LAW360

Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Competition In Music Licensing — DOJ Has More To Do

By **Thomas Lenard, Technology Policy Institute, and Lawrence White, NYU Stern School of Business**

Law360, New York (January 20, 2017, 12:23 PM EST) --
ASCAP and BMI are the two largest music performing rights organizations that represent composers/song writers and their publishers in music copyright license contracts with radio stations, internet and other digital music services, TV and movies, restaurants and bars, and other music distributors. The two PROs have operated under similar antitrust consent decrees since 1941.[1]

Thomas M. Lenard

With the emergence of new streaming music platforms like Pandora and Spotify, publishers have wanted to partially withdraw their catalogues from the PROs for the purpose of negotiating directly with these platforms. This became a major issue leading up to and during the recent Pandora rate case, with the court determining that partial withdrawal was not permissible under the consent decree.[2]

Lawrence J. White

In the aftermath of the Pandora case, ASCAP and BMI in 2014 requested that the Antitrust Division of the U.S. Department of Justice open a review of the consent decrees, with the aim of modifying the decrees to permit partial withdrawal. The review surfaced a related thorny issue: whether the consent decrees require the two PROs to fully license a work if they represent only a fraction of the ownership.

The division concluded its review in August 2016, stating that it would not seek to modify the decrees so as to allow partial withdrawals.[3] At the same time, the division stated its position that the consent decrees require, and should continue to require, “full-work” licenses, which allow the PROs to license any work in which they hold a fractional interest. The judge that oversees the BMI decree did not, however, agree with that interpretation, stating, “The Consent Decree neither bars fractional licensing nor requires full-work licensing.”[4] The division has given notice that it will appeal.[5] So, this issue will carry over to the new administration.

This article focuses on the economic implications of these two issues: partial withdrawal and full-work licensing.[6] We conclude that the Antitrust Division’s position will (and is intended to) reinforce the current system of collective licensing of performance rights. This is not consistent with the emergence of a more competitive market, which entails direct bargaining between the rights holders and the distributors. Permitting partial withdrawal while also requiring full-work licensing would be a more pro-competitive policy, because it would encourage what is already a trend toward more direct bargaining.

Historic Purpose of the PROs

The issues of partial withdrawal and full-work (or 100 percent) versus "fractional" licenses (where permission must be obtained from each fractional owner of a work) can properly be understood only in the context of the historic rationale for the PROs. The essential purpose of PROs is to reduce the transactions costs that would otherwise be associated with music licensing, including: negotiating between the many thousands of composers and music publishers that own copyrights and the many music distributors/users of those licenses; enforcing the license contracts against infringers; and distributing royalties. Composers and publishers join a PRO and give that PRO the nonexclusive right to license their works collectively. PROs further reduce transactions costs by granting blanket licenses to all of the works in their catalogues.

The drawback to this system is that the centralization of the licensing and other performance rights functions, while reducing transactions costs, has allowed the PROs to acquire market power. After all, the PROs represent the collective actions of thousands of composers and publishers who would otherwise be competing. This centralization, in turn, led to the Antitrust Division's original antitrust suits and the subsequent consent decrees under which the PROs operate and which were the subject of the recently concluded review. Included in the consent decrees is the adjudication of disputes between the PROs and the music distributors/users by the federal courts in New York, which has turned these "rate courts" into the de facto (as well as de jure) regulator of composer royalties.

Both of the central questions that the division's review of the consent decrees considered involve the issue of transactions costs. In coming to its conclusions, the Division's principal criterion seems to be to minimize transactions costs and the possibility of holdup/holdout problems to the exclusion of other criteria, such as trying to move to a more market-oriented, competitive system. Thus, the Division's position is an endorsement of the current licensing system in which the PROs issue blanket licenses under the umbrella of the rate courts.

Partial Withdrawal

New streaming platforms, such as Pandora and Spotify, have reduced the transactions costs that are associated with music licensing for two reasons: First, these platforms are national or even global in scope — in contrast to the historically large number of geographically based radio stations and other local users. Second, the technology reduces the cost of monitoring which recordings and compositions are being performed. The result is to diminish the benefits of using a PRO as an intermediary.[7] This explains why some publishers want to negotiate directly with the licensees, as has increasingly been happening.
The issue of partial withdrawal was prominent in the Pandora case, with the rate court concluding that some publishers were coordinating their actions rather than competing and that a critical part of their strategy was to withdraw their new media rights without making available to music distributors/users an accurate list of their works. Nevertheless, it is increasingly common for publishers and users to negotiate directly, as is evidenced by a 2015 deal between Pandora and Sony/ATV — who were principal antagonists in the Pandora rate case.

The division decided not to support modification of the decrees that would permit partial withdrawal. The motivation appeared to be to reinforce the blanket license, which minimizes transactions costs.

The division also noted that the lack of consensus as to whether the PROs currently do offer full-work licenses created too much uncertainty to be able to assess the competitive impact of allowing partial

withdrawal. If PROs offer fractional licenses, partial withdrawal would make PRO licenses less reliable (in avoiding infringement claims) — i.e., a user couldn't rely on a PRO license if a publisher with fractional interests had withdrawn.

Thus, while partial withdrawal was the initial impetus for the review, the full-work-versus-fractional-license question became pivotal.

Full-Work vs. Fractional Licenses

Most musical works have more than one copyright holder. Under full-work (or 100 percent) licensing, any fractional owner can grant a nonexclusive license to a music user/distributor without the permission of the other owners, so long as the fractional owner notifies and pays the other owners their pro rata share of the proceeds. By contrast, under fractional licensing, to avoid infringement each licensee would be required to obtain a license from each fractional owner.
The DOJ's position is that the consent decree requires ASCAP and BMI to offer full-work licenses "because only full-work licensing can yield the substantial procompetitive benefits associated with blanket licenses that distinguish ASCAP's and BMI's activities from other agreements among competitors that present serious issues under the antitrust laws." The Antitrust Division believes that "the current system has well served music creators and music users for decades and should remain intact." Under the current system, music users rely largely on ASCAP and BMI blanket licenses to avoid infringement exposure.

In economic terms, the benefit of a full-work license is that it minimizes transactions costs. There is no need for licensees to negotiate with every fractional owner, some of whom may be difficult to find. An inability to negotiate a license with even a small fractional owner would make the work unusable. Moreover, fractional owners may sometimes have excessive leverage (the holdup problem) in licensing negotiations, leading to higher royalties. This presumably is a major reason why licensees favor and licensors oppose full-work licenses.

Whether ASCAP and BMI currently offer full-work or fractional licenses is the subject of dispute. The Antitrust Division believes that PROs currently do offer, and should continue to offer, full-work licenses, under which the licensee can fully utilize the work even if the PRO members have only a fractional interest. This is also the view of the users (the licensees), including broadcasters, satellite radio, and streaming services.

The PROs and their composer/publisher members — the licensors — assert that the status quo is fractional licensing, which requires licensees to obtain a license from all of the fractional owners of a work, and that this interpretation should continue.

How can these different perceptions of the status quo persist? One explanation lies in the way that licensing for musical composition "public performance" rights occurs today. In the current PRO-based system, licensees typically purchase blanket licenses from the major PROs — ASCAP and BMI — as well as from smaller PROs (SESAC and GMR). In this world, in which music services typically have licenses for virtually everything, whether the licenses are fractional or full-work doesn't make much difference. Having blanket licenses from all of the PROs implies that the licensee has all of the fractions that are necessary to add up to 100 percent.

Conclusion

As a competition agency, the Antitrust Division should encourage more direct bargaining between copyright holders and music users. This is a prerequisite for a more competitive, less regulatory system.[8] In order to encourage more direct bargaining, the division should permit partial withdrawal.

The division is correct that fractional licenses combined with partial withdrawal would likely be a problem, because of the substantial transactions costs involved. Or, put a different way, fractional licenses would increase the transactions-cost-mitigating benefits of the PRO blanket licenses.

As a first step, it would be desirable to encourage more direct bargaining between rights holders and users — via partial withdrawal — which would be difficult with fractional licenses. Therefore, the pro-competitive policy in this situation would be to permit partial withdrawal combined with full-work licenses. Whether the current litigation will arrive at this solution remains to be seen.

Thomas M. Lenard is senior fellow and president emeritus at the Technology Policy Institute. Lawrence J. White is a professor of economics at the NYU Stern School of Business.

The authors thank Dale Collins, Amy Smorodin, Christopher Sprigman and Scott Wallsten for helpful comments, and Brandon Silberstein for helpful research assistance.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] Music performers/artists and their recording companies ("labels") possess a different set of sound-recording copyrights, which are not addressed in this note.

[2] Opinion & Order, In Re Petition of Pandora Media, Inc.: Related to United States of America v. American Society of Composers, Authors, and Publishers, 12 Civ. 8035 (DLC) 41 Civ. 1395 (DLC), 6 F.Supp.3d 317 (S.D.N.Y. Mar. 18, 2014).

[3] Statement of the Department of Justice on the Closing of the Antitrust Division's Review of the ASCAP and BMI Consent Decrees, August 4, 2016.

[4] Opinion & Declaratory Judgment, in United States of America vs. Broadcast Music, Inc., 64 Civ. 3787 (LLS), (S.D.N.Y September 16, 2016).

[5] Notice of Appeal, in United States of America vs. Broadcast Music, Inc., 64 Civ. 3787 (LLS), (S.D.N.Y November 11, 2016).

[6] As non-lawyers, we do not offer any opinion on what the consent decrees require.

[7] Bruce H. Kobayashi, "Opening Pandora's Black Box: A Coasian 1937 View of Performance Rights Organizations in 2014," George Mason University Law and Economics Research Paper Series, December 8, 2014.

[8] As we argue in a forthcoming UCLA Entertainment Law Review article, the creation of a comprehensive database of unique identifiers for all music ownership rights would also be crucial for the development of greater competition. All Content © 2003-2017, Portfolio Media, Inc.