

# TRANSACTIONS COSTS AND ADMINISTERED MARKETS: THE CASE OF MUSIC PERFORMANCE RIGHTS

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## 1. Introduction

Since 1934, the Antitrust Division of the U.S. Department of Justice has concerned itself with competitive issues in the licensing of music performance rights by the nation's two major performing rights organizations, the American Society of Composers, Authors, and Publishers (ASCAP) and Broadcast Music Inc. (BMI).<sup>2</sup> Performance rights organizations (PROs) provide transactional efficiency for music users and copyright owners by negotiating contracts, collecting revenue, and paying royalties for the rights to publicly perform musical compositions, replacing their need to deal individually with one another in bilateral licensing.<sup>3</sup> Since the respective formation of ASCAP and BMI in 1914 and 1940, performance rights for catalogued works have generally been made available to users through *blanket licenses*, which convey the rights to perform, or have performed on licensed premises, all registered works in the

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<sup>2</sup>A third PRO, SESAC, accounts for the remaining compositions. SESAC has always operated without Justice Department and court involvement.

<sup>3</sup>The U.S. Solicitor General (1967, pp. 10,11) made the case for centralized licensing. "The extraordinary number of users spread across the land, the ease with which a performance may be broadcast, the sheer volume of copyrighted compositions, the enormous quantity of separate performances each year, the impracticality of negotiating individual licenses for each composition, and the ephemeral nature of each performance all combine to create unique market conditions for performance rights to

corresponding catalog of registered works. In a landmark Supreme Court decision *Broadcast Music Inc. v. Columbia Broadcasting System Inc.* (1979), Justice White ruled that blanket licenses enabled transactional efficiency and were properly examined under a rule of reason that generally applied to Sherman Act cases.<sup>4</sup> Sobel (1983) offers a more thorough scholarly discussion.

In addition to contracting instruments that enhance transactional efficiency, blanket licenses are sometimes recognized as anticompetitive restrictions that compel each user to make an “all or nothing” choice that may force acceptance of a full license contract in place of a less inclusive alternative that a user may actually prefer. Since there are no savings to be had from converting an individual use to any alternative license unless all uses are so converted, the prospective transactions costs of a global readjustment present high switching costs (Klemperer, 1987) that lead to path-dependent equilibria (David, 1985, 1986, 1997; Nye, 2000) with no inherent tie to economic efficiency. Competitive concerns at the Antitrust Division of the U.S. Justice Department regarding blanket licensing at ASCAP and BMI led to two separate Consent Decrees in 1941 (*U.S. v. American Society of Composers, Authors, and Publishers*, 1941; *U.S. v. Broadcast Music Inc.*, 1941), two more in 1950 and 1966 (*U.S. v. American Society of Composers, Authors, and Publishers*, 1950; *U.S. v. Broadcast Music Inc.*, 1966), and key modifications in 1960 and 1994 (*U.S. v. American Society of Composers, Authors and Publishers*, 1960; *U.S. v. Broadcast Music Inc.*, 1994). In

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recorded music. If this market is to function at all, there must be ... some kind of central licensing agency by which copyright holders may offer their works in a common pool to all who wish to use them.”

<sup>4</sup> “The blanket license is greater than the sum of its parts [and] to some extent, a different producer [with] certain unique characteristics. It allows the licensee immediate use of covered

September 2000, the Department and ASCAP again filed a Joint Motion to enter a Second Amended Final Judgment (AFJ2) that is now in the process of renegotiation (U.S. Department of Justice, 2000a).

The DOJ Consent Decrees stipulated that *blanket licenses* for performance rights must be non-exclusive; i.e., each writer or publisher has the option to directly license any of her catalogued works to any prospective licensee. Furthermore, ASCAP and BMI must also offer to individual radio and television stations *program licenses* that make full catalog available on an individual program basis. The terms of these program agreements must provide a “genuine choice”, a problematic concept that different courts have interpreted in various manners.

Each license element in a menu of choices presents a different potential for improving transactional and allocational efficiency. Competitive markets to license performance rights to feature songs and rerun movie soundtracks are necessarily “thin” due to limited substitution between compositions. Blanket licenses that economize on negotiating costs here present the potential for transactional savings. By contrast, markets for works in newly created themes and soundtracks can be “thick” if producers can solicit bids from a number of competitive providers. Competitive licensing here can enhance allocational efficiency with less of an increase in transactions costs.

Based on the underlying costs of using the competitive market, license fees for individual programs can be part of either a group of monopoly services that would be efficiently provided by ASCAP or a group of competitive services that would deploy

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compositions, without the delay of prior individual negotiations, and great flexibility in the choice of musical material.” 441 U.S. 1, 22.

alternative arrangements. Facing a mixed competitive market, performing rights organizations would resemble public utilities, whose respective monopoly and competitive services depend on the presence or absence of economies of scale (or scope). The economic theory of public utility regulation has been particularly well developed in the past twenty five years to consider the relation between the core services of an incumbent monopoly and new services from a competitive fringe. As such, it can serve well to inform economic debate in the related market for music performance licenses, where some elements are appropriately licensed in a competitive manner.

In view of the disparate transactional efficiencies made possible by blanket and competitive licensing of music performance rights, we shall consider market performance in line with three phenomena characteristically found in the theory of public utility regulation:

1. *Subsidy-Free*: A vector of prices at a regulated utility is subsidy-free if incoming revenues for each particular service are greater than the associated costs of providing the service (Faulhaber, 1975). In music licensing, this means that fees paid are sufficient to cover the royalties paid for each license element.

2. *Natural monopoly*: A provider of a group of core services is a natural monopoly in that domain if there are no less costly means by which any combination of these services can be provided by two or more competitors.

3. *Structural Separation*: Public utilities may be reasonably enjoined from providing certain services if anticompetitive behavior or other administrative anomalies are feared under more integrated production.

As distinct from the economies of scale and scope that prevail in public utility services, we shall argue that ASCAP and BMI's respective efficiencies derive primarily from savings in administrative and transactions costs in the licensing and monitoring process, which will principally determine whether a license is efficiently monopolized, made competitive, or structurally separated from a group of core services.

The paper is organized as follows. Section 2 overviews the nature of the performance right for musical compositions and the current means for its enforcement. Based on the economic theory of public utility regulation, Section 3 reviews the theoretical notions of natural monopoly and cross-subsidization. Section 4 considers the most recent proposal to reform music licensing, as presented by ASCAP and the Department of Justice in a draft modification to their Consent Decree (U.S. Department of Justice, 2000a). Section 5 reviews the administered duopoly in which ASCAP and BMI compete, and suggests that the market would be more efficiently served by a monopolist provider of blanket licenses. Section 6 considers whether ASCAP and BMI should be structurally enjoined from licensing any performance right that involves non-broadcast digital transmission. Section 7 concludes the paper.

## **2. The Performance Right and its Enforcement**

ASCAP and BMI are the two major American performing rights organizations that license public performances of the words and lyrics of copyrighted musical compositions that are performed independently of a staged dramatic or musical

production.<sup>5</sup> For negotiated or administered license fees, the PROs license catalog of member or affiliated publishers and writers, and distribute license revenues based on the estimated number of performances.<sup>6</sup> Public performance rights in musical compositions should not be confused with related rights to mechanically reproduce the music or lyrics of a musical composition, or with copyrights in actual *sound recordings* made by artists and owned by record labels.

Founded in 1914 to collect royalties for live performances in music halls and theaters, ASCAP is a nonprofit association controlled by its songwriter and publisher members. Collected license fees are assigned to monitored performances based on usage minutes, with relative weights for different music types determined and published by ASCAP's member board. Founded in 1940 to enable a radio boycott of ASCAP, BMI is a corporation owned by 300 radio stations that counts songwriters and publishers as affiliates. Affiliates are compensated for performances with basic usage rates set forth in a published royalty book and a secret bonus system that is changed from quarter to quarter. Weights assigned to different music uses in both organizations are based on judgments of relative worth that have no comparable market benchmarks.<sup>7</sup> This has led to a curious phenomena; while the Department of Justice disclaims any ability to

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<sup>5</sup> By contrast, *grand* or *dramatic* rights pertain to musical compositions that are performed as part of a larger theatrical production and which are licensed directly by the writer or publisher.

<sup>6</sup> A writer retains a publisher to market the song, own and administer the copyright, collect and divide mechanical royalties, and sometimes edit the song. ASCAP and BMI split performance royalties evenly between the two. To retain royalties, major writers often become their own publishers.

<sup>7</sup> "Because of the difficulty in assessing composer's investment and opportunity costs, a true regulatory price for musical compositions could probably not be determined ... The investment in musical compositions, however, cannot be estimated accurately .. Even if the investment could be assessed, however, a fair rate of return, or opportunity cost, for composers could probably not be gauged because of the difference in quality and popularity of various musical compositions." (Cirace, 1978, p. 277)

determine appropriate rates, ASCAP claims a Department imprimatur on its weighted outcomes.<sup>8</sup>

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<sup>8</sup> The Department “has been unable to identify any principled way to evaluate whether the changes are appropriate and therefore has almost never objected. The requirements ... thus impose costs on ASCAP, on the Department, and on the Court, but provide little if any protection to its members. Yet ironically, when members do object to ASCAP’s distribution practices, ASCAP frequently invokes the Department’s review of its formula and rules as demonstrating that its distribution practices are fair and appropriate.” (U. S. Department of Justice, 2000b, Section III(I))

Now representing over 80 percent of domestic licensing revenues (ASCAP, 2000), broadcast usage of musical compositions is considered a public performance and has been so licensed since 1922. Each PRO now periodically negotiates with local radio and television stations, or their collective agents, to set blanket fees based on adjusted advertising revenue of the licensing customer.<sup>9</sup> While amounts in blanket contracts purportedly represent the value of music to the user, there is no real economic basis for such a determination. Rather, percent rates are simply an heuristic adjustment of an historic or a related contract rate, based on estimated changes in customer usage, as required by a District Court decision.<sup>10</sup> Per the terms of each binding Consent Decree, either party may refer negotiations that last longer than sixty days to an arbitration hearing of a Rate Court, which operates under the administration of the U.S. Federal Court in the Southern District of New York.

Broadcast uses of music may entail feature compositions, soundtracks, themes, and commercial and promotional jingles; radio usage primarily involves the former, while television usage now primarily involves pre-recorded themes and soundtracks that

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<sup>9</sup> Each of the three full time television networks now pays flat fee rates, while premium cable channels pay license fees on a per subscriber basis.

<sup>10</sup>“Surveying the fluctuations in the amount of music used by a network over time provides an adequate proxy by which to gauge whether the significance of music to network programming has changed relative to prior years, assuming all other factors remain constraints, the direction in which a network’s music use has headed should chart the course for the music licensing fees owed to ASCAP.” *U.S. v. American Society of Composers, Authors, and Publishers* (1993, p. 156) “It appears to the Court that a formula that factors into the calculation of a royalty ... the changes in both the levels of gross income earned by a network and the degree to which music is used by a network, provides an approach that addresses many of the concerns raised by the parties.” (p. 158).



are subsequently performed on non-live program or commercial broadcasts.<sup>11</sup>

Contracting for soundtrack material first involves the synchronization of music into the program tape, which involves reproduction rights that music writers and publishers contractually convey to the program producer. These synchronization rights are distinct from subsequent rights to publicly perform the work, which is now retained by writer and publisher for television broadcasts (but not cinema or video).<sup>12</sup> Since synchronization and performance rights are complementary to one another, some advocates (Owen, 1982) suggest that synchronization payments will adjust in the market to offset changes in performance compensation. As Nye (2000a) evidences, the view may be simplistic; writers most often convey “synch rights” in television productions at nominal amounts in order to collect subsequent performance royalties that are substantially greater.

Instead of a blanket arrangement based on total advertising revenue, a broadcast user may obtain the same performance rights through a combination of direct, source, program, and commercial licenses that cover, *en toto*, the same program material. *Direct licensing* entails integrated contracting between station (or network) and writer (or publisher) for synchronization and performance rights to cover musical works performed

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<sup>11</sup>Usage minutes can now be categorized as feature (1.4%), theme (3.2%), background (41.4%), and commercial (54.0%) (Holden, 2000, p. 345). *Feature music* includes compositions that are the primary focus of audience attention, *theme music* is used to open and close programs, *background music* is used to complement screen action, and *commercial music* includes advertising jingles, public service announcements, and promotional music that pitch other programs. Theme, background, and commercial music almost invariably entail pre-recorded soundtrack or sound bites.

<sup>12</sup>Television production contrasts with music used in cinema movies and home videos, where writers convey *all* rights for implicated performances in “work-for-hire” contracts and receive no additional compensation for theater or home performances. PROs were effectively stopped from licensing

on network- or station-produced shows, such as introductory themes on news and sports programs. *Source licensing* entails similar deals between studio producers and writers, with rights for soundtrack or theme music conveyed to station buyers of produced programs.<sup>13</sup> As competitive instruments that circumvent ASCAP and BMI, direct and source licenses present higher negotiation and monitoring costs, but save the PRO the need to collect revenues and to pay out royalties for the implicated element.

Finally, each PRO must offer a *program license*, which confers full rights for all catalog used during the presentation of a broadcast program and is based on a percentage of the related advertising revenue. PROs augment program licenses with separate *commercial* “mini-blankets” that cover all off-program uses for advertising and promotional interludes. A broadcast licensee will then choose its most preferred licensing system by comparing blanket fees with a modular alternative that implements a combination of direct, source, program, and commercial elements.

As will be argued below, stations that opt for non-blanket options in some applications will need to make use of the program license in other instances. Therefore, real choice to a blanket license would not be possible if program license fees were priced prohibitively in comparison. Per the terms of their respective Consent Decrees, ASCAP and BMI program licenses must then be “genuine choices” compared with the blanket. However, the meaning of the term was never specified, and program rates were established for a time that all but eliminated the viability of the option.

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separate performance rights in movies in 1948. *Alden-Rochelle Inc. v. American Society of Composers, Authors, and Publishers* (1947).

<sup>13</sup>The wide majority of this material is commissioned work-for-hire. The remainder is prerecorded songs that may add to the background of the program.

### **3. Efficiency and Subsidy**

We now consider the transactions costs (which include negotiation, administration of collections and payments, and policing for abuse) that are implicated in licensing various kinds of music. The degree of substitutability between program music, and the resulting applicability of alternative licensing modes, may vary considerably with the type of music in a particular application.

Three music uses should be viewed as non-competitive. For feature presentations that are the prime focus of audience attention, the competitive need to maintain top-flight quality entertainment constrains the ability of any user to avoid or substitute between different compositions. Second, recognizable musical accompaniments in program soundtracks and themes add moods or time contexts to programs, movies, or commercials and are not readily interchanged with one another. Third, music synchronized into movie and program soundtracks cannot be changed out when these shows are rerun on subsequent television broadcasts.

More competition between musical compositions is possible for newly created “works for hire”, where producers, networks, and stations can choose among composers to write original soundtracks or themes for sitcoms, dramas, sports events, or news and talk shows.<sup>14</sup> Alternatively, program producers may obtain background music from prerecorded instrumental themes now available from commercial music libraries. With

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<sup>14</sup>Such competitive arrangements are generally characteristic of video production, where producers convey a package of rights contracted from writers, actors, directors, stagehands, etc., who are usually compensated for their efforts beforehand (and only occasionally with payment based on show success).

more substitution possibilities, the supply side of the market for new uses is “thick”, as producers may solicit contracts from different providers.

For any licensed program, transactions costs of competitive licensing can be expected to vary directly with the number of writers, compositions, and usage minutes, as well as the prestige of the work and the idiosyncrasy of its application. Negotiations for competitive licenses may break down in programs when music use is most intense or varied. By contrast, transactions costs may be relatively small – and negotiation quite feasible -- for uses involving "work for hire" and library music. Competition here between ASCAP licenses and direct- and source-alternatives may be workable.

When competition is possible, each licensee will have the incentive to design an efficient strategy that minimizes overall license costs; an optimal strategy may include a menu of program, direct, and source-licenses which can then be compared with a blanket. Two allocational gains are made possible from the lower prices that may result. First, program quality and viewer enjoyment may improve as producers have access to better writers and musical content at lower prices. Second, more music can be used for marginal applications and “new media”, where lower license costs may affect the profitability of particular programs or providers and engender more entry.

If both the licensee and the writer(s)/publisher(s) are to bypass ASCAP and participate voluntarily in a competitive contract for music in a particular program, both must find the outcome advantageous to an ASCAP program alternative. Two equilibrium conditions must then prevail:

1. Adjusting for differences in administration and transaction costs, ASCAP's collected license amount  $S_i$  for music performed on any licensed program  $i$  is greater than or equal to royalties paid for the same music under any competitive alternative  $R_i$ . That is,  $S_i \geq R_i + X_i$ , where  $X_i$  represents the additional transactions costs necessary for competitive licensing for program  $i$ .

2. ASCAP's paid out royalties for music  $P_i$  on any licensed program are less than or equal to royalties paid for the same music any competitive alternative. That is,  $P_i \leq R_i - X_i$ .

The composite inequality that describes the core for a competitive outcome  $R_i$  on program  $i$  is  $P_i \leq R_i - X_i < R_i + X_i \leq S_i$  presumably at least one outside inequality would be strong. If  $P_i > R_i - X_i$  or  $R_i + X_i > S_i$ , at least one relevant party will not agree to the competitive alternative and the ASCAP program license will necessarily prevail as a default option.

If  $P_i \leq S_i$ , collected revenues from a particular program license would be sufficient to compensate writers and to make some contribution toward ASCAP overhead. If this inequality does not hold in programs covered by the default license, composer payments must be *cross-subsidized* by revenues collected from another license element (Faulhaber, 1975). Cross-subsidization would not be possible in a competitive instance where transactions costs for all license elements were zero. Under conditions where transactions costs are positive, cross-subsidization may be enjoined as a matter of fairness, as well as a surrogate procedure to establish a quasi-competitive outcome.

#### **4. A Modified Paradigm**

On September 5, 2000, the Antitrust Division and ASCAP filed with the U.S. District Court of the Southern District of New York a Joint Motion to enter a newly negotiated Second Amended Final Judgment (AFJ2) that attempted to resolve many outstanding competitive issues in music licensing (U.S. Department of Justice, 2000a). As discussed in an accompanying memorandum (U.S. Department of Justice, 2000b), AFJ2 expanded and clarified ASCAP's obligation to offer genuine license alternatives to more user groups, such as background music providers and Internet companies. As a principal concern, AFJ2 aimed to enhance competition in program licensing by changing the mechanism by which the program percent would be set.<sup>15</sup> The draft agreement is now being modified again, subject to additional negotiation. If implemented, a subsequent effort with BMI can be expected to follow.

Subpart VII(A)(1) of AFJ2 would oblige ASCAP to offer program licenses to any requesting broadcaster or digital transmitter. Music licensees are to be categorized in classes of similarly situated customers based on business structure and music use.<sup>16</sup> For each class, AFJ2 aims to ensure a rough revenue equivalence between an ASCAP blanket license and a functionally equivalent slate of ASCAP program licenses. That is, adjusting for differences in administration and transactions costs, ASCAP's expected fees for a blanket license and a full menu of program licenses in each customer class are

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<sup>15</sup>"The objective is to ensure that a *substantial number of users* within a similar situated group will have an opportunity to substitute enough of their music licensing needs away from ASCAP to provide some competitive constraint on ASCAP's ability to exercise market power with respect to that group's license fees." AFJ2, Section III(F).

<sup>16</sup>Among others, classifying factors include nature and frequency of performances, ASCAP's administration cost, competition among licensees, and licensee revenue source. AFJ2, Section II(S).

to be equal for each representative customer; a hypothetical licensee whose music usage is typical of the group-at-large.<sup>17</sup>

To understand revenue equivalence more formally for an application where customers are licensed individually, let  $P$  represent the percent fee charged for a blanket license, which is based on the station's overall adjusted advertising revenue  $R$  for a blanket fee total  $PR$ . Let  $x$  represent the fraction of a representative station's programs that use ASCAP music (defined as having *any* music written by an ASCAP composer *regardless* of how eventually licensed). The appropriate percentage multiple for the ASCAP program license would then be  $P/x$ , which is assigned only to those program revenues  $r < R$  for specific shows that ASCAP actually licenses. Stations may license remaining programs that use ASCAP music through direct or source contracts, with a royalty payment  $p$  that can be expected to be directly related to the uncovered revenue gap  $R - r$ . AFJ2 also specified a program surcharge  $y$  to cover the incremental transactions costs imposed on ASCAP in administering the program system. An optimizing station would prefer the blanket (program-based) system if  $PR < (>) [1 + y]Pr/x + p(R - r)$ .<sup>18</sup>

As a key modification for music uses in "new media", Subpart VII(A)(2) of AFJ2 would extend the idea of program licenses to *segment licenses* that may break down music usage by modified times or locations, such as day part or web page. The per-segment license aims to ensure that "new media" users without formal programs may

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<sup>17</sup> *Id.*, Section II(Q).

<sup>18</sup> The matter is somewhat more complicated for group licensing, as aggregate fees here would be negotiated for the group as a whole, and assigned to license amounts for covered programs in individual stations based on a rough measure of relative viewership.

nonetheless have access to a modular licensing alternative. This is particularly relevant to license elements partitioned across channels (e.g., music subscription and digital satellite) or hyperlinks (webcasters).

If AFJ2 were adopted, the ASCAP Rate Court would face three outstanding economic issues that are now left ambiguous.

1. AFJ2 did not specify whether ASCAP's percent rate  $P/x$  applied to an individual program (or segment) license should be equal for *each* license chosen by a station, or whether the derived percentage may be applied to the *average* of individual percent rates. In the latter case, individual discounts and upgrades for single program licenses may be implemented. Rate equality, which has historically been the case, is an uneconomic way of determining the market value of program music and has led to uneconomic bypass of the ASCAP system.<sup>19</sup>

2. AFJ2 failed to specify how often a licensee may substitute from a blanket license to a menu of program licenses. ASCAP contracts now confine station licensees to one or the other license system for the full duration of the agreement, which can be five years. Were intermediate substitution made possible, licensees could readily move out of blanket licenses to take advantage of competitive rates elsewhere, made particularly advantageous when program formats change. As license structures involve

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<sup>19</sup> A very relevant example is the licensing of music for local news programs, which provide considerable advertising revenues for local television stations. If program license fees were based on a constant percentage-of-advertising revenues, the implicated dollar amounts for ASCAP-licensed programs would be quite high. In fact, music usage on news programs is confined to an opening theme and is therefore minimal. Since ASCAP has not been able to lower its program rate selectively for news shows, local stations routinely set out to bypass ASCAP by directly licensing theme music.



little sunk cost, there is no economic reason why this flexibility cannot be achieved.

Blanket fees can then be imputed to individual programs, which can be made subject to competition from direct and source alternatives.

3. AFJ2 failed to specify that royalty payouts for each program must be weakly less than the related license fee for each explicit or implicit program. As noted in Section 3, this inequality would avoid cross-subsidization. While competition between equally efficient producers and entrants may protect against cross-subsidization, this result is no sure outcome when transactions costs are positive. An explicit restraint then is necessary.

## **5. Administered Duopoly**

The U.S. market for music performance licenses now includes two court-administered nonprofit PROs (ASCAP and BMI) plus a non-regulated profit-making fringe competitor (SESAC) that serves 3 percent of the market. We shall now consider competitive difficulties in the structure and operation of the administered duopoly that serves the bulk of the market.

While BMI was originated in 1940 to replace ASCAP material then under station boycott, ASCAP and BMI do not now compete against one another in the provision of licenses to music users. Rather, the two organizations have catalogs that are evenly used and no writer or publisher may register the same material with both.<sup>20</sup> Consequently, no broadcaster or general licensee can realistically avoid obtaining licenses from each. Indeed, the two organizations use each other's contract fees as benchmarks for their own

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<sup>20</sup> The only exception are works composed by teamed writers from different organizations.

subsequent negotiating positions. Accordingly, if this administered duopoly is to serve any competitive purpose, it is conceivably in the domain of writer and publisher compensation.

From a theoretical perspective, competition for writers would be a desirable means of maintaining payment integrity, particularly for those royalties not realistically conditioned under direct or source competition. However, competition for writers between the two administered PROs is not easily established as a practical administrative matter. With two different Rate Courts now operating under two separate Consent Decrees, there is no existing administrative procedure by which blanket fees at either of the two organizations can be adjusted for offsetting quarterly or annual changes in relative catalog size or usage that may result between negotiations. Consequently, fees paid to new writers and material at either PRO can only be compensated by reducing payments to other incumbents.<sup>21</sup> This “zero-sum constraint” at each organization evidently limits the ability of the two organizations to maintain strong head-to-head competition for writers in any consistent fashion.

Furthermore, while ASCAP presumably can earn more at its next major negotiation if it can attract talent from BMI (before BMI attracts other writers back), here too there is no consistent relation between license fees and catalog size or usage. Rather, the dependence between negotiated contract fees and co-existing catalog size is quite diffuse, if not entirely independent. Though each PRO may attempt to glean a limited number of feature writers from its “rival”, the net effect of "star-chasing" upon subsequent license amounts is equally dubious. Without any clear relation between fees

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and catalog size, new migrants to a particular PRO can only be paid if royalties to other members or affiliates are reduced.

Competition for migrating writers could be strengthened if license payments at ASCAP or BMI were adjusted immediately for changes in respective market share, much in the manner of automatic rate adjustments for fuel costs and purchased power requirements in electric power companies. However, such legal arrangements would be difficult to implement in the market for music licensing. With independent Rate Courts now operating under two separate Consent Decrees, no one entity has the legal authority to simultaneously tie license fees at both organizations to offsetting changes in market shares. An integrated authority to set offsetting and balanced fees could only be established with the consent of both ASCAP and BMI, which is evidently not likely, or through a Federal Statute.

Were an integrated authority established, different music usage types would have to be weighted and aggregated by corresponding weights to determine a reasonable index of music usage. The matter would reintroduce more arbitrary judgment about the relative value of music usage and each advocate could be expected to produce a weighting scheme favorable to its market strengths. Finally, license fees do not always go to arbitration, which means that the organizations themselves would be left to do the necessary indexing in private negotiations, with further adjustments presumably to be automatically implemented at intermediate times when measured market share declines.

Were related blanket and program licenses handled instead through one collecting society, there would be no need to estimate and implement offsetting

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<sup>21</sup> To a degree, some additional savings may be made possible by reducing overheads.

adjustments for changes in market share involving ASCAP and BMI. Furthermore, writers, publishers, and licensees would benefit from scale economies in negotiation, litigation, and administration. Based on most recent web site data, ASCAP and BMI respectively retain 15.4 and 18.0 percent of collected revenues to meet overhead and “marketing”; each organization maintains a separate executive branch and headquarters, staffs a chain of regional offices, and employs over 500 people for negotiating, collecting and administering contracts on behalf of its market half.<sup>22</sup> These total overhead costs might reasonably be halved were licensing restructured under one organization.

If legal and structural reform were possible, performance rights in the U.S. could operate under an administered monopoly, as is the case in every nation except the U.S. and Brazil.<sup>23</sup> Other Western countries have reached operating efficiencies by integrating administration of performance revenues and related royalties for mechanical reproduction. The U.K.’s Performing Rights Society and Mechanical Copyright Protection Society are separate entities that share administrative costs. The former outperforms both ASCAP and BMI by retaining only 14 percent of a smaller base of collected revenues, with a long-run target of 11.1 percent. The German collecting society GEMA economizes further on costs by integrating performance and mechanical collections entirely.

## **6. Structural Separation**

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<sup>22</sup>At <http://www.ascap.com/press/meeting-020800.html> (visited January 5, 2001); <http://www.bmi.com/iama/media/faq/money.asp> (visited May 1, 2000; link no longer active)

<sup>23</sup>At [http://www.prs.co.uk/prs.nsf/sitepages/press\\_results99](http://www.prs.co.uk/prs.nsf/sitepages/press_results99), visited January 5, 2001.

As a key competitive strategy in the breakup of AT&T, regional monopoly providers of local exchange service were proscribed from entering the competitive market for long-distance. The Department's accompanying memorandum to the modified Consent Decree hints at a similar structural safeguard for music performing rights.<sup>24</sup>

For the first time in the U.S., copyright protection was successively extended in 1995 and 1998 to the performances of the actual sound recordings used in wired (i.e., non-broadcast) digital audio transmissions (as distinct from the underlying musical compositions, which were always protected).<sup>25</sup> When performing rights in both sound recordings and musical compositions are in effect, evident transactional economies would be possible if the same collecting agent could administer both. Accordingly, a structural safeguard for digitally transmitted musical compositions can be implemented now for non-broadcast uses covered by sound recording protection.

As one practical administrative solution to collecting integrated performance fees for sound recordings and musical compositions, the Recording Industry Association of America, the trade association for the five major record labels, unveiled in November, 2000 the online arm of its Sound Exchange royalty payment system, which had collected

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<sup>24</sup>“Technologies that allow rights holders and music users to easily and inexpensively monitor and track music usage are evolving rapidly. Eventually, as it becomes less and less costly to identify and report performances of compositions and to obtain licenses for individual works or collections of work, these technologies may erode many of the justifications for collecting licensing of performance rights by PROs. The Department is continuing to investigate the extent to which the growth of these technologies warrants additional changes to the antitrust decrees against ASCAP and BMI, including the possibility that the PROs should be prohibited from collectively licensing certain types of users of performances.” (U.S. Department of Justice, 2000b, footnote 10).

sound recording royalties for digital music subscription services. Adapting the mechanism to accommodate compositions would entail a statutory reassignment of legal authority, an administered adjustment of due royalty amounts, and a modified application of digital tracking technology to count and credit uses of recordings and compositions. The resulting outcome -- i.e., the collection of royalties for two recognized properties -- would be similar to the administration of levies on sales of digital audio tape and recorders, which are now collected under the domain of the Copyright Office and divided among copyright owners of sound recordings and musical compositions under administrative hearing (17 U.S.C. 1008). Additional statutory and administrative safeguards would also be necessary to ensure to writers and owners of compositions a fair share of collected revenues (for more discussion, see Einhorn, 2001).

Under integrated administration of sound recordings and musical compositions in digital audio transmissions, regulatory approaches can be made consistent across similar uses and complementary media. This process would be more open and administratively efficient than the present system for licensing performance rights for compositions, where Rate Courts necessarily fail to coordinate operations among one another or with the Copyright Office. In addition, writers and publishers who actually create and own copyright in the music that ASCAP and BMI license lack legal standing in the Rate Courts. Consent Decrees must be interpreted within their plain meaning, are not modifiable by the Court, and are adjusted only with the bilateral consent of the

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<sup>25</sup>Extensions of copyright appear in 17 U.S.C. 114(a)-(c). Over-the-air broadcasters in the U.S. continue to enjoy an exemption from royalty payments for performances of copyrighted sound recordings, but not the underlying musical compositions.

Department and the signing party. (*U.S. v. Atlantic Refining Co.*, 1959; *Suarez v. Ward*, 1990; *Berger v. Heckler*, 1985)

## **7. Conclusion**

The end result of the rules and operations that have been adapted for regulating music performance licenses is an administered duopoly that fails in a number of key respects to maximize transactional, administrative, and allocational efficiency. Having presented some possible efficiencies that would have improved the operation of the market for performance licenses, AFJ2 is now on hold. ASCAP and the Department of Justice can be expected to modify the agreement, which will be sent out for another round of regulatory comments in some inestimable amount of time. Many of the terms will be conditional upon BMI's subsequent agreeing to similar provisions. Whether any reform eventually congeals and improves upon the limited efficiency of the present market is anyone's guess.

Should the reform process continue on its present course, a modified decree could explicitly allow selective discounting and easy substitution between blanket and program licenses, and explicitly disallow cross-subsidization between revenues and royalties collected under different license elements. Legislative action may be necessary to keep the performing rights organizations from extending themselves into digital domains where other mechanisms are more efficient. Whether ASCAP and BMI would ever voluntarily agree to merge, or otherwise rationalize operations, is arguable.

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In the [technology](#) sector, Dr. Einhorn worked at Bell Laboratories and the U.S. Department of Justice (Antitrust Division) and consulted to General Electric, AT&T, Argonne Labs, Telcordia, Pacific Gas and Electric, and the Federal Energy Regulatory Commission. He has advised parties and supported litigation in matters involving [patent damages](#) and related valuations in semiconductors, medical technologies, search engines, e-commerce, wireless systems, and proprietary and open source [software](#).

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