn amid Increased Piracy*, GUARDIAN (March 28, 2011), available at <http://www.theguardian.com/business/2011/mar/28/global-recorded-music-sales-fall>.

67. See, *e.g.*, Michael Arrington, *Confirmed: MySpace to Launch New Music Venture with Big Labels*, TECHCRUNCH (Apr. 2, 2008), <http://techcrunch.com/2008/04/02/myspace-to-launch-new-music-joint-venture-with-big-labels/> (describing the distribution of monies to equity-holding copyright owners). The MySpace Music venture folded in 2011.

68. See, *e.g.*, Paul Resnikoff, *So Turntable.fm Just Got Its Label Licenses. R.I.P. Turntable.fm?*, DIGITAL MUSIC NEWS (Mar. 13, 2012), <http://www.digitalmusicnews.com/permalink/2012/120312turntable> (discussing digital start-up Turntable.fm’s struggle with indifferent and disinterested content licensors).

Private copyright reform is also considerably more responsive than the statutory regime at addressing the rapid changes in technology inherent in the content industries. This is because private deals are relatively easily and cheaply revised. If one party wants to run a trial of a new type of service, it need simply negotiate a trial rate and term with the content owner, who has every incentive to cooperate now that it shares in the revenues.

Finally, all parties under a statutory license pay the same rate, regardless of the use, or even the particular content. Private copyright reform, on the other hand, allows for tailoring of terms to fit the contemplated content and use, thereby alleviating concerns presented by the one-size-fits-all nature of a statutory licensing regime in which all content of a particular genre is subject to the same rate, regardless of merit or use, and in which the market is unable to differentiate among different valuations. In this way, private ordering supports the creation and dissemination of the “best” (*i.e.*, most valuable) content, as determined by the market, thereby producing more desirable outcomes insofar as the parties are (at least in theory) constrained by the discipline of a competitive market.

In sum, private copyright reform improves efficiency for the parties involved. But do these efficiency gains extend to non-parties? To societal welfare? The next Part will consider these questions in the context of two case studies demonstrating private copyright reform in action.

## II. CONTRACTING AROUND COMPULSORY LICENSES, OPTING OUT OF COLLECTIVE RIGHTS ORGANIZATIONS, & MAKING PRIVATE VALUATIONS LAW: A CASE STUDY IN PRIVATE COPYRIGHT REFORM

Although private copyright reform, as herein defined, could conceivably take place in any industry with a circumventable compulsory license, the sound recording and music publishing industries are particularly susceptible to private deal making given their rampant instability and unpredictability. This is especially true in the case of performance rights, offering an ideal case study in the causes and effects of private copyright reform. The first example—a private agreement to circumvent the compulsory license for digital performance rights—is a direct result of the disparity and uncertainty surrounding these rights, and it exemplifies the distributive injustice made possible by private copyright reform. The second example involves circumvention of a CRO and establishment of a private performance royalty that results in both reduced royalties to songwriters and misrepresentation of a private valuation as representative of the market rate.

### A. Break-ups & Distributive Injustice

In order to appreciate the controversy and import around performance rights, it is helpful to understand that any song played on the radio is protected by two distinct copyrights: one on the underlying musical composi-

tion<sup>69</sup> (this is known as the “mechanical” right) and one on the aural representation of that composition<sup>70</sup> (this is known as the “master” right). The latter constitutes a sound recording, popularly termed a “song” or a “track.” Recording artists typically assign their copyrights in sound recordings, or master rights (in whole or in part) to record labels, while songwriters typically assign their copyrights in compositions or mechanical rights (in whole or in part) to music publishing companies. As a result, different parties generally hold the rights to these two copyrights (neither of which is typically the artist herself). Big Machine artist Taylor Swift’s recent hit single “We Are Never Ever Getting Back Together,”<sup>71</sup> for example, is protected by two separate copyrights: a copyright on the composition, held by Taylor Swift, Max Martin and Shellback as songwriters, and their music publishing company, Sony/ATV; and a separate copyright on the sound recording held by Taylor Swift, as recording artist, and her record label, Big Machine:<sup>72</sup>

If another recording artist wants to record a cover version of “We Are Never Ever Getting Back Together,” he would need to obtain a mechanical license for use of the composition. The cover artist could then obtain a separate copyright on his own cover recording, or master. Thus, there can be many different masters (*i.e.*, sound recordings) of the same song, but still only one composition. In addition, many different composers or songwriters can contribute to any given composition, and several different recording artists—both featured and non-featured<sup>73</sup>—can contribute to any given sound recording. The corresponding industries servicing musical compositions and sound recordings are the music publishing and record industries, respectively.

Under the current U.S. copyright regime, a third right—that of exclusive public performance—has derived from the mechanical and master rights. This public performance right affords the holder the exclusive right to perform the work publicly, and attaches both digitally (*i.e.*, online) and terrestrially (*i.e.*, via traditional broadcast radio) as to compositions, but digitally only as to sound recordings. Therefore, a spin of Taylor Swift’s “We Are Never

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69. 17 U.S.C. § 102(a)(2) (2012).

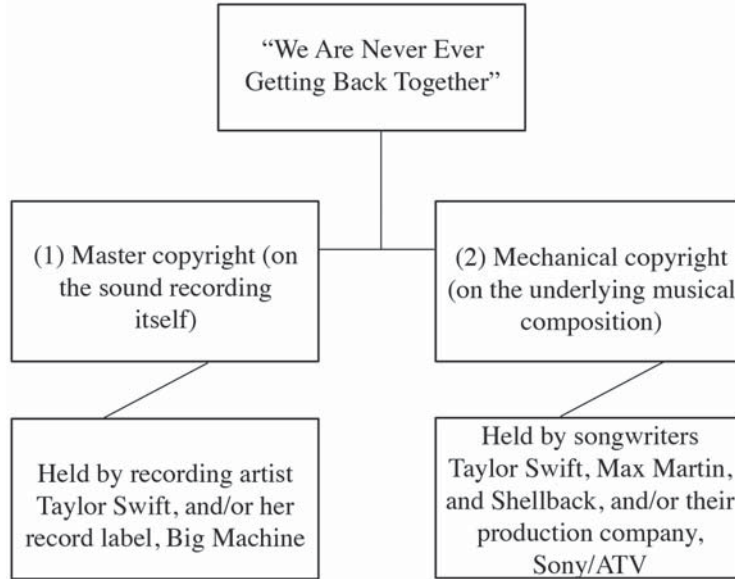
70. *Id.* § 102(a)(7).

71. TAYLOR SWIFT, *We Are Never Ever Getting Back Together*, on RED (Big Machine Records 2012). While hardly her first hit, “We Are Never Ever Getting Back Together” enjoys the distinction of being the fastest selling digital single to date, with over 623,000 downloads in its first hour of release. *See, e.g.*, Chase Hunt, *Taylor Swift’s New Single Makes Digital History on Hot 100*, EXAMINER (Aug. 23, 2012), <http://www.examiner.com/article/taylor-swift-s-new-single-makes-digital-history-on-hot-100>.

72. Big Machine Label Group is a Nashville, Tennessee-based independent record label whose roster includes Taylor Swift, Rascal Flatts and Reba McEntire. *See* BIG MACHINE RECORDS, <http://www.bigmachinelabelgroup.com/> (last visited February 27, 2013).

73. Typically, a “featured” recording artist is the artist or band whose name appears on the record. Band members, session musicians and back-up vocalists are generally categorized as “non-featured.”

TWO COPYRIGHTS FOR THE SONG “WE ARE NEVER EVER GETTING  
BACK TOGETHER”



Ever Getting Back Together” on a local broadcast radio station would require a performance royalty be paid to the songwriter and/or owner of the mechanical copyright (in this case, Taylor Swift, Max Martin, Shellback and/or Sony/ATV Publishing); no royalty would be paid to the recording artist and/or owner of the sound recording (*i.e.*, Taylor Swift and/or Big Machine).<sup>74</sup> A spin of the same track on an Internet radio station like Pandora, however, would require royalties be paid to both. A spin of yet again the same track on a preexisting satellite radio station, like Sirius XM, also requires royalties be paid to both, but the sound recording incurs a significantly lower rate (the composition rate remains the same):

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74. As discussed in this Part, most recording artists and songwriters assign their copyrights, in whole or in part, to record labels or music publishers, respectively. The royalties are administered accordingly.

2013 PERFORMANCE ROYALTY RATES FOR SOUND RECORDINGS BY  
SERVICE TYPE

Format	Digital	Digital	Terrestrial
Service Type	Preexisting Satellite Radio Service (e.g. Sirius XM)	Pureplay Internet radio service (e.g. Pandora)	Broadcast radio station
Performance Royalty Rate	10% of revenues <sup>75</sup>	\$0.00121/plan + 25% of revenues <sup>76</sup>	None <sup>77</sup>

The inequality between digital and terrestrial performance royalties for sound recordings has long been a point of contention between the sound recording and broadcast industries.<sup>78</sup> In the June 2012 deal struck between Taylor Swift’s record label, Big Machine, and Clear Channel Communications, Inc. (“Clear Channel”),<sup>79</sup> the parties agreed to a lower digital rate in exchange for, among other things, the establishment of a terrestrial perform-

75. See David Oxenford, *Full Text of Copyright Royalty Board Decision on Sirius XM and Music Choice Royalties Released – The Basics of the Decision*, BROADCAST LAW BLOG (Jan. 4, 2013), <http://www.broadcastlawblog.com/2013/01/articles/full-text-of-copyright-royalty-board-decision-on-sirius-xm-and-music-choice-royalties-released-the-basics-of-the-decision/>.

76. See David Oxenford, *Final Webcasting Royalty Rates Published – A Comparison of How Much Various Services Pay*, BROADCAST LAW BLOG (Mar. 14, 2011), <http://www.broadcastlawblog.com/2011/03/articles/internet-radio/final-webcasting-royalty-rates-published-a-comparison-of-how-much-various-services-pay/>.

77. See 17 U.S.C. § 106(6) (2012) (granting an exclusive right, “in the case of sound recordings, to perform the copyrighted work publicly by means of a *digital* audio transmission”) (emphasis added).

78. Broadcasters have always resisted a performance right for sound recordings on the basis that their programming provides a valuable promotional service to artists and record labels, and as such they should not have to pay. Music publishers, worried that the creation of a performance right for sound recordings would cut into the performance royalties they were entitled to receive from broadcasters, teamed up with broadcasters to successfully block a performance right for sound recordings from the 1976 Act. It would be another thirty years before a performance right for sound recordings would finally be instituted. See, e.g., John R. Kettle III, *Dancing to the Beat of a Different Drummer: Global Harmonization and the Need for Congress to Get in Step with a Full Public Performance Right for Sound Recordings*, 12 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 1041, 1053 (2000) (discussing the NAB’s opposition to a performance right for sound recordings and noting that “[j]oining the NAB’s position against a full public performance right for sound recordings are songwriters, music publishers, and performing rights societies. They claim it is the songwriter and music publisher who will lose a substantial portion of income.”).

79. Clear Channel Communications, Inc. is a national broadcast and digital media provider based in Texas. See CLEAR CHANNEL COMM’NS, INC., <http://www.clearchannel.com/Pages/Home.aspx> (last visited February 27, 2013).

ance right.<sup>80</sup> They also settled on a royalty rate calculated as a share of revenue, to be paid directly from Clear Channel to Big Machine, in lieu of the statutory, per-play royalty rate paid to SoundExchange under the compulsory license.<sup>81</sup> This direct payment circumvents the direct payment to Taylor Swift that would otherwise be made under the statutory license. The statutory distribution of royalties is laid out in 17 U.S.C. § 114(g)(2) of the Copyright Act:

- 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.

This statutory distribution scheme accomplishes two related goals. First, the statute provides royalty disbursement directly to creators, as opposed to intermediary copyright holders. It also provides payment for a traditionally—and frequently—unrepresented and disadvantaged class of non-fea-

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80. The introduction of a terrestrial performance right is significant not only for the fact that Clear Channel has no legally obligation to pay it, but also for the fact that “[t]errestrial radio still accounts for 98% of U.S. radio’s music advertising revenue.” Dan Rys, *Clear Channel Inks Second Radio Royalties Label Deal, This Time with Glassnote*, BILLBOARD BIZ (Sept. 27, 2012), <http://www.billboard.biz/bbbiz/industry/radio/clear-channel-inks-second-radio-royalties-1007962302.story#PQdPtV2bJYdOM5RR.99>.

81. Since the signing of the Big Machine-Clear Since the signing of the Big Machine-Clear Channel deal in June 2012, nearly a dozen copycat deals have been completed. *See, e.g.*, Ed Christman, *Big Machine Cuts Deal with Beasley Broadcasting to Share ‘Certain’ Revenue*, BILLBOARD BIZ (Feb. 5, 2013), <http://www.billboard.com/biz/articles/news/legal-and-management/1537936/big-machine-cuts-deal-with-beasley-broadcasting-to> (describing a deal “which will bring terrestrial performance royalties to its artists in exchange for more predictable rates for its digital broadcasting.”); Priscilla Kim, *Clear Channel Inks Another Direct Licensing Deal (This Time, With Fearless Records)*, DIGITAL MUSIC NEWS (June 3, 2013) <http://www.digitalmusicnews.com/permalink/2013/20130603ccmeandfearlessrecords>; Glenn Peoples, *Big Machine Label Group Signs Terrestrial Royalties Deal with Entercom*, BILLBOARD BIZ (Sept. 20, 2012), <http://www.billboard.biz/bbbiz/industry/record-labels/big-machine-label-group-signs-terrestrial-1007954192.story#mJSF3atSR1bIYMil.99> (describing the Big Machine-Entercom deal and quoting Entercom President and CEO David Field as calling the deal “a bold step forward to align our interests with those of Big Machine and their artists.”); Rys, *supra* note 80 (describing the Clear Channel-Glassnote deal and quoting Glassnote Founder/CEO Daniel Glass describing the deal as a “partnership [that] aligns our business interests more closely with Clear Channel.”). The model has become so prevalent, in fact, that naysayers have begun discouraging opt-in: “Instead of deserting all the hard work that was put into setting up SoundExchange . . . American musicians and labels should stick together and push even harder to extend collective licensing to terrestrial radio.” Heliene Lidvall, *Should Labels Bypass SoundExchange and Enter Into Direct Deals With Clear Channel?*, DIGITAL MUSIC NEWS (May 3, 2013), <http://www.digitalmusicnews.com/permalink/2013/20130503bypass>.

tured artists. This distribution scheme is important insofar as a goal of copyright law is to encourage creation by providing artists with a means of making a living.<sup>82</sup>

Under the statutory license, Clear Channel would pay SoundExchange \$0.0022<sup>83</sup> for each spin of Taylor Swift's record "We Are Never Ever Getting Back Together" on its iHeart Radio digital subscription service.<sup>84</sup> SoundExchange would then deduct its administrative fee<sup>85</sup> and distribute the remaining royalties directly to featured and non-featured artists, and to the copyright holder. In this example, Taylor Swift is the featured recording artist, Max Martin and Shellback are the non-featured artists, and Big Machine is the copyright holder.<sup>86</sup>

Under their private deal, Clear Channel and Big Machine circumvent not only the compulsory license, but also this statutory distribution, thereby avoiding direct payments to artists, musicians and vocalists. Given Clear Channel's position as the nation's radio broadcasting company, this is no small loss for Taylor and company.<sup>87</sup> Importantly, the detrimental effects on non-parties—in this case, Taylor Swift as recording artist—are legally binding, and contradict the provisions and intentions of the circumvented statute. Specifically, the agreement potentially denies artists royalties to which they are legally entitled.<sup>88</sup>

In addition, the privately established royalties are paid directly from Clear Channel to Big Machine, circumventing not only the Section 114(g)(2)

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82. There is debate in the academic literature regarding the proper goal(s) and scope of authority under Article I, Section 8, Clause 8 of the U.S. Constitution, which authorizes Congress to "promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries," however, there is a general consensus around the goal of artist compensation. *See generally*, David S. Olson, *A Legitimate Interest in Promoting the Progress of Science: Constitutional Constraints on Copyright Laws*, 64 VAND. L. REV. 185 (2011) (discussing Congress' authority and limitations under this Clause).

83. For 2013, \$0.0022 is the broadcasters' performance royalty rate for sound recordings. *See* Oxenford, *supra* note 75.

84. Notably, Clear Channel would pay nothing to SoundExchange for a spin of the same track on one of its terrestrial radio stations. *See* Jeffrey, *supra* note 58.

85. In 2011, the latest year for which this information is currently available, SoundExchange charged an administrative fee of 5.3%. *See* SOUNDEXCHANGE ANNUAL REPORT FOR 2011 PROVIDED PURSUANT TO 37 C.F.R. § 370.5(d) at 8, available at <http://www.soundexchange.com/wp-content/uploads/2013/04/2011-Annual-Report.pdf>.

86. *See* credits from CD single liner notes for TAYLOR SWIFT, *We Are Never Ever Getting Back Together*, on RED (Big Machine Records 2012).

87. *See* PUBLIC RADIO CAPITAL, RESOURCE GUIDE: THE CASE FOR MORE CHANNELS, MORE SERVICE 10 (April 2005), <http://www.publicradiocapital.org/pdf/MCMSResourceGuide4202005.pdf> (noting that "Clear Channel, the largest commercial station entity, owns more than 1,100 stations (including up to the maximum of eight stations in most of the major markets).").

88. In the interest of considering the full picture, Section 114(g)(2)'s mandatory distribution could alternately be viewed as itself a detriment to artists insofar as intermediaries may discount the advances they are willing to offer in light of this *ex ante* royalty reduction.

distribution, but also SoundExchange's role as a CRO.<sup>89</sup> This prevents SoundExchange from collecting the administrative fee to which it is legally entitled. The loss of administrative fees owed to SoundExchange is significant not only for its effect of denying the CRO its legally entitled monies, but also for the potential effect on other, smaller members should the Big Machine-Clear Channel deal become accepted as an industry norm. For example, if licensee Pandora—an Internet radio service whose royalty fees constituted nearly 40% of SoundExchange's non-interactive revenue and 70% of SoundExchange's year-over-year revenue gains in 2011<sup>90</sup>—decides to follow in Clear Channel's footsteps and negotiate privately with its licensors, it could spell the end for SoundExchange, the sound recording industry's sole CRO. At the very least, loss of a significant portion of administrative revenues could severely impact SoundExchange's ability to effectively serve its remaining members.

The capacity for private copyright reform to influence industry norms exacerbates the distributive justice concerns owing directly to statutory circumvention. The Big Machine-Clear Channel deal, for example, involves a large broadcaster licensee with sufficient market influence to entice cooperation from a smaller, but still significant, licensor. Smaller, local, or start-up broadcasters without comparable bargaining power are left to the compulsory scheme, or worse, to be peer pressured into unsustainably high “market” rates. To the extent that the bargain struck by Clear Channel features a lower digital performance royalty rate and affords them exclusive or early access to content, this puts the smaller broadcasters at a disadvantage with respect to the ability to attract both listeners and advertisers. This disadvantage comes on top of the challenges they already face as a result of smaller market share and market cap. The same goes for other licensors insofar as the fact that Big Machine has agreed to forego its statutory right to a per-play royalty—at an implied loss<sup>91</sup>—entitles its artists to preferential treatment by the broadcasters.<sup>92</sup>

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89. See, e.g., Christman, *supra* note 63 (“[S]ince the deal is a negotiated rate, payments will bypass SoundExchange and be made directly to the label[.]”).

90. See Rocco Pendola, *The Future of Royalty Fees: Another Piece of the Pandora Bull Case*, SEEKING ALPHA (Apr. 11, 2012), <http://seekingalpha.com/article/492621-the-future-of-royalty-fees-another-piece-of-the-pandora-bull-case> (citing calculations indicating that “Pandora accounted for nearly 37% of SoundExchange’s 2011 revenues, up from an already-high 23.5% in 2010 . . . nearly 70% of SoundExchange’s year-over-year revenue gains are attributable to Pandora, and Pandora’s revenue commitments to SoundExchange more than doubled over the past year.”).

91. See Christman, *supra* note 63 (quoting Big Machine’s Borchetta acknowledging of the agreed valuation that when the numbers come out, “we will take some criticism; that is expected. The first one through the door takes the arrow,” but insisting that “this is a ‘starting point.’”).

92. To the extent that Big Machine’s foregoing of its legal entitlement to a per-play royalty can be viewed as “buying” preferential treatment for its artists, this also raises potential payola concerns. Payola, or the payment of monies to secure airplay of a track, is governed by



In other words, the success of Clear Channel and Big Machine's bargain may "peer pressure" other industry players into agreeing to the same or similar terms, thereby establishing an industry norm. Those who do not, or cannot, match terms will be disadvantaged vis-à-vis the parties who are willing and able to do so. Licensees who do not agree to grant Big Machine and similarly situated licensors a terrestrial performance right, for example, may miss out on exclusive content. Likewise, licensors who will not accept lower digital royalties—perhaps because their roster is comprised of mostly digital artists—may be disadvantaged when it comes to securing preferential promotional opportunities. If unable to offer Big Machine the same terms, for example, a smaller broadcaster may be passed over for an exclusive interview with Taylor Swift, making it even more difficult for them to compete with the likes of Clear Channel for advertisers.

A focus solely on the potential, detrimental effects of private copyright reform, however, misses the bigger picture. For one thing, private copyright reform can bring stability to an otherwise volatile situation. If passed, the Fairness Act would reduce artist and record label revenues by roughly 40%, whereas passage of the Interim Act would increase the digital performance royalty rate paid by cable and satellite providers nearly six-fold. Even if neither act passes in its current form, digital performance rates are scheduled to change every five years, and industry-wide support (and contempt) for the concepts embodied in these acts promises ongoing attempts at substantive rate adjustment in the future. The Big Machine-Clear Channel deal avoids all of this uncertainty by setting its own, non-fluctuating rate that is unaffected by the outcome of proposed legislation and pending litigation.

The predictability afforded parties to private copyright reform is especially attractive from a broadcasters' point of view. For Clear Channel, negotiation of a private royalty valuation has several advantages, chief among them the opportunity to shake the specter of the per-play royalty. In addition to potentially lowering their overall digital performance royalties exposure, a revenue share approach allows a broadcaster to build a more predictable digital business model than under a per-play rate.<sup>93</sup> In the words of Clear Channel CEO Bob Pittman, "I can't build a business space based on paying money for every time I play a song, but I can build a business by saying I will give a percentage of revenue that I bring in. . . . What we are really

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47 U.S.C. §§ 317, 508. Those sections require disclosure of any such payment received by a radio station, by whom, when and in what amount. The "cooperation" induced by the Clear Channel-Big Machine deal would not be subject to this requirement.

93. Although the Pureplay Agreement includes a percentage-of-revenue option, a licensee's rate derives from a greater-of formula, which places all of the major broadcasters under the per-play option. See Notification of Agreements Under the Webcaster Settlement Act of 2009, 74 Fed. Reg. 34,796, 34,798 (July 17, 2009). The term "pureplay" refers to businesses engaged solely, or "purely" in the business of Internet radio.

trying to do is come up with a predictable model.”<sup>94</sup> By offering Big Machine a percentage of advertising revenues, Clear Channel rids itself of the economic unpredictability inherent in a per-play royalty rate, especially a fluctuating one.

For both broadcasters and record labels, the incentives under a per-play rate are misaligned. A per-play royalty encourages broadcasters to minimize costs by playing as little music as possible,<sup>95</sup> while record labels want as much airtime as possible to promote their artists. A royalty valuation as a share of revenue, in contrast, may encourage more spins, since each additional spin may be used to attract additional listeners and potential advertisers. More spins also mean more promotion for record labels, who are encouraged to offer broadcasters more—and even exclusive—content, which further attracts advertisers, leading to greater revenues for both broadcaster and record label.

The Big Machine-Clear Channel deal accomplishes another important goal at which the existing compulsory licensing scheme fails: it fosters a mutually cooperative relationship between parties whose businesses are interdependent. While terrestrial radio continues its decline,<sup>96</sup> digital radio is experiencing exponential growth. Digital radio advertising revenues are expected to grow from \$713 million in 2011 to \$1.55 billion in 2021, or from 1.5% of broadcaster revenues in 2007 to over 7% by the end of 2021.<sup>97</sup> Internet-only radio is forecast to grow even faster, from a current market cap of roughly \$293 million to over \$1 billion by the end of 2021.<sup>98</sup> A broadcaster looking to establish and grow its digital market share, then, is best served by cooperative relationships with content owners—relationships that afford them early and exclusive content in order to attract both advertisers and listeners.

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94. See Christman, *supra* note 63.

95. *Id.* (statement of Clear Channel CEO Pittman) (“I don’t want to try and guess how much advertising I can sell—and if it’s not coming in fast enough, can I slow down the song plays? Or should I do an interview show, or do more talk radio and news and sports, or maybe do more pre-1972 music programming? That’s just a bad way to run—and even more importantly, try and build—a business. It encourages us to try and play as little music as possible.”).

96. See, e.g., Richard Siklos, *Changing Its Tune*, N.Y. TIMES (Sept. 15, 2006), [http://www.nytimes.com/2006/09/15/business/media/15radio.html?ex=1158897600&en=3ec38c17f8408ff2&ei=5099&partner=TOPIXNEWS&\\_r=0](http://www.nytimes.com/2006/09/15/business/media/15radio.html?ex=1158897600&en=3ec38c17f8408ff2&ei=5099&partner=TOPIXNEWS&_r=0) (“[T]he prospects of radio companies have dimmed significantly since the late 1990’s, when broadcast barons were tripping over themselves to buy more stations. Radio revenue growth has stagnated and the number of listeners is dropping. The amount of time people tune into radio over the course of a week has fallen by 14 percent over the last decade, according to Arbitron ratings. Over the last three years, the stocks of the five largest publicly traded radio companies are down between 30 percent and 60 percent. . . .”).

97. SNL KAGAN, *ECONOMICS OF INTERNET MUSIC & RADIO 2* (2011) (on file with author).

98. *Id.*

Record labels are also eager to expand their revenue opportunities. Advances in digital technology, such as streaming, and resultant changes in consumer behavior have decimated traditional recording industry business models, forcing these licensors to seek revenues in greener pastures—namely in radio, which is often still credited with encouraging record sales.<sup>99</sup> A cooperative relationship with broadcasters may ensure better product placement and more opportunities for content owners to share in the growth of digital radio. In addition, the revenue share established by the Big Machine-Clear Channel deal sets up a cooperative partnership in which the parties share both the risk and the upside. This is a significant departure from the industry's standard digital deal consisting of either an equity requirement,<sup>100</sup> or an exorbitant advance for the content owner(s), with no consequence from, or responsibility for, the fate of the licensee.<sup>101</sup>

Statutory licensing regimes are commonly believed to reflect the industry bargain, or at least to set the baseline for private deal making. In the case of digital performance royalties, however, the existing compulsory licensing regime does neither. Instead of looking to the statutory per-play rate as a guideline, Clear Channel and Big Machine have rejected the compulsory rate as wholly unfit for their purposes.

Similarly, CROs are traditionally thought to be beneficial for copyright owners as a means of increasing bargaining power, and for establishing and enforcing a collective valuation.<sup>102</sup> The direct payment from Clear Channel to Big Machine challenges this assumption by obviating the need for a CRO; in this case, SoundExchange. In addition to saving on administrative costs, the parties control distribution of the royalties and are not held to the Section 114(g)(2) distribution. This means they do not have to pay any royalties directly or indirectly to any artist, featured or non-featured. This is not an isolated rejection: Sony/ATV's withdrawal from ASCAP, discussed in the next example, also suggests that the CRO model may not meet the needs of licensors and licensees in a digital world.

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99. See, e.g., Kristen Thomas, *Does Radio Airplay Matter?*, ARTIST REVENUE STREAMS (May 7, 2012), <http://money.futureofmusic.org/does-radio-airplay-matter/> (“[N]ew forms of radio are providing airplay opportunities for more musicians and more types of music. . . . Radio airplay contributes to an artists’ brand. . . . For some musicians, airplay is perceived as a major driver of record sales and other revenue streams. . . .”).

100. See, e.g., Arrington, *supra* note 67 (describing the distribution of monies to equity-holding copyright owners). The MySpace Music venture folded in 2011.

101. See, e.g., Resnikoff, *supra* note 68 (discussing digital start-up Turntable.fm’s struggle with indifferent and disinterested content licensors).

102. See generally, Robert P. Merges, *Contracting Into Liability Rules: Intellectual Property Rights and Collective Rights Organizations*, 84 CAL. L. REV. 1293, 1294 (1996) (noting CROs function as “promulgat[ing] rules and procedures for placing a monetary value on members’ property rights” and thereby “conserv[ing] on transaction costs by either making it easier to identify and locate rightholders, or by creating the occasion for repeat-play, reciprocal bargaining”).

### B. *The King of Pop and Misrepresentation in Rate Setting*

In 2002, pop star Michael Jackson was involved in a very public spat with his music publishing company and co-venture, Sony/ATV, concerning the promotion of his *Invincible* album. Among other allegations, Jackson accused then-Sony head Tommy Mottola of being the devil, and made a rather impassioned speech about the company's lack of scruples and propensity to take advantage of its songwriters.<sup>103</sup> To the extent that Sony/ATV has begun circumventing ASCAP—the performance rights organization (“PRO”)<sup>104</sup> that previously collected and administered the performance royalties for their catalog—in favor of direct licensing deals that cut out songwriters and misrepresent market rates, the King of Pop just may have been on to something.

In 2007, Sony/ATV negotiated a direct deal with DMX, a digital music service that provides music programming for retail stores and restaurants, in which Sony/ATV accepted a lower performance royalty rate than that set by ASCAP in exchange for a hefty advance.<sup>105</sup> Unlike payments from ASCAP that go directly to songwriters, privately negotiated royalties from the Sony/ATV-DMX deal are paid directly to Sony/ATV, who then may (or may not) pass along some unknown portion to their songwriters. An unrecouped<sup>106</sup> songwriter may not receive any payment at all. Even fully recouped songwriters are likely to lose out because standard music publishing contracts deny composers a share in any advance payments received in connection with a blanket licensing agreement, and sometimes even in royalties stemming from a collective license.<sup>107</sup> Free market advocates might argue that these songwriters should negotiate better contract terms. This argument fails

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103. See, e.g., Roger Friedman, *Mottola Steps Up Spin War on Jacko, Implicates Producer*, FOX NEWS (July 13, 2002), <http://www.foxnews.com/story/0,2933,57640,00.html>. For video footage of Jackson's speech, see hassnain786, *Michael Jackson Against Sony Speech in London*, YOUTUBE (Oct. 29, 2009), <http://www.youtube.com/watch?v=Mx0Un9K5dKQ>.

104. A PRO is a specialized type of CRO for the administration of music publishing performance royalties. See *supra* note 10 for a discussion of the form and function of CROs generally.

105. See Paul Resnikoff, *Songwriters May Never See a Dime from Apple's New Music Service . . .*, DIGITAL MUSIC NEWS (Oct. 2, 2012), [www.digitalmusicnews.com/permalink/2012/121002dime](http://www.digitalmusicnews.com/permalink/2012/121002dime) (“DMX paid Sony/ATV an advance of \$2.7 million dollars, and in exchange, Sony accepted a much lower royalty rate than that charged by ASCAP and BMI.”).

106. In a typical record or publishing deal, the record label or music publisher will pay the recording artist or songwriter an advance to cover such expenses as recording, marketing and tour support. Income received from sales of that artist's recordings or compositions are then applied against the advance until it is matched (*i.e.*, until the artist is “recouped”). Only then do most artists begin to see royalties from album sales. Until then, they are considered “unrecouped.”

107. See, e.g., Resnikoff, *supra* note 105 (“[A]lmost all [publishing] agreements have a provision similar to this one: ‘In no event shall composer be entitled to share in any advance payments, guarantee payments or minimum royalty payments which Publisher may receive in connection with any sub publishing agreement, collection agreement, licensing agreement or other agreement covering the Composition.’”) (alteration in original).

to account for the significant difference in bargaining power between songwriters and publishers. Congress recognized this disparity and sought to correct it via the establishment of the rate court and PROs like ASCAP, both of which are circumvented here.

Not only do Sony/ATV's songwriters lose out on a share of the advance (as most are contractually excluded from advance monies), they also suffer reduced royalties resulting from the privately negotiated performance royalty rate, which is lower than that which they would receive under ASCAP's blanket license. DMX was able to take their new, lower performance royalty rate to the rate court<sup>108</sup> as evidence of an alleged "market" valuation in order to have the rate statutorily reduced, thereby further reducing songwriter revenues across the board.<sup>109</sup> In this example, then, not only are songwriters as a class potentially affected, but so too are all licensors operating under the new, lower performance royalty rate.

In addition to the distributive justice concerns raised vis-à-vis songwriters who stand to lose performance royalties to which they are legally entitled, the Sony/ATV-DMX deal also introduces concerns about misrepresentation of a private valuation as a "market" rate. As in the Big Machine-Clear Channel example, this misrepresentation can be accomplished legislatively via adoption by the rate court, or informally via industry norms that come to accept the rate as "standard." Both ignore the \$2.7 million advance involved in this case, thereby creating an artificially low "market" rate.

To make matters worse, Sony/ATV's withdrawal from ASCAP simultaneously lowers the value of ASCAP's service by reducing the amount of content a licensee obtains under a blanket license (making that license worth less), while increasing transaction costs associated with engaging in multiple licensing negotiations. By putting smaller publishers and songwriters that lack the clout to engage in direct deals at a disadvantage, this adverse selection also introduces potential antitrust concerns, as Sony/ATV is under no

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108. Like ASCAP in *United States v. Am. Soc'y of Composers, Authors, Publishers*, No. 41-1395 (WCC), 2001 WL 1589999, at \*6 (S.D.N.Y. June 11, 2001), BMI operates under a consent decree that sets the S.D.N.Y. as its "rate court." See *United States v. Broad. Music, Inc.*, No. 64 CIV. 3787, 1994 WL 901652, at \*1 (S.D.N.Y. Nov. 18, 1994).

109. See *Broad. Music, Inc. v. DMX, Inc.*, 683 F.3d 32, 49 (2d Cir. 2012) (confirming adoption of DMX's proposed rates over those presented by ASCAP and BMI); 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> (discussing DMX's successful rate reduction campaign based on the Sony/ATV direct deal campaign and asking "how can 550 direct licenses [the number held by Sony/ATV] be a benchmark for the true value of the PROs' blanket license when those 550 licenses represent, in probability, only a tiny fraction of the songs represented by the PROs?").

obligation to license its content at all, nor at a set rate, nor to all potential licensees.

Since its deal with DMX, Sony/ATV has announced full withdrawal of its content from ASCAP.<sup>110</sup> This announcement means that all potential licensees must now negotiate direct licenses with Sony/ATV, and demonstrates a lack of confidence in the ability of a collective rights organization—in this case, ASCAP—to obtain the best rate. In addition to serving as proof of the “market” valuation for the purposes of future rate settings, the values reached under Sony/ATV’s direct deals will influence other industry players by setting a new baseline for other major licensors. The adoption of these (presumably) higher rates as the new industry norm can serve to further disadvantage smaller licensees who will be forced to adopt those same rates, whether via formal rate court adoption or informal industry norms.

As with the Big Machine-Clear Channel example, an analysis in this case that looks only at the potential downside ignores the major upside driving this private copyright reform in the first place: money. According to Martin N. Bandier, Chairman of Sony/ATV, the publisher’s withdrawal from ASCAP was “simply an effort to obtain a higher royalty rate[.]”<sup>111</sup> It worked. On January 17, 2013, Sony/ATV inked a direct licensing deal with Pandora that increased performance royalties by 25% over ASCAP’s going rate.<sup>112</sup> This result demonstrates the ability of private parties to achieve a better rate than the CRO, and serves as evidence that ASCAP is not necessarily the most efficient option.

### III. NORMATIVE IMPLICATIONS

#### A. *Is Private Copyright Reform a Problem?*

From a free market or economic efficiency perspective, the private copyright reform described herein is arguably a good thing: privately established, fixed rates lend stability to an otherwise volatile and unpredictable situation where the market rate is subject to both regular fluctuation, and legislative and judicial whim.<sup>113</sup> To the extent the private value can be set up

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110. See Ben Sisario, *MEDIA DECODER: Apple Web Radio Plans Stall Over Music Rights from Sony/ATV*, N.Y. TIMES (Sept. 29, 2012), <http://query.nytimes.com/gst/fullpage.html?res=9407E7D81238F93AA1575AC0A9649D8B63&partner=rssnyt&emc=rss> (“EMI already withdrew its digital rights from ASCAP, and Sony/ATV will follow suit with the rest of its catalog, effective Jan 1 [2013].”).

111. *Id.* We’ve seen, however, that this increase in royalty revenues does not necessarily translate to songwriters, or to smaller licensors and licensees that lack Sony/ATV’s clout and market power.

112. See, e.g., *Sony/ATV Negotiates 25% Royalty Increase from Pandora: Report*, *supra* note 61.

113. In the decades since its establishment, Section 114 has been the subject of multiple hearings and agreements, each resulting in unhappy (and frequently ill-suited) compromise. For a good overview of the legislative turmoil surrounding performance rights, see Peter DiCola & Matthew Sag, *An Information-Gathering Approach to Copyright Policy*, 34 CAR-

as a revenue share, the parties also avoid the unpredictability inherent in a per-play rate, while better aligning incentives between licensors and licensees and helping to foster a mutually cooperative relationship between parties whose businesses are interdependent. The partnership fostered by a revenue share sees the parties sharing in both the risk and the upside, unlike traditional licensing deals in which neither party faces any consequence from, or responsibility for, the success (or failure) of the other.

Under a revenue share, listeners may benefit from improved access to new content and technology. Artists may benefit from increased exposure and promotional opportunities. Technology companies may be more willing to experiment with new services. To the extent private valuations like Clear Channel and Big Machine's grow to become an industry norm, society as a whole may also benefit from a decrease in the social cost of legislation and litigation around rate setting.<sup>114</sup> If private copyright reform is both statutorily permitted, and potentially more efficient and beneficial for the parties involved than the compulsory regime, should we be concerned about its recent proliferation? Why should we object to circumvention of an inefficient licensing scheme? For one thing, the goal of copyright is broader than economic efficiency. The constitutional mandate for copyright calls for the promotion of "the Progress of Science and useful Arts."<sup>115</sup> A phenomenon such as private copyright reform, with its origins in risk aversion, is unlikely to protect the interests of artists. In the Clear Channel-Big Machine deal, for example, the parties circumvent Section 114 in an effort to attain better terms and to avoid the uncertainty associated with terrestrial performance rights, not in an effort to better support creators. In fact, precisely the opposite effect is seen because circumvention of Section 114 denies artists the direct royalty payments they would otherwise be entitled to.

Further, the fact that private copyright reform allows for gamesmanship in rate setting runs contrary to the functions of the CRB laid out in Section 801(b)(1)(A)-(D), and the rate court under the consent decrees. The presentation of a private valuation as representative of the "market" rate—when in fact no market exists or substantive deal terms are omitted—questions the reliability of the statutory (or industrially accepted) rate. Specifically, an artificially low royalty rate can discourage the creation of new works by denying artists a "fair income."<sup>116</sup>

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DOZO L. REV. 173, 221-238 (2012) (describing the history of royalties for "webcasting," also known as Internet radio).

114. That said, industry-driven customs focused on decreasing litigation are not always socially optimal. *See, e.g.*, Rothman, *supra* note 11 (positing that "incorporating such behavior [referring to risk averse private action] greatly expands infringement findings under trademark, copyright, patent, and publicity laws, while narrowing defenses to such infringements. Industry practices establish a highly restrictive IP regime—one in which virtually nothing is free and no use is a fair one.").

115. U.S. CONST. art. I, § 8, cl. 8.

116. 17 U.S.C. § 801(b)(1)(B) (2012).

In addition, smaller players may find themselves forced to operate under a private valuation ill-suited to their business model, but without the means to negotiate otherwise. In this sense, parties to private copyright reform improve their own positions to the potential detriment of others'. Thus, despite its potential benefits and efficiencies, unchecked private copyright reform challenges copyright's ability to best serve artists (via revenue generation) and the public (via the encouragement of creation). It may also further exacerbate inequalities between industry players via the encouragement of adverse selection. The next section describes in greater detail some of the potential drawbacks of private ordering.

#### B. *Amelioration of Adverse Selection and Distributive Justice Challenges*

Despite its efficiency advantages for the parties involved, private copyright reform introduces adverse selection and distributive justice concerns. As discussed *supra* in Part II.A, one concern is the ability to alter the rights of non-parties under the law via circumvention of statutory protections. This is the case where Section 114(g)(2)'s statutory distributions are passed over in a private deal. Another concern is the capacity for private parties—usually larger, market-dominant players—to misrepresent a privately established valuation as representative of the “market.” This is the case where DMX presented its private rate to the CRB as representative of the “market” rate in order to obtain a lower statutory rate. Finally, private copyright reform can present adverse selection problems where only more powerful parties with large market shares are able to secure private deals, thereby leaving smaller parties to operate under a weakened statutory regime.

Congress could alleviate these concerns by making compliance with the statutory license mandatory, thereby eliminating private copyright reform as an option. The fact that circumvention is taking place signals inefficiency in the statutory regime, however, and it is counterintuitive to nonetheless force parties to continue to operate under a system that leaves them worse off. Another solution might be comprehensive copyright reform; *i.e.*, a full rewrite of the copyright laws to better suit the new, digital age. If Register of Copyrights Maria Pallante gets her way, that might eventually happen, but even she acknowledges the ambition of such a proposal.<sup>117</sup> In the meantime, this section proposes two modest statutory amendments to ameliorate these concerns.

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117. In March 2013, Register of Copyrights Maria Pallante delivered a speech before Congress calling for a full reconsideration of the copyright laws. Maria A. Pallante, Register of Copyrights, *The Next Great Copyright Act* (March 4, 2013), *available at* [http://www.law.columbia.edu/null/download?&exclusive=filemgr.download&file\\_id=612486](http://www.law.columbia.edu/null/download?&exclusive=filemgr.download&file_id=612486).



### 1. Inalienable Statutory Protections for Non-Parties

The potential for circumvention of statutorily mandated protections by parties engaged in private copyright reform is problematic insofar as it allows private actors to thwart the spirit and purpose of the law; here, that of assuring royalty payments for artists and songwriters. Section 114(g) allocates a portion of royalty receipts to each of copyright owners, featured recording artists, non-featured musicians, and non-featured vocalists.<sup>118</sup> This allocation is the result of Congressional intent to ensure payment to these parties:

In the absence of the applications of the work made for hire doctrine of the copyright law, record companies, as authors of the sound engineering, and performers, as authors of their recorded interpretations, are joint authors of a sound recording. However, the work made for hire doctrine often applies to recorded performances. Under this doctrine, upon creation of the sound recording, record companies are authors of both the performance and the sound engineering portions of the sound recordings, and thus the sole rights holders. Performers, in these cases, receive their compensation for the performance from the rights holder on a contractual basis. *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.*<sup>119</sup>

In fact, while revising the statute in the context of the Small Webcasters Agreement of 2002,<sup>120</sup> Congress specifically adopted a new methodology that “contemplates that instead of the copyright owner serving as the intermediary to receive all royalties and thereafter remit 50% to others, an agent would receive 100% of the royalties and would remit 50% to the copyright owners.”<sup>121</sup> 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

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118. 17 U.S.C. § 114(g). Article XVII(1)(c) of ASCAP’s Articles of Association likewise specifies the distribution of royalties as follows: “one-half thereof to be distributed among the ‘Music Publisher’ members, and one-half among the ‘Composer and Author’ members, respectively.” AM. SOC’Y OF COMPOSERS, AUTHORS, AND PUBLISHERS, ARTICLES OF ASSOCIATION OF THE AM. SOC’Y OF COMPOSERS, AUTHORS, AND PUBLISHERS 19-20 (May 2002), available at <http://www.ascap.com/~media/Files/Pdf/members/governing-documents/articles.pdf>. 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. . . .” *Id.* at 22.

119. H.R. REP. NO. 104-274, at 23-24 (1995) (emphasis added).

120. Small Webcasters Agreement of 2002, Pub. L. No. 107-321, 116 Stat. 2780.

121. See 2 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 8.22(c)(3)-(4) (2013).

other intermediaries.”<sup>122</sup> The rationale 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, precisely as seen in the examples of private copyright reform from Part II.

If Congress did not trust intermediaries to pay artists their share of royalties, it is unlikely they intended to allow those same intermediaries to deny artists their legal entitlement via the statutory authorization for circumvention of the compulsory license contained in Sections 114(e) and 115(c)(3)(B). Private copyright reform that avoids this statutory distribution therefore acts contrary to congressional intent.

Instead, I recommend a statutory amendment that requires parties who negotiate around the compulsory license to adhere to the statutory distributional schema. This modest improvement obviates the potential for disenfranchisement of artists, songwriters and other non-parties. This statutory amendment would correct the congressional oversight, and would recognize the legal entitlement to royalties as an inalienable right held by artists.<sup>123</sup> There is precedent for this brand of congressional paternalism: the termination right for sound recordings.<sup>124</sup> This right is an example of an immutable rule established in an effort to protect a party (in this case, recording artists) perceived as vulnerable relative to an intermediary (in this case, the record label). Section 203, which allows an artist to terminate a grant of copyright 35 years after the date of execution of the grant, was established in an effort to “safeguard[ ] authors against non remunerative transfers” and to specifically address “the unequal bargaining position of authors, resulting in part from the impossibility of determining a work’s value until it has been exploited.”<sup>125</sup> As an immutable right, the right of termination cannot be waived, and survives even in the face of an agreement to the contrary.

The idea of inalienability in intellectual property right entitlements is also supported by the literature. Professor Guido Calabresi and A. Douglas Melamed reach their famous conclusion in favor of liability rules for intellectual property through evaluation of various entitlements that they group into three categories: (1) economic efficiency; (2) distributional preferences; and (3) “other justice reasons,” which they use as a catch-all for idiosyncratic entitlements that might not fit neatly into one of the other categories.<sup>126</sup> The examples of private copyright reform presented in Part II

122. 148 CONG. REC. H7047 (daily ed. Oct. 7, 2002) (statement of Rep. Conyers).

123. As mentioned in *supra* note 88, an alternate view of Section 114(g)(2)—that of a clause which reduces artist bargaining power up front—would not favor making the distribution inalienable. Insofar as this position assumes otherwise equal bargaining power between artists and intermediaries, this Article rejects the alternate view, and advocates Section 114(g)(2)’s inalienability as the preferable course for most artists.

124. 17 U.S.C. § 203 (2012).

125. H.R. REP. NO. 94-1476 at 124.

126. See Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1093 (1972).

challenge the “other justice considerations” prong insofar as they potentially cut out an entire class of intended beneficiaries; to wit, recording artists and songwriters. Calabresi and Melamed also introduce the concept of “rules of inalienability.”<sup>127</sup> Such a rule should apply to protect non-parties whose entitlements can currently be diminished, and even bargained away, by private action in which they do not participate. That is to say, to the extent that Congress allows circumvention of the compulsory license under Sections 114(e)(1) and 115(c)(3)(B), those deals should be limited to terms that respect non-parties’ legal entitlements.

Application of an inalienability rule to artists’ royalty distributions would still allow for the Big Machine-Clear Channel deal under Section 114(e)(1), for example, but would require that the monies received by Big Machine, as rights holder, be distributed in accordance with Section 114(g)(2)’s mandated distribution. In this way, the spirit and intent behind that section—*i.e.*, that of guaranteeing income to traditionally disadvantaged artists—would not be circumvented by otherwise legally-sanctioned private action. To this end, I propose an amendment to Sections 114 and 115 that requires compliance with the statutory distributions to recording artists and songwriters. This language would make the statutory distribution scheme in Section 114(g)(2) inalienable. In other words, it would allow for circumvention of the statutory license so long as the mandatory distribution scheme laid out in Section 114(g)(2) is observed.

In making the case for amendment over free market resolution, or even litigation, it is important to note that the affected non-parties belong to a class of smaller players who lack the size and market share to effectively challenge the private action that threatens to legally bind them. In the Big Machine-Clear Channel deal, for example, the typical back-up singer or session musician does not have a manager to negotiate for him, nor a powerful trade association, like the NMPA, to lobby or litigate on his behalf. The same goes for the songwriters in the Sony/ATV-DMX example. Most songwriters are locked into publishing contracts that explicitly deny them a share of any advances received, and even of a share of any royalties received under a collective agreement.<sup>128</sup>

Again, the free market argument that these songwriters should negotiate a better contract, or enroll with a different PRO, is challenged by Congress’ recognition of the disparity in bargaining position and consequent statutory protection. Similarly, smaller, start-up digital music programming companies that would compete with DMX in the Sony/ATV example are too small in terms of market share to be worth the giant publisher’s time and effort for a direct deal, and so are left to pay the higher ASCAP rate, making it more expensive for them to expand their operations and to compete effectively.

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127. See *id.* at 1111-15.

128. See Resnikoff, *supra* note 105.

## 2. Full Disclosure of Terms Surrounding Private Valuations

The second potential concern raised by private copyright reform is the ability for private parties to unduly influence law. This concern stems from the influence that private valuations have on both the statutory rate and on industry norms. The relationship between a privately established value and the statutory rate is a direct one: in the case of musical compositions, the rate court adopts a value presented as representative of the market rate so long as it is deemed reasonable. In the case of sound recordings, the CRB adopts a value presented as representative of the market rate if, after publication in the Federal Register with a call for comments, there are no effective objections.<sup>129</sup>

The CRB itself has lamented this state of affairs. In a 2009 rate setting proceeding concerning digital phonorecord delivery, or DPD, the rate court said “we have no choice but to adopt [the private valuation] as the basis for the necessary statutory rates and terms applicable to the corresponding licensed activities. . . . The statute provides that the settlement is an adjustment of rates and terms by the parties that we must adopt.”<sup>130</sup> Given the potentially prohibitive amount of time and money required to effectively challenge a private valuation in the rate court, and the disparity in both power and financing between larger (presenting) players and smaller (objecting) players, 17 U.S.C. §§ 801-803 effectively delegates lawmaking authority to private parties. To the extent that a private valuation is artificially low, or incomplete, or misinformed, there exists a very real risk of setting a royalty rate that suits the needs of the presenting parties at the detriment of the objectors.

In isolation, the valuation reached in the Big Machine-Clear Channel deal, for example, is lower than the current CRB rate. Presentation of this private valuation as the “market” rate would therefore support a reduction in the statutory rate. Such a representation ignores the broader picture, however, which includes a substantial share of revenue in the form of a terrestrial performance royalty, as well as the promise of preferential provision of, and placement for, content. In the Sony/ATV-DMX deal, for example, DMX was able to take the new, lower digital performance rate—*sans* the \$2.7 million advance—to the rate court as evidence of the “market” valuation in order to influence a lower rate across the board, thereby further reducing songwriter revenues.<sup>131</sup>

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129. See 17 U.S.C. §§ 801-803.

130. Mechanical and Digital Phonorecord Delivery Rate Determination Proceeding, 74 Fed. Reg. 4510, 4515 (Jan. 26, 2009) (referring to 17 U.S.C. §§ 801-803).

131. In the rate court decision surrounding the DMX rate, *Broadcast Music, Inc. v. DMX, Inc.*, 683 F.3d 32, 49 (2d Cir. 2012), it was alleged that DMX hid the advance’s existence in order to convince other licensors to agree to the same low rate, but it appears that “the court did not consider it relevant that DMX paid a \$2.7 million dollar advance to Sony. BMI maintains that although the nominal rate Sony agreed to was \$25, they would never have entered

Even where a private valuation is not formally adopted by the CRB or the rate court, the existence of a private royalty rate can effectively set a “market” rate through industry norms. In his piece on rights accretion in intellectual property, James Gibson discusses the phenomenon of private determinations—such as the decision to seek a license for a use that may or may not require one, just to be safe—that catch on until they come to be engrained in industry practice.<sup>132</sup> If the Big Machine-Clear Channel deal proves successful, for example, other major broadcasters seeking to secure exclusive content in order to build their digital radio businesses will be pressured to offer the same terms (*i.e.*, a terrestrial performance royalty in exchange for a lower digital rate) or risk losing out.<sup>133</sup> Smaller licensors who might prefer to continue collecting the higher digital royalty under the compulsory license will likewise be pressured into conceding to the lower “market” rate in order to avoid having their content excluded from airplay.

The same phenomenon can be seen in Sony/ATV’s withdrawal from ASCAP and negotiation of a higher digital royalty rate with Pandora. Other major publishers can now demand that same rate from Pandora, and from other similarly situated licensees, eventually establishing it as the *de facto* “market” rate, when in fact it was merely a compromise reached between two parties in an industry of thousands. This industrial influence, or “peer pressure,” extends even to private determinations that appear at first blush to fall outside of the norm. These extraordinary valuations—such as the creation of a terrestrial performance royalty in the Big Machine-Clear Channel deal—when endorsed by private action, can come to be seen as acceptable in the marketplace.

This industry acceptance has a strong signaling effect. Other scholars have considered the expressive power of courts,<sup>134</sup> and of settle-

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into the direct license unless they received the advance, and that DMX used the deal with Sony to persuade many of the 549 other direct licensees to accept the \$25 per location rate. As BMI’s appellate brief reported, DMX never told the other direct licensee publishers about the advance to Sony, and instead assured them ‘they would be the same as a sophisticated major publisher who had accepted the same deal.’ Moreover, the \$2.7 million represented approximately 150% of all royalties Sony received from both ASCAP and BMI for one year.” *See* Gordon, *supra* note 109.

132. *See* Gibson, *supra* note 20, at 884 (“[T]he practice of licensing within gray areas eventually makes those areas less gray, as the licensing itself becomes proof that the entitlement covers the use.”).

133. Indeed, the Big Machine-Clear Channel deal structure has already caught on, with several similarly-structured agreements having closed in the several months following its signing. *See* Peoples, *supra* note 81; Rys, *supra* note 80.

134. *See, e.g.*, Richard H. McAdams, *The Expressive Power of Adjudication*, 2005 U. ILL. L. REV. 1043, 1120 (2005) (concluding, in the context of adjudication, that: “When the relevant facts or conventions are ambiguous, an adjudicator can resolve disputes by signaling his beliefs—which works by screening out strategic disputes with sufficient probability and then by providing a focal point that creates self-fulfilling expectations for how the individuals will proceed. When the ambiguity is conventional, the adjudicator’s clarification of the con-

ments,<sup>135</sup> on both private actors and future legislation. Private copyright reform, especially where it sets a “market” rate in the context of an instable and fluctuating industry, also has strong signaling potential, and shares the primary concern presented by Depoorter in his work on settlement signaling; namely, incomplete information. Depoorter notes that limitations on publicly available information in settlement reports “introduce[ ] a potential bias in the information that is available.”<sup>136</sup> Likewise, in the case of the private copyright reform, both the lack of a true market and the concomitant opportunity to influence the statutory rate can, and in some cases like DMX have, resulted in misrepresentation of a “market” rate. To the extent a private valuation genuinely represents market interests, it can improve on congressional attempts to set a rate in isolation. Where utilized to manipulate the market and unduly influence congressional rate setting, however, private rate setting is problematic.

In order to alleviate this concern, I propose a statutory amendment to require full disclosure of terms and conditions surrounding a privately determined valuation. As with the fidelity language proposed in Part III(B)(1) *supra*, a mandatory disclosure requirement could be added to Sections 114(e) and 115(c)(3)(B) as a condition for availing oneself of these circumvention authorizations. The language would require complete and accurate disclosure of the circumstances and conditions surrounding a private valuation to be made either to the CRB, in the case of sound recordings, or to the rate court, in the case of musical compositions. These disclosures could be filed and made publicly available much like a securities filing. While this statutory amendment would not completely obviate concerns around misguided industry norms—since those can develop independent of statutory adoption—and would undoubtedly invite objections around protection of proprietary business information, this amendment would at least make gamesmanship more difficult by publicizing the relevant deal terms surrounding establishment of a private rate, and privacy objections could be handled in parallel to those raised in the case of securities filings.

### 3. Adverse Selection

The final, and most challenging, concern presented by private copyright reform is the tendency for larger, more powerful players to opt out of the statutory license in favor of private ordering, thereby leaving smaller, weaker players with a less effective, and less well funded, statutory regime.

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vention can set a precedent and thereby affect the behavior of parties other than the immediate disputants.”).

135. See, e.g., Ben Depoorter, *Law in the Shadow of Bargaining: The Feedback Effect of Civil Settlements*, 95 CORNELL L. REV. 957, 959-60 (2010) (discussing the potential for bias in looking to public settlements—which tend to be outliers—as opposed to settlements whose terms are kept private).

136. *Id.* at 986.

Part II.B. *supra* described Sony/ATV's withdrawal of its content from ASCAP, for example, as earning the company a royalty 25% higher than that received under ASCAP's blanket license. Without Sony/ATV's content, ASCAP will undoubtedly command an even lower license fee going forward, to the disadvantage of those smaller music publishers left behind.

To the extent that the statutory amendments suggested in this Part work to ameliorate the distributive justice concerns, they also mitigate the effects of adverse selection resulting from private copyright reform by minimizing the impact on these smaller parties. Not only do they preserve artist payments, they also encourage fair rate setting. These results allow greater efficiency for the parties involved in private copyright reform, without making those left to the statutory regime worse off. As such, a more efficient result is reached for both parties and non-parties. Given the call for the "next great copyright act,"<sup>137</sup> efficiency-minded legislators would be wise to pass these amendments as part of their push to improve the copyright laws and their ability to protect artists, and to encourage creation and innovation.

### C. Doctrinal Considerations

For decades, private parties in the sound recording and music publishing industries have operated under their respective compulsory licenses as a practical, economical, and efficient means of content licensing. Recently, the detrimental effects of technological developments, such as digital streaming, have decimated the traditional business model of selling records. The accompanying decline in revenues in these industries have driven these same parties to circumvent the compulsory license, and related CROs, in search of stability, predictability, and—perhaps most importantly—revenue. The resulting private copyright reform, while suffering from the deficiencies highlighted in Part II—namely the reduction, and even elimination, of royalties to which artists and songwriters are legally entitled, and the misrepresentation of private valuations as "market" rates—brings stability and predictability to royalty rates, while aligning incentives and encouraging cooperation among licensors and licensees.

In other words, despite the touted efficiencies of compulsory licenses and CROs, the private copyright reform observed in the sound recording and music publishing industries points to rejection of the respective compulsory licenses and corresponding CROs. Big Machine and Clear Channel, for example, found the per-play nature of the statutory digital performance royalty too onerous and unpredictable, and contrary to their shared goals of cooperation and revenue building, and so opted instead for a royalty rate based on a revenue share. Sony/ATV has withdrawn its content from ASCAP in order to negotiate a higher valuation in the market. Sometimes the valuation goes the other way: satellite radio provider Sirius XM recently reported conclud-

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137. See *supra* note 117 and accompanying text.

ing over sixty direct deals, which they have presented to the CRB as “evidence . . . that the market rate for sound recording performance rights . . . is actually below the current statutory rate.”<sup>138</sup>

How can we reconcile these rejections with the common understanding that compulsory licenses and collective rights organizations are an effective means of governing intellectual property rights? And what do the conflicting valuations presented from these private agreements tell us about the fairness of a rate setting procedure that allows—even arguably encourages—private law making? This Section will examine private copyright reform’s contributions to our understanding and treatment of intellectual property through consideration of each of these questions in turn.

### 1. Compulsory Licenses and Collective Rights Organizations

Private copyright reform challenges the traditional understanding of compulsory licenses and collective rights organizations as optimally efficient mechanisms for content licensing. In their seminal work on property rights, Calabresi and Melamed established a preference for liability rules in intellectual property as a more effective means of collective valuation by a court or legislative body; in other words, the precursor to a compulsory licensing regime.<sup>139</sup> Indeed, we see compulsory licensing in industries—*e.g.*, music and television—in which individual negotiation with rights holders would be most burdensome and impractical given the quantity of, and lack of commonality amongst, licensees and licensors. Compulsory licenses in these industries allow for efficient, *en masse* licensing of content and subsequent scalability of service where individual transactions are not practicable. Yet we see private copyright reform circumventing the compulsory license and collective valuation in favor of a direct deal and a private valuation.

Part I discussed two impetuses for private copyright reform: industry instability and legislative unpredictability. Both of these impetuses lead to risk adversity, which favors private deal making. Under their deal, Big Machine and Clear Channel avoid an alternately unknown and fluctuating digital performance rate, and are able to forego the expense of lobbying around pending legislation affecting those rates. Sony/ATV avoids leaving money on the table where the collective valuation falls below what they can secure in the marketplace. Private copyright reform therefore suggests that stability and predictability outweigh the efficiencies of scale afforded by the compulsory license.

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138. See Paul Resnikoff, *Sirius XM Has Now Signed More Than 60 Direct Deals with Labels . . .*, DIGITAL MUSIC NEWS (Dec. 17, 2012), <http://www.digitalmusicnews.com/permalink/2012/121217sirius>. Query whether a mere sixty deals can be rightfully considered representative of the market as a whole.

139. See Calabresi & Melamed, *supra* note 126, at 1110 (“[T]he collective valuation involved in liability rules readily lends itself to promoting distributional goals.”).



Private copyright reform also contradicts the commonly held belief, first introduced by Merges in 1996, that CROs are a superior means of establishing valuations in an intellectual property rights regime.<sup>140</sup> A couple of decades after Calabresi and Melamed pled their case for liability rules, Professor Merges countered, among other things, that a property rights regime was in fact preferable as it was more likely to lead to the formation of CROs, and that these entities raised overall welfare by serving a collective valuation purpose while also saving transaction costs.<sup>141</sup> That CROs save transaction costs is undeniable. One, or even a few, blanket negotiations with a handful of entities costs a potential licensee considerably less in terms of both time and money than hundreds or perhaps thousands of negotiations with individual licensors. Merges suggested that, in the absence of a compulsory licensing regime, an industry can and will minimize costs by setting up CROs to accomplish the same end, while allowing for greater flexibility.<sup>142</sup> In this way, he recommended the encouragement of CROs—a product of a property rule regime—as a superior approach to intellectual property rights allocation.<sup>143</sup> Of course, the action effected by the resultant CRO—that of establishing and enforcing a collective valuation—sets up precisely a liability rule regime, only determined by individual rights holders instead of the state.

Merges also suggested that property entitlements make sense in intellectual property because IP owners can and will contract those property rights away when it is efficient to do so, thereby avoiding “transactional bottleneck[s].”<sup>144</sup> In a recent article, Professor Lemley questions this conclusion by pointing out that IP owners can, and do, just as easily contract around liability rules.<sup>145</sup> In support of his argument, Lemley cites multiple examples, notably the formation of SoundExchange: “It was the creation of a legal right [referring to the digital performance right], not the creation of a prop-

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140. See Merges, *supra* note 102, at 1295 (citing “two distinct advantages of CROs: expert tailoring and reduced political economy problems.”).

141. *Id.* at 1302-03 (“It is the high transaction costs associated with the initial entitlements that lead the parties to establish the [CRO] — an organization that then dramatically lowers the costs of exchanging the rights.”).

142. *Id.* at 1296 (“What separates private CROs from compulsory licensing schemes is that the former have proven to be more flexible over time.”).

143. *Id.* at 1297 (“[P]roperty rule entitlements may be superior in other situations where rights holders encounter each other frequently.”).

144. *Id.* at 1295.

145. See Mark A. Lemley, *Contracting Around Liability Rules*, 100 CALIF. L. REV. 463, 464-65 (2012) (“True, parties can contract around inefficient property rules in IP cases. But . . . they can—and do—contract around inefficient liability rules as well. This is an important adjunct to Merges’s key insight. My evidence does not prove the superiority of liability rules over property rules, but it does undermine a major premise that has been used to support the claim that IP rights must be protected by property rules.”).

erty rule to enforce that right, that drove the founding of collective rights organizations to administer public performance rights.”<sup>146</sup>

If CROs are so well suited for intellectual property valuation, why are players in two CRO-rich industries—specifically, music publishing and sound recording—opting out? Not surprisingly, the examples of private copyright reform that we’ve seen recommend that a CRO viewed as inefficient or suboptimal by the industry it governs—whether for insistence upon a per-play rate basis or for failure to drive the hardest bargain—encourages private bargaining where the parties believe they can do better.

Unlike the music publishing and sound recording industries, broadcast cable and satellite companies pay their statutory royalties directly to the Register of Copyrights by order of the statute. As such, there are no CROs in those industries. I argue that it is precisely the existence of a non-governmental entity for collective valuation and administration in the music publishing and sound recording industries that contributes to private parties’ willingness to negotiate around a compulsory license. First, the valuation established by a CRO gives private actors a mutually agreeable starting point. The collective valuation provides valuable information about the parties’ respective positions, thereby greatly reducing the risk associated with negotiating an alternate rate. Second, the existence of a CRO gives the parties the comfort and security of a “back-up” that allows for small-scale experimentation without commitment to multiple and costly negotiations. Neither party has to commit to the terms *vis-à-vis* all partners, nor does either party have to engage in costly, multiple negotiations, since licensing with all other parties (with whom a private copyright licensing deal has not been reached) can continue under the compulsory regime. Without the fallback statutory license, parties would not be so free to experiment and try out different terms with minimal risk. In this sense, private copyright reform builds upon literature suggesting that the existence of a compulsory license may in fact encourage private negotiation.

Ian Ayres and Eric Talley were the first to suggest that to the extent a compulsory licensing regime is inflexible and unable to account for differentiations among parties, its imposition may in fact lead to more efficient private contracting and greater tailoring of terms than a property rule regime.<sup>147</sup> They also showed that not only can liability rules induce private deal making, but also that ambiguity can induce cooperation.<sup>148</sup> This has certainly proven true in private copyright reform: for example, ambiguity surrounding

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146. *Id.* at 477-78.

147. Ian Ayres & Eric Talley, *Solomonic Bargaining: Dividing a Legal Entitlement to Facilitate Coasean Trade*, 104 *YALE L.J.* 1027, 1033 (1995) (“[L]iability rules may induce both *more contracting* and *more efficient contracting* than property rules.”).

148. *Id.* at 1035 (using economic modeling to show “how ambiguity can induce bargainers to act more cooperatively.”).

digital and terrestrial performance royalty rates led to private action between Big Machine and Clear Channel.<sup>149</sup>

Finally, the private copyright reform phenomenon contradicts the received wisdom that risk aversion creates entitlements.<sup>150</sup> In his piece on risk aversion and rights accretion, Gibson names “[u]ncertainty regarding the reach of intellectual property entitlements” as one factor leading to unnecessary licensing and rights accretion for copyright owners.<sup>151</sup> Private copyright reform teaches us that uncertainty, and the risk adversity that accompanies it, can have precisely the opposite effect where circumvention of statutory distributions can diminish or even eliminate artists’ rights.

## 2. Private Law Making

Private copyright reform also questions the efficacy and fairness of a regime that allows, and even encourages, private law making. While the parties to private copyright reform stand to gain from their bargain, non-parties without sufficient clout and funding to attract direct deals and to successfully present private valuations to the CRB or a rate court are at a distinct disadvantage. Those without sufficient means and institutional know-how to challenge a proposed rate will ultimately be pressured into acquiescence either by necessity or non-action. So we see that often what is termed a “collective” valuation, and treated as such in practice, is actually a private valuation imposed upon non-parties in contravention of a statutory mandate intended to protect their interests.

Not only are the private actors we’ve seen able to do better by circumventing the compulsory license—and with that, some of the intended beneficiaries thereunder—they have also set a new baseline for both future negotiation and future legislation. The Big Machine-Clear Channel rate, for example, can both influence industry norms around digital and terrestrial performance royalty rates, and can be presented as proof of the “willing buyer, willing seller” rate in the upcoming digital performance royalty hearings.<sup>152</sup> Likewise, the rates agreed upon between Sony/ATV and licensees outside of ASCAP, such as DMX, will undoubtedly influence ASCAP’s collective rate as members lobby for a rate increase to match the new “market” valuation. Meanwhile, potential licensees such as Pandora have sued for rate reductions,<sup>153</sup> suggesting DMX’s “market” valuation is hardly representative. Similarly, licensees who want access to Sony/ATV’s content will be

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149. See *supra* Part I.

150. See Gibson, *supra* note 20.

151. *Id.* at 942.

152. The Pureplay Agreement set the relevant rates through 2015. 74 Fed. Reg. 34,796, 34,798 (July 17, 2009). In January 2013, the CRB began accepting and reviewing rate proposals for 2015-2020.

153. See Petition of Pandora Media, Inc., *supra* note 53; Peoples, *supra* note 62 (discussing Pandora’s lawsuit against ASCAP seeking a rate reduction).

forced into terms similar to those reached with DMX, as they can no longer access that content through ASCAP's blanket license. Private copyright reform therefore suggests that private actors—especially those in a position of greater influence and power—should not be allowed to legally bind an entire class of copyright owners.

#### CONCLUSION

Advances in technology offer an amazing opportunity for experimentation in both new content delivery services, and the licensing of that content. As technology continues to introduce uncertainty and unpredictability into industries governed by compulsory licenses and CROs, it is more important than ever to hold the copyright laws to their constitutional mandate to protect and encourage creators, and to prevent externalizing costs from parties to non-parties. To the extent those laws inadvertently allow circumvention of statutory protections for artists, those loopholes can and should be corrected by statutory amendment.

Private copyright reform is in its nascent stage; ever-evolving changes in industrial business models and consumer behavior will undoubtedly encourage its proliferation and influence its trajectory. Congress and scholars alike can benefit from private copyright reform's challenges and contributions to intellectual property theory. We can start by recognizing the shortcomings of compulsory licenses, CROs, and private rate setting in the new technological age, and by promoting awareness of the risks to artists' rights posed by unchecked statutory circumvention.