THE ASCAP AND BMI CONSENT DECREES: IS PARTIAL WITHDRAWAL WISE?

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1. INTRODUCTION

As an economic consultant active in media, entertainment, and technology since 2001, I submitted these comments in August, 2014 as an independent party in response to the Justice Department’s request for comments regarding modification of the present Consent Decrees with ASCAP and BMI. Note I previously worked in the Antitrust Division of the U.S. Department of Justice.

As an immediate concern before the department, possible modifications include New Media services that implicate a digital performance right for works in a PRO

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catalog. New Media rights would generally implicate as complements performance rights in sound recordings, reproduction rights in compositions, synchronization rights in videos, and/or transmission rights for cloud services.

As a professional economist active in the concerns of the music industry, I advance to this Department the following recommendation. To ensure the fullest potential for innovation, feedback, response, and realignment in the market for New Media services, music publishers must be free to innovate, interact, negotiate, contract, and design cooperative agencies without impairment from ASCAP and BMI, the Rate Court administration, and all strictures thereof. In so far as its concerns regarding present anti-competitive behavior at ASCAP and BMI can be resolved, the Department should move to allow partial withdrawal of publisher rights for New Media services.

Outside of the potential for price rationalization, markets present two critical benefits to investors, rights owners, and users of new technologies and intellectual property. First, music publishers and service providers in bilateral market arrangements may more broadly implement contracting processes that enable incremental learning, balancing of risk, mutual problem-solving, and adaptation. Second, music publishers may respond to emerging opportunities through new organizational modes that are more
administratively efficient and more adaptive than predecessor regimes at ASCAP and BMI.

2. RATE COURTS AND ADMINISTERED PRICING

ASCAP and BMI are the two major organizations in the U.S. that license collectively the public performance rights for all musical works listed in their respective catalogs. Due to an ongoing history of anti-competitive behavior at both organizations, ASCAP operates under the terms of a Consent Decree originally entered with the U.S. Department of Justice in 1941; a provision for a Rate Court was added in 1950 and the decree was again modified in 2001 (AFJ2). The BMI decree was originally established in 1941, vacated and renegotiated in 1966, and amended with a Rate Court in 1994.

Per Article IX of AFJ2, ASCAP must provide in writing to any prospective user a royalty fee for a license on a blanket, program, or one time use basis. Licensing under the Consent Decree is non-exclusive; i.e., music publishers may also license music directly from their individual catalogs. If ASCAP and a prospective licensee are unable to agree on a royalty arrangement, either party may take the matter before a Rate Court.
established and administered in the Southern District of New York. The purpose of the Rate Court is to set rates for licenses when the parties cannot agree.

In any such proceeding, the legal burden falls upon ASCAP or BMI to prove that its prospective fees are reasonable. If deemed unreasonable, the Court may determine an alternate rate. -- “a reasonable fee based on all the evidence” (i.e., “the price that a willing buyer and a willing seller would agree to in an arms’ length transaction.”

Once determined, ASCAP must offer the same fee to all similarly situated users who may come to seek a comparable license. Before a license fee is established, a prospective user may operate under a rate-less interim license that ASCAP may modify after court approval.

The Rate Court process is evidently cumbersome; hearings for new rates now extend well beyond one year, with settings of court deadlines, hearings for interim fees, and administrations of pretrial discovery. Indeed, ASCAP now claims to have spent nearly one hundred million dollars on litigation expenses related to all rate court proceedings since 2009. In addition to all costs of litigation that ASCAP and BMI must serially pay, each music provider itself must incur the legal costs of duplicate efforts before each Rate Court. This legal cost may be a considerable burden for smaller businesses yet to turn an annual profit.

ASCAP concludes that the expense and delay of Rate Court proceedings “could be avoided by the elimination of the ASCAP Consent Decree.” But this is impractical.
Neither ASCAP nor BMI present credible evidence that any of the Department’s many competitive concerns with their general behavior are mitigated in the past decade. Indeed, some additional concerns of recent misconduct by ASCAP and BMI are once again under investigation at the U.S. Department of Justice.\(^7\)

The problem of Rate Court overhang now bears acutely on the licensing of musical compositions in streaming services, such as Pandora Media. The major publisher entities (Sony/ATV, EMI, BMG Chrysalis, and Warner Chappell Music) in 2013 withdrew (or announced plans to withdraw) related rights from ASCAP and BMI in order to license catalog directly to Pandora Media and other comparable streaming services.\(^8\) By withdrawing works from the ASCAP and BMI catalogues, the publishers would could license music to New Media users without competing against their own compositions that would otherwise be made available at ASCAP and BMI.

In 2013, Sony/ATV actually negotiated a direct deal with Pandora with a five percent composite royalty (or 2.28% for the ASCAP share);\(^9\) the composite is about 25 percent above the four percent royalty that Pandora paid for catalog in 2013.\(^10\) For its part, UMPG came to negotiate a 7.5% composite royalty (or 3.42% prorated) in a subsequent deal.\(^11\)

While accommodating these rates with Sony/ATV and UMPG in order to avoid immediate copyright infringement, Pandora contended nonetheless that the practice of
partial withdrawal was disallowed by both Consent Decrees. Both the ASCAP and BMI Rate Courts came to agree with Pandora that ASCAP and BMI representation was “all or none”. That is, music publishers could not partially withdraw works from either catalog under the terms of the present Consent Decrees.¹²

Music publishers now press on, as Sony/ATV has vowed to withdraw its works entirely if partial withdrawal is not permitted.¹³

With regard to the rates themselves, Judge Denise Cote in the ASCAP Rate Court also later issued a decision in March, 2014 that ruled that the Sony and UMPG rates were not suitable free market standards for a benchmark in Rate Court.¹⁴ In Judge Cote’s view, Pandora had come to the UMPG license under some legal duress in order to avoid immediate copyright infringement.¹⁵ Moreover, Pandora came to contract with Sony only after both Sony and ASCAP refused to itemize catalog that Pandora would have used to remove works from its service.¹⁶

In the same decision, Judge Cote rather affixed a lower 1.85% royalty fee for the blanket fee for the ASCAP catalog. This amount was based on an experimental license established in 2005 and deployed subsequently in 2011-2012 in a negotiated deal between ASCAP and EMI Music Publishing.¹⁷ Moreover, the Judge raised questions of coordinated practices involving ASCAP, BMI, Sony, and UMPG that the Justice Department is now investigating.¹⁸
3. UNDERSTANDING ECONOMIC EFFICIENCY

For its part, the Justice Department opened a new consideration of its Consent Decree, with partial withdrawal a critical concern. Presuming that the Antitrust Division can resolve recent anti-competitive concerns that Judge Cote raised, I suggest that the Department move along the following path.

First, whatever the immediate factual context before recent happenings involving Pandora’s streaming service, the Department should recognize that some market rates yet might actually be lower outside of the Rate Court process. As a case in point, subscription service provider DMX successfully established (after administrative adjustments) free market valuations of the entire ASCAP and BMI catalogs at $10.74 and $10.25 per service location at DMX. Based on previous licensing outcomes in Rate Court, ASCAP and BMI respectively sought to implement market valuations of $41.21 and $36.36. Upheld by the Second Circuit, both Rate Courts upheld DMX’s valuations and compelled each PRO to license DMX and other similarly situated music services at the free market rate (subject to additional adjustments for minimum fees and carveouts that worked in DMX’s favor.) Consequently, a commitment to partial withdrawal does not necessarily impose higher rates.
Pricing in the market of music licensing is evidently a “zero-sum game”; e.g., higher royalty rates benefit ASCAP but hurt Pandora. There is no discernible improvement in the allocation of static resources (the standard textbook measure of economic efficiency) that higher or lower prices may produce. Moreover, there is no factual evidence that supports the possibility that more musical works would be forthcoming if royalty rates were higher (a dynamic conception often termed Schumpeterian).

However, economic efficiency does not stop at market prices and royalty rates. Markets may promote efficient contracting and reorganization in several additional dimensions.

4. BILATERAL CONTRACTING

First, bilateral contracting between music publishers and service providers presents an improved system for accommodating mutual concerns, balancing risks, and promoting market adaptation.

This seems intuitive enough. Music publishers and service providers in a flexible market may more fully learn in the negotiation process what issues are specific to one another’s position. Through communication and negotiation, the engaged parties have
the opportunity for mutual accommodation. A “win win” outcome seems less apparent in Rate Court disputes where parties engage on rights for entire catalogs of works, largely with concern to rates.

In bilateral engagement, music publishers and their licensees may come to deploy in each contract a slate of instruments – e.g., sales dollars, number of plays, number of subscribers, and advertising revenues -- in a manner that can more effectively promote growth and balance risks between one another. In this regard, the menu of contract instruments may also include advances, options, or equity shares, *inter alia*. *Contract flexibility* is now found in the recording industry, where labels and artists have come to negotiate “360 deals” that share revenues from product sales, royalties, concerts, and merchandise, to varying levels in each.\(^\text{21}\)

Multi-level monetization in “360 arrangements” protects the label from the *risk of fluctuations* in product sales now affected by online infringement, album disintermediation, and migration to subscriptions. It also gives the label more *incentive to invest* in many activities – e.g, video design and tour promotion – knowing that a direct share of the resulting publishing and concert revenues will be recouped along with record sales.

*This aspect of the record industry is entirely bilateral and market-driven; there is no higher level of government oversight of artist and label in the arrangement.* It is
critical to allow music publishers the same flexibility to vary their agreements as circumstances may fit; one size should not fit all. One publisher may seek to generate more cash flow with a negotiated advance, a second may prefer a revenue balance that involves number of plays, advertising, and/or subscriptions, while a third may seek long term growth and acquisition potential with a percentage equity share in the music service.

The third item – equity share – is particularly interesting. Record labels now have an 18 percent share in Spotify. “The shift is a result of some re-engineering by the major labels on how they profit from streaming services. In the older model, labels focused more on large, upfront guarantees in exchange for the rights to use their valuable catalogs ...[A]ccording to a pair of sources close to those deals, that has shifted considerably over the past few years. ‘[The big recording labels] decided they want equity more than payments, because there’s a market [for acquisition] now’ ...” [emphasis mine]

Secondly, parties to a contract may more broadly promote growth and share market risks if they can make some portion of payments contingent upon the achievement of certain revenue targets or circumstances. For example, a percent pureplay streaming royalty may vary depending on whether the listener comes to buy the track, view an advertisement, or sign up for a subscription service. Moreover, if compulsory licensing of musical compositions can be relaxed for publisher royalties (17 U.S.C 115),
the payment terms for mechanical royalties at a download service can depend on other contingencies as well. Covered contingencies generally can be related to achievement of certain goals (i.e., incentives), or simple risk hedges against unforeseen events beyond any party’s control.

Thirdly, a compelling feature of any contract with any digital service is the possible sharing of personalized data regarding a listener’s online activity or geographic location. Depending on a listener’s use profile (and willingness to share information), music publishers and service providers can jointly promote works or playlists through a digital interface. However, the powerful capabilities of interfacial organization will not be made fully effective unless the publisher can engage the service provider directly on the widest terms.

Fourth, not often found in digital music, some publishers may yet come to redirect revenues by “passing through” composition rights. This allows the label to collect revenues from sales or licensing and subsequently compensate both publisher and artist. Pass-through licensing may be preferred if the administrative process at the label proves to be more efficient than elsewhere. Unlike digital services, pass-through licensing to record labels has always been found in physical recordings where labels have collected sales revenues and pay to publishers their contracted royalty share; publishers also license synchronization rights to movies and videos through pass-through structures. Pass-
through licensing may reemerge if publishers are freed from the licensing terms of 17 U.S.C. 115 that often implicate actual rates or benchmarks set by the Copyright Royalty Board.

Practically speaking, contract specificity can happen only if each publisher is free to recognize its own circumstances, assert its own interests, and negotiate its own terms with any service provider. The resulting terms are efficient in the sense that participants have the opportunity to resolve issues through negotiation to the mutual benefit of both parties – i.e. “win win”. It is here difficult to see how such accommodations can arise when service providers have access to the same musical works through a fallback arrangement licensed through ASCAP or BMI and channeled by a restrictive Rate Court process.

If partial withdrawal is allowed, the Department will need to put in place restrictions on a publisher’s right to re-catalog its rights with ASCAP and BMI after some period. The purpose of this restriction is to prevent any strategic repositioning of catalog by removal and re-entry, possibly with favorable terms negotiated between the PRO and its publisher (to the presumed detriment of others)  The most direct course of action here is a presumption of permanent withdrawal. The matter can be revisited.
5. AGENT REORGANIZATION

In addition to contract flexibility, markets allow rights holders more opportunity to realign their operations and market interfaces through flexible self-organized agencies that may be more administratively and transactionally efficient.\textsuperscript{25} This is the thrust of the \textit{new institutional economics} that understands the role of institutions in enhancing economic efficiency, and the capacity of markets in accommodating them.\textsuperscript{26}

If unencumbered by the administration and legal domain of ASCAP and BMI, music publishers that control New Media rights may come to design or realign alternative cooperative agencies to order to negotiate licenses and administer collection and distribution of their copyright royalties. While larger publishers would predictably come to negotiate their own contracts, smaller publishers may come to negotiate rights collectively through the National Music Publishers Association (as was done with YouTube in 2012\textsuperscript{27}) or to put in place an independent licensing agency similar to Merlin, the licensing agency of independent labels.\textsuperscript{28}

From a vantage of scale economies owing to shared overhead costs, integrated data bases, and fewer transactions, integrated licensing of a full catalog of digital works through a collective of small publishers seems more administratively efficient than vesting ASCAP and BMI parallel roles in licensing the same collection of works through
two independent interfaces that would implicate largely distinct catalogs. In addition to fully integrated New Media rights, alternative licensing interfaces would allow publishers to present to music services an additional slate of mechanical and synchronization rights, now disallowed at ASCAP and not found at BMI. There are no benefits for “mission drift”; neither ASCAP nor BMI should engage in mechanical and synchronization licensing that can be capably performed elsewhere under the roof of a specifically dedicated collecting organization.

6. COLLECTION AND DISTRIBUTION

Whatever the outcome of new licensing arrangements, some music publishers may prefer to vest some cooperative agency with back office roles for collection and distribution. Three options are possible.

First, the ASCAP Board has recently approved its willingness to perform back office roles of collection and distribution.29 This is a plausible but difficult proposition. Overhead costs at ASCAP and BMI are considerable,30 and well above ratios known for agencies (such as Sound Exchange) that are less engaged in litigation.31 With fiduciary responsibilities to recover administrative costs from all members or affiliates of their
respective organizations, each PRO may need to tithe from its collections an additional clip that might otherwise be avoided through an alternative arrangement.

Second, publishers may assign collection rights for performance royalties to a licensing interface of the Harry Fox Agency (e.g., Slingshot), which has acted as a publishers’ administrator of mechanical and synchronization royalties. Although publishers control the copyright in the works, the publishers here would face major songwriter concerns for balanced representation and treatment in the administration of the agency and the distribution of collected royalties. A collection solution administered through Harry Fox Agency or any other publisher collective does not seem practical.

Third, publishers and songwriters may vest their trust in an independent collection agency, such as Music Reports Inc.,\textsuperscript{32} that has lower administration costs and the presumed ability to act as a credible fiduciary for publishers and songwriters alike. If other agency interfaces are not appropriate, this realignment is a balanced option that rights owners may wish to consider.

7. ANTI-COMMONS AND HOLDUP

The author is aware that several critics of copyright law may voice concerns that disaggregated publisher rights may lead to an \textit{anti-commons} for any service provider that
seeks to put together rights for an entire catalog of works. In an anti-commons, a provider will presumably face holdups from one or several publishers that may individually seek to extract disproportionate payments for some rights in their catalogs.

This concern is admissible, but not one for the Department of Justice to resolve. The Department is confined in its mission to enforce the nation’s antitrust laws, and so oppose coordinated actions that are harmful to the market. If acting in an uncoordinated and otherwise legal fashion, any owner of intellectual property may restrict or disallow the licensing of its works to any party. Other means of restricting the anti-commons are at the government’s disposal, if and when the problem arises.

8. CONCLUSION

If and when its present competitive concerns can be resolved, the U.S. Department of Justice should adopt the following course:

1. A category of music services should be designated New Media. New Media services should implicate digital performance rights for musical compositions when complemented by performance rights in sound recordings, reproduction rights, synchronization rights, or cloud services.
2. Publishers should be allowed to withdraw from ASCAP and BMI catalogs all rights related to the presentation of musical compositions in New Media services. A restriction should be placed on a publisher’s ability to reenter rights into a PRO catalog.

3. Large publishers may license works for New Media service directly to the service provider. Smaller publishers should be allowed to license their works through a designated licensing collective other than ASCAP or BMI.

4. Rights holders may appoint agencies for collection and distribution of royalties. ASCAP and BMI may be considered as candidates for such a role.

ABOUT THE AUTHOR

Michael A. Einhorn (mae@mediatechcopy.com, http://www.mediatechcopy.com) is an economic consultant and expert witness active in the areas of intellectual property, media, entertainment, damage valuation, licensing, antitrust, personal injury, and commercial losses. He received a Ph. D. in economics from Yale University. He is the author of the book Media, Technology, and Copyright: Integrating Law and Economics (Edward Elgar Publishers), a Senior Research Fellow at the Columbia Institute for Tele-Information, and a former professor of economics and law at Rutgers University. He has published over seventy professional and academic articles and lectured in Great Britain, France, Holland, Germany, Italy, Sri Lanka, China, and Japan.

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.
Litigation support involving media economics and copyright damages has involved music, movies, television, advertising, branding, apparel, architecture, fine arts, video games, and photography. Matters have involved Universal Music, BMG, Sony Music Holdings, Disney Music, NBCUniversal, Paramount Pictures, DreamWorks, Burnett Productions, Rascal Flatts, P. Diddy, Nelly Furtado, Usher, 50 Cent, Madonna, and U2.

Matters involving trademark damages have included the Kardashians/BOLDFACE Licensing, Oprah Winfrey/Harpo Productions, Madonna/Material Girl, CompUSA, Steve Madden Shoes, Kohl’s Department Stores, The New York Observer, and Avon Cosmetics. Matters in publicity right damages have involved Zooey Deschanel, Arnold Schwarzenegger, Rosa Parks, Diane Keaton, Michelle Pfeiffer, Yogi Berra, Melina Kanakaredes, Woody Allen, and Sandra Bullock.

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ENDNOTES

1 United States v. ASCAP, 1940-43 Trade Cas. ¶56, 104 (S.D.N.Y. 1941); 1950-51 Trade Cas. ¶62,595 at 63,754 (S.D.N.Y. 1950); 41 Civ. 1395 (S.D.N.Y. 2001).


4 An earlier licensing agreement between ASCAP and Pandora terminated in December, 2010. After nearly two years of negotiation and interim arrangements, Pandora came to file in November, 2012 a petition for a Rate Court ruling to be made effective retroactively from January, 2011 through December, 2015. After a year, the ASCAP Rate Court held a three-week trial in February, 2014 and handed down a decision in March, 2014; the verdict may yet be appealed. BMI filed a petition for a Rate Court hearing in June 2013 and a trial is yet to be scheduled.

6Id.


8For example, see Rao, infra note 13


11Beise, supra note 9.


15Id., at 72.

16Id., at 60.
17Id., at 92

18Id., at 97


22The music service provider DMX paid to Sony/ATV Music Publishing a royalty advance of $2.4 million and an administrative payment of $300,000 pursuant to an agreement. Supra note 20

23Apple iTunes Radio now compensates record labels based simultaneously on a pureplay rate per stream (.13 cents per stream) and a percent of net advertising revenue (15%). The negotiated solution system differs from the formula in 17 U.S.C. 114, where the Copyright Royalty Board must base due payments on an “either or” system. E. Christman, Publishers to Get Bigger Payday From Apple Thanks to Direct Licensing Deals, Billboard Magazine, June 5, 2013, at http://www.billboard.com/biz/articles/news/digital-and-mobile/1565762/publishers-to-get-bigger-payday-from-apple-thanks-to-direct-licensing-deals.


27https://www.nmpa.org/media/showrelease.asp?id=201

28http://www.merlinnetwork.org/

29Supra note 5, 27.

30Id., at 23.
ASCAP has overhead ratios between 11 and 12 percent of collected revenues in each year. Id. Without the ongoing burdens of litigation costs, SoundExchange had an administrative fee of 4.5%, which it claims to be the lowest administrative fee of any major performance rights organization in the world. At http://www.soundexchange.com/generalfaq/#sthash.dLki8Svn.dpuf

http://www.musicreports.com/