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RECONCEPTUALIZING COMPULSORY COPYRIGHT LICENSES

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ABSTRACT

United States copyright law generally assumes that by providing property entitlements in creative works, the free market will balance between two competing priorities: incentivizing creators to produce works and ensuring the public has adequate access to this content. But the Copyright Act also outlines several detailed compulsory licensing schemes requiring the owners of certain copyright interests, musical works in particular, to license to anyone at government-set prices. Consistent with broader property theory concepts, scholars tend to treat compulsory copyright licenses as liability rules used only to address market failures caused by transaction costs. This Article questions that account, arguing that compulsory licensing also plays an important and underexplored role in furthering copyright's specific policy agenda. A close analysis of the music regulatory regime and its history shows that its primary function has been to recalibrate the balance between creators' financial incentives and public access to expressive works in situations where free market licensing would yield problematic outcomes. Unlike liability rules designed only to address transaction costs, for which regulators generally try to mimic market rates using market proxies, the compulsory music licensing regime traditionally used copyright policy-oriented rate-setting criteria. Applying these criteria, regulators often chose below-market royalty rates in order to allow access-expanding music dissemination technologies—from the player piano to digital radio—to flourish.

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In recent years, however, policymakers have begun to lose sight of this access-encouraging role. A series of legislative changes, including the recent Music Modernization Act ("MMA"), have made the compulsory music licensing regime increasingly inconsistent and ill-equipped to handle new forms of music dissemination. Policymakers now seem to view compulsory licensing as only justified in the face of transaction costs-based market failures and, accordingly, have begun privileging market mimicking over copyright policy when choosing royalty rates. This shift has yielded increasingly high royalty rates, which have made it more difficult for new disseminators, such as streaming services, to facilitate access to music.

The Article argues that this shift away from policy-focused compulsory licensing prevents the regime from maintaining balance in the copyright system, a problem that is especially apparent in the experience of the burgeoning music streaming industry. In particular, a copyright policy-based approach is necessary to prevent the subjectivity and manipulability of market-mimicking rate-setting standards from yielding royalty rates that are unworkable for streaming services. Although the MMA has pushed the existing regime even further away from its original role by implementing a market-focused rate-setting standard, the Article suggests how regulators could still further copyright policy goals in future rate-setting proceedings.

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INTRODUCTION

The United States copyright system generally favors free-market licensing negotiations. For almost all copyright interests, creators of the copyrighted works—or the business entities that frequently hold the actual copyright interests, such as movie studios or book publishers—are free to choose their licensees and negotiate royalties.[1] This Article addresses an outlier: when music distributors like Spotify or Pandora want to obtain licenses in order to disseminate a song, they can sometimes take advantage of compulsory licenses outlined in the Copyright Act.[2] Although these schemes are notoriously complex, their basic function is to allow anyone to license a work without permission of the copyright owner for a predetermined royalty rate, set periodically by a regulatory body known as the Copyright Royalty Board ("CRB").[3]

Many find this unusual regulatory regime difficult to explain or justify, and its very existence is increasingly controversial.[4] As a recent government report noted: "[v]iewed in the abstract, it is almost hard to believe that the U.S. government sets prices for music. In today's world, there is virtually no equivalent for this type of federal intervention."[5] This Article provides a new account and defense of compulsory copyright licensing. By

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[1] 17 U.S.C. § 106 (copyright owners' exclusive rights). *See also Copyright and the Music Marketplace: A Report of the Register of Copyrights*, Chap. 2, 2015 WL 1227760, at *3 [hereinafter *Register's Music Licensing Report*].

[2] 17 U.S.C. §§ 114, 115 (outlining, respectively, the compulsory license for digital performance of sound recording copyrights and the compulsory license for reproduction and distribution of musical compositions in playable forms). There are now several large gaps in the scope of the regime, discussed further below. *See infra* Part III.A.3 (discussing lack of compulsory license for use of sound recordings by interactive streaming services).

[3] 17 U.S.C. § 801. While parties may forego the compulsory licensing regime and negotiate licenses directly or via intermediaries, the shadow of the compulsory licensing regime usually leads the CRB rate to become a de facto cap on any negotiated deals. *See Register's Music Licensing Report, supra* note 1, Chap. 2, 2015 WL 1227760, at *9 (noting this phenomenon); Mark A. Lemley, *Contracting Around Liability Rules*, 100 CAL. L. REV. 463, 479 (2012) (same).

[4] *See, e.g.*, Aloe Blacc et. al., *A Sustainable Music Industry for the 21st Century*, 101 CORNELL L. REV. ONLINE 39, 47 (2016); John Seabrook, *Will Streaming Music Kill Songwriting?* NEW YORKER (Feb. 8, 2016), https://www.newyorker.com/business/currency/will-streaming-music-killsongwriting; *Deregulate the Music Industry*, BLOOMBERG (Dec. 16, 2015), https://www.bloomberg.com/opinion/articles/2015-12-16/deregulate-the-music-industry; Thomas Lenard & Lawrence White, *Moving Music Licensing into the Digital Era: More Competition and Less Regulation*, (Dec. 4, 2015), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2740656&download=yes; Robert Merges, *Compulsory Licensing vs. the Three "Golden Oldies" Property Rights, Contracts, and Markets*, CATO (Jan. 15, 2004) at 1, 4-5.

[5] *Register's Music Licensing Report*, *supra* note 1, Chap. IV 2015 WL 1227762, at *9.

charting the history of the compulsory music licensing regime and its unique policy-oriented approach to royalty rate setting, as well as the trends that have slowly eroded the regime over time, the Article identifies why compulsory licensing remains a necessary regulatory tool for ensuring a well-functioning copyright system, both in the particular case of the music industry and generally.

Today, most scholars and policymakers analyze the compulsory music licensing regime—in addition to the several other industry-specific compulsory licenses in the Copyright Act[6]—through the lens of property and liability rules theory[7] and argue that these licenses are meant to manage transaction costs.[8] A compulsory license, like other liability rules, can remedy transaction costs-related market failures by allowing licensees to bypass costly or unfeasible negotiations. On this account, a distributor like Pandora can take advantage of a compulsory license so that it can forego negotiations with a large number of individual music copyright owners.[9] While some suggest that private ordering would provide better solutions to such

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[6] *See, e.g.*, 17 U.S.C. §§ 111, 117 (cable and satellite rebroadcast compulsory licenses); *see also infra* note 61 and Part II (explaining how these licenses fit more neatly into the conventional transaction costs justification for compulsory licensing, whereas the music regime does not).

[7] *See generally* Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972); *see also infra* Part I.B.

[8] *See* Robert P. Merges, *Of Property Rules, Coase, and Intellectual Property*, 94 COLUM. L. REV. 2655, 2661–62 (1994) (The "common rationale for the several statutory compulsory licenses in copyright law is that they are needed in order for certain types of exchange to take place. Transaction costs preclude the formation of a market for certain types of rights; in the absence of statutorily mandated transactions, none would take place."); *see also, e.g.*, Pamela Samuelson, *Justifications for Copyright Limitations & Exceptions* (Feb. 2015) at 23-27, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2476669; Yafit Lev-Aretz, *The Subtle Incentive Theory of Copyright Licensing*, 80 BROOK. L. REV. 1357, 1378 (2015); Lenard & White, *supra* note 4, at 20; Kristelia A. García, *Private Copyright Reform*, 20 MICH. TELECOMM. & TECH. L. REV. 1, 39 (2013); Richard A. Epstein & F. Scott Kieff, *Questioning the Frequency and Wisdom of Compulsory Licensing for Pharmaceutical Patents*, 78 U. CHI. L. REV. 71, 85 (2011); Daniel A. Crane, *Intellectual Liability*, 88 Tex. L. Rev. 253, 270 (2009); Mark A. Lemley & Philip J. Weiser, *Should Property or Liability Rules Govern Information?*, 85 TEX. L. REV. 783, 825 (2007); Robert P. Merges, *Contracting into Liability Rules: Intellectual Property Rights and Collective Rights Organizations*, 84 CAL. L. REV. 1293, 1311 (1996); Wendy J. Gordon, *Fair Use As Market Failure: A Structural and Economic Analysis of the Betamax Case and Its Predecessors*, 82 COLUM. L. REV. 1600, 1613 (1982); *Register's Music Licensing Report*, supra note 1, Chap. IV., 2015 WL 1227762, at *20.

[9] Kristelia A. García, *Penalty Default Licenses: A Case for Uncertainty*, 89 N.Y.U. L. REV. 1117, 1127 (2014) ("[C]ompulsory licensing occurs in industries such as sound recordings. . . in which individual negotiation with numerous, disparate rights holders would be both time and cost prohibitive.").

problems,[10] the transaction costs account remains the dominant explanation of why copyright, more so than any other form of intellectual property,[11] tolerates compulsory licensing.

While it is true that many modern music distributors utilize the compulsory licensing regime to bypass costly licensing negotiations, the transaction costs account fails to consider the important role that compulsory licensing has played in addressing policy concerns and market failures unique to copyright licensing markets. This Article argues that the compulsory licensing regime should be understood as a mechanism for modulating the tension between copyright's two competing utilitarian priorities: financially incentivizing creators to produce works of value to the public and mitigating the costs that restricting access to such works can impose (known by many as the "incentives/access tradeoff").[12]

The rate-setting context is key to understanding this distinction. Liability rules exclusively focused on remedying transaction costs will generally try to set prices using analogous free-market licensing deals, on the theory that this evidence can help approximate the prices that would prevail in an open market free of transaction costs.[13] In contrast, compulsory music license rate setting traditionally used a set of "policy objectives"[14] codified at 17 U.S.C. § 801(b) (the "801(b) objectives" or "801(b) factors"), designed to

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[10] *See, e.g.*, Robert P. Merges, *Contracting into Liability Rules*, *supra* note 8, at 1311; Howard B. Abrams, *Copyright's First Compulsory License*, 26 SANTA CLARA COMPUTER & HIGH TECH. L.J. 215, 250 (2010); Lydia Pallas Loren, *Untangling the Web of Music Copyrights*, 53 CASE W. RES. L. REV. 673, 710 (2003); I. Trotter Hardy, *Copyright and "New-Use" Technologies*, 23 NOVA L. REV. 659, 701 (1999); Robert P. Merges, *Of Property Rules, Coase, and Intellectual Property*, 94 COLUM. L. REV. 2655, 2662 (1994).

[11] United States patent law permits the government to grant compulsory licenses on a case-by-case basis. But these licenses tend to be limited to specific circumstances, such as where the government has funded the research leading to a patent and where the compulsory license is needed to address a public health or safety concern. *See* 35 U.S.C. § 203 (laying out the government's march-in rights under the Bayh-Doyle Act); *see also* 28 U.S.C. § 1498 (establishing that when the government or its contractors infringe a patent, the patent holder's only remedy is "reasonable compensation" as determined by the Court of Federal Claims).

[12] For purposes of this Article, copyright's "policy" agenda is to balance between these utilitarian goals. *See infra* Part I (examining how copyright provides incentives to create new works, which benefit the public, but also creates costs in the form of deadweight loss and barriers to positive externalities); *see also infra* note 41 (discussing alternative non-utilitarian conceptions of copyright's aims).

[13] *See* Richard A. Posner, *Transaction Costs and Antitrust Concerns in the Licensing of Intellectual Property*, 4 J. MARSHALL REV. INTELL. PROP. L. 325, 328 (2005) ("The fee that the licensee under a compulsory license must pay. . . . is the equivalent of the contract price and is distinct from the transaction costs."). *See generally* Ian Ayres & Eric Talley, *Solomonic Bargaining: Dividing A Legal Entitlement to Facilitate Coasean Trade*, 104 YALE L.J. 1027, 1032 (1995) (explaining the conventional understanding that "liability rules are 'market-mimicking.'"); *see also infra* Part I.A.

[14] SoundExchange, Inc. v. Copyright Royalty Bd., 904 F.3d 41, 56 (D.C. Cir. 2018).

identify the royalty amount that would reward copyright owners and disseminators commensurate to their role in providing the public with access to creative works.[15] Through this unique approach to rate setting, the regime explicitly fostered technologies that expand and enhance access to existing copyrighted works by allowing them to sometimes take advantage of below-market[16] royalty rates.[17] In this respect, compulsory licensing—like the more frequently discussed copyright limitation, fair use[18]—has provided an essential safety valve for preventing the exclusive rights provided by copyright from overly impeding public access to creative works. But unlike fair use, which provides no compensation to copyright owners, the regime accounted for copyright's incentive function by ensuring that copyright owners received some licensing revenue.

Recognizing compulsory copyright licensing as a tool for modulating the incentives/access tradeoff yields three important insights. First, it helps explain the origins of the compulsory music licensing regime and the historical development of its unique rate-setting approach. Second, it calls into question recent legislative and regulatory changes that have eroded aspects of the regime, leading to increasingly inconsistent application of compulsory licensing to new forms of dissemination, such as streaming. Third, it reinforces arguments for the continued relevance of policy-driven compulsory licensing in certain copyright licensing markets.

The original compulsory music license, the "mechanical license," was created in the 1909 Copyright Act to regulate the reproduction of sheet music into "mechanically" playable forms like player piano rolls and records.[19] Though sometimes understood as a response to sui generis monopolization

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[15] 17 U.S.C. § 801(b)(1) (2012); *see also infra* Part II.B.

[16] More specifically, regulators used rates at the lower end of the range suggested by market benchmarks in order to account for the public's interest in access. *See infra* Part III.B.1.

[17] Private licensing of copyright interests covered by the regime is common, but the statutory rates almost always function as a de facto cap. In this respect, the regime has facilitated low rates for disseminators that use the compulsory licenses as well as disseminators that engage in private licensing negotiations in the shadow of the compulsory rate. *See supra* note 3 and *infra* note 100.

[18] Fair use allows for uncompensated use of a copyrighted work on a case-by-case basis. Fair use can also be thought of as a solution to transaction costs-related market failures, but many have argued that it is better understood in more copyright-specific terms. On this account, fair use directly recalibrates the incentives/access tradeoff, enabling specific innovative uses to occur as long as the copyright owner's incentive to create is not disproportionately damaged through harm to her market. *See infra* Part I (drawing a link between fair use and compulsory licensing).

[19] 17 U.S.C. § 115(a).

problems in the early recording industry,[20] the mechanical license is better understood through the lens of copyright's policy agenda. By requiring copyright owners to license their works at a fixed royalty rate, the regime allowed access-expanding technologies of music dissemination—the player piano and phonograph—to flourish, while still ensuring copyright owners received some compensation.[21] In the 1976 Copyright Act, Congress refined the original regime by replacing the fixed rate with an adjustable rate informed by the 801(b) policy factors, thus allowing for a more flexible inquiry into what rate would ideally balance between copyright's priorities.[22] Regulators ultimately applied the 801(b) factors to set rates designed to ensure that burgeoning dissemination industries, such as digital radio, could receive royalty rates that would allow them to thrive, even if those rates were lower than what free market proxies suggested.[23]

In recent years, however, legislative changes have made the compulsory music licensing regime less equipped to enable access-expanding technologies of dissemination to succeed. In particular, some new forms of dissemination, such as on-demand streaming, are now only partially subject to compulsory licensing.[24] The Article argues that many of these changes emerged because policymakers embraced a narrative that sees compulsory licensing as only appropriate for the limited purpose of addressing transaction costs. This narrative has led to the slow erosion of the original policy-based focus of compulsory licensing. Notably, the recently passed Music Modernization Act ("MMA") replaced the 801(b) policy-oriented rate-setting standard with a market-mimicking standard[25] and suggested that the compulsory licensing regime's only role is to address market failures connected to digital distributors' need to engage in bulk licensing of copyrighted content. A market-proxy-privileging narrative has also taken hold in the CRB's rate setting. While past rate-setting decisions recognized that facilitating balance between incentives and access sometimes required departure from market benchmarks, the recent *Phonorecords III*

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[20] *See, e.g.*, Abrams, *supra* note 10, at 220 (explaining the conventional understanding that the license was created over fears that a manufacturer of player piano rolls would monopolize the piano roll market and shut out competitors); Lydia Pallas Loren, *The Dual Narratives in the Landscape of Music Copyright*, 52 HOUS. L. REV. 537, 548 (2014) (same); *see also infra* Part II.A (arguing that the monopoly account is incomplete).

[21] *See* Timothy Wu, *Copyright's Communications Policy*, 103 MICH. L. REV. 278, 297 (2004) (discussing this compromise approach); Jane C. Ginsburg, *Copyright and Control Over New Technologies of Dissemination*, 101 COLUM. L. REV. 1613, 1627 (2001) (same).

[22] *See infra* Part II.B.

[23] *See infra* Parts II.B and III.B.1.

[24] *See infra* Part III.A.3 (discussing differences between "interactive" and "non-interactive" streaming services).

[25] *See* Music Modernization Act, PL 115-264, October 11, 2018, 132 Stat 3676; *see also infra* Part III.A.5.

decision for streaming *only* considered ostensibly free-market proxies. This led to a dramatic rise in royalty rates for streaming services, which will likely limit consumers' access to music.[26]

Music streaming provides an important example of why this erosion is problematic and why compulsory licensing remains a necessary tool for ensuring a well-functioning copyright system. Recent copyright cases in other contexts have highlighted how technologies like streaming benefit the public by expanding and enhancing access to existing copyrighted works.[27] In the music licensing market, however, music copyright owners appear able to use their market power to demand extraordinarily high licensing fees, which have limited streaming services' ability to reach the broadest range of consumers.[28] Compulsory licensing remains uniquely equipped to address these problems and, in so doing, restore balance between incentives and access.

The case of streaming also clarifies why a policy-focused approach to rate setting remains necessary to achieve this balance. Recent rate-setting decisions that have privileged market benchmarks, without considering any broader copyright policy goals, have yielded royalty rates ill-equipped to allow new forms of music dissemination to flourish.[29] More importantly, as the D.C. Circuit has recently recognized, market-mimicking rate-setting standards are inherently subjective when applied to markets, like music, that have always been regulated.[30] Without policy-based guidelines, the proceedings end up at best inconsistent and at worst tainted by manipulation; indeed, in some prior CRB rate-setting decisions under market-mimicking standards, copyright owners introduced strategically inflated licensing deals

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[26] *Phonorecords III*, Initial Determination (Mar. 19, 2018), https://app.crb.gov/case/viewDocument/2288; Paula Parisi, *Copyright Royalty Board Boosts Songwriters' Streaming Pay Nearly 50%,* VARIETY (Jan. 27, 2018), https://variety.com/2018/biz/news/copyright-royalty-board-boosts-songwriters-streaming-pay-nearly-50-1202679118/. In particular, the new rates will likely make it difficult for streaming services to continue to reach the largest range of consumers by offering free ad-supported plans along with subscription plans. *See infra* Part III.B.2. Spotify, Google, Pandora, and Amazon recently announced plans to appeal this decision. *See* Jem Aswad and Chris Willman, *Spotify, Google, Pandora, Amazon Go to U.S. Appeals Court to Overturn Royalty Increase*, VARIETY (Mar. 7, 2019), https://variety.com/2019/music/news/spotify-google-and-pandora-go-to-u-s-appeals-court-to-overturn-royalty-increase-exclusive-1203157697.

[27] *See infra* Part IV.A.1 (discussing recent "utility expanding" fair use case law).

[28] *See infra* Part IV.A.2.

[29] *See infra* Parts III.B.2 and IV.B.1.

[30] *See* SoundExchange, Inc. v. Copyright Royalty Bd., 904 F.3d 41, 56 (D.C. Cir. 2018) (noting "the inherent ambiguity" in the "willing buyer and willing seller" rate-setting standard).

in order to manipulate the regulators' analysis.[31] The subjectivity of market-mimicking rate-setting standards, however, could potentially be used to allow the compulsory licensing regime to once again facilitate balance in the music copyright system. Drawing on some recent rate-setting decisions, the Article suggests how future rate setting could again account for copyright policy goals, even though the MMA has replaced the 801(b) policy factors with an ostensibly market-mimicking "willing buyer and seller" standard.[32]

The Article proceeds in four Parts. Part I presents competing theoretical rationales for compulsory copyright licensing by examining the concept in relation to copyright's fair use doctrine, arguing that, like fair use, compulsory licensing should be conceived of not simply as a tool for remedying transaction costs but rather as a broader mechanism capable of addressing copyright-specific concerns over incentives and access. Part II explores the origins of compulsory music licensing and its unique approach to rate setting, explaining how the regime originally focused on facilitating copyright policy goals. Part III examines the complex trends that have eroded this original purpose and led to a compulsory music licensing regime that is now both inconsistently applied and increasingly ill-equipped to address new dissemination technologies. Part IV makes the normative argument that compulsory licensing should still be recognized as a tool for moderating between copyright's competing priorities and, thus, should continue to play a role in ensuring that new access-expanding forms of dissemination, like streaming, can succeed. Part IV also points to some ways that this goal can be achieved under the compulsory music licensing regime's current statutory framework.

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This Article deals with a particularly complex and confusing area of copyright law. Some additional background may prove helpful.

Music is unusual among copyright goods in that it implicates two, often separately owned, copyright interests. There is the "musical composition," the collection of notes, orchestration, lyrics, and the like, and the "sound recording," the actual recorded, listenable version of the song.[33] These interests may be owned exclusively by the creators of the works—composers and recording artists—but are more often owned in whole or in part by business entities such as music publishers and record labels. Thus, playing Celine Dion's 1996 recording of *It's All Coming Back to Me* can

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[31] *See infra* Part IV.B.2.

[32] *See infra* Part IV.C.

[33] The sound recording copyright is a relatively new creation and remains somewhat limited in scope, as explained further below.

implicate both a sound recording copyright (co-owned by Dion's record labels, Columbia Records and Epic Records) and a copyright in the underlying musical composition (co-owned by composer Jim Steinman and music publisher Universal Music Publishing Group).[34]

Every distinct copyright interest also carries with it a number of separately enumerated exclusive rights: most importantly, the rights to reproduce a copyrighted work and distribute copies (for example, selling copies of a book),[35] the right to publicly perform a copyrighted work (for example, performing a play or broadcasting a song on the radio),[36] and the right to make a "derivative work," *i.e.* a work "based upon one or more preexisting works" (for example, translating a poem or adapting a novel into a television show).[37]

The creation and dissemination of a new recording[38]—such as Dion's original recording and sale of *It's All Coming Back to Me*—implicates the reproduction/distribution rights of the musical composition copyright owner.[39] As explained in Part II, this relationship has, to a large extent, been regulated by a compulsory license. The resulting sound recording is protected by a copyright distinct from the musical composition.

The dissemination of *existing* recorded songs by third parties implicates both the musical composition copyright and (with some exceptions) the sound recording copyright. Where things get particularly confusing, however, is that different forms of dissemination are understood to involve different exclusive rights. For example, the sale of a digital file of Dion's *It's All Coming Back to Me* by iTunes implicates the *reproduction/distribution* rights for both the musical composition and sound recording copyrights, but playing the song on a satellite radio station implicates the *public performance* rights for both the musical composition and the sound recording. As Part III explores in more detail, Congress and regulators have often struggled to come up with coherent ways of applying these exclusive rights to new forms of dissemination, such as music

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[34] Universal Music Publishing Group, It's All Coming Back To Me, https://www.umusicpub.com/il/Digital-Music-Library/song/155986/celine-dion-its-all-coming-back-to-me-now-radio-edit; *see also* Andrea Warner, *Celine Dion, Meat Loaf, Jim Steinman and the Weird, Wonderful and Sometimes Sad History of 'It's All Coming Back to Me Now'* CBC MUSIC (Feb. 1, 2016), https://www.cbcmusic.ca/posts/11113/celine-dion-meat-loaf-more-the-weird-wonderful-and.

[35] 17 U.S.C. § 106(1), (3).

[36] 17 U.S.C. § 106(4).

[37] 17 U.S.C. § 106(2); *see also* 17 U.S.C. § 101.

[38] Or any device capable of replaying a piece of music, such as a player piano roll. *See infra* Part II.A.

[39] 17 U.S.C. § 106(1), (3) (discussing right to reproduce and distribute "phonorecords"); 17 U.S.C. § 101 (defining phonorecords).

streaming. What has resulted is a highly complex web of regulation, in which different forms of dissemination, including uses that seem analogous, are now subject to compulsory licensing whereas others are not.

I. JUSTIFICATIONS FOR COMPULSORY COPYRIGHT LICENSING

Copyright is predominantly understood as an "instrumentally driven entitlement" designed to incentivize the creation of expressive works.[40] This is certainly not the only account of why the law recognizes property rights in information, but it is one of the most ubiquitous in American law and legal scholarship.[41] According to the instrumentalist explanation, by granting property entitlements in works of authorship, copyright law allows creators to charge for access. This ensures that authors are motivated to invest the time and money necessary to create new works without concern that freeriding by the public will leave them without any reward for their efforts.[42]

At the same time, copyright law recognizes that propertization has the potential to allow copyright owners to charge a premium for works, which generates costs.[43] This tradeoff is a central concern of copyright law. As Judge Richard Posner and William Landes explain:

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[40] Shyamkrishna Balganesh, *Foreseeability and Copyright Incentives*, 122 HARV. L. REV. 1569, 1572 (2009).

[41] There are other non-utilitarian justifications for copyright, including theories that tie copyright to labor desert or personhood concepts. *See generally* William Fisher, *Theories of Intellectual Property*, in NEW ESSAYS IN THE LEGAL AND POLITICAL THEORY OF PROPERTY 169 (Stephen R. Munzer ed., 2001). But the utilitarian account is by far the most prevalent in Anglo-American copyright law. For that reason, alternative theories are generally outside the scope of this Article.

[42] Jeanne C. Fromer, *Market Effects Bearing on Fair Use*, 90 WASH. L. REV. 615, 620–21 (2015). Put another way, copyright addresses a public goods problem. The expressive material covered by copyright is by its nature non-excludable and non-rivalrous. Whereas a chattel can (generally) only be utilized by one person at a time, expressive content can in theory be duplicated and used by any number of people, with creators unable to prevent such use. For that reason, there is a risk that this material will be underproduced unless copyright grants authors a right to exclude that allows them to prevent freeriding. *See* WILLIAM M. LANDES & RICHARD A. POSNER, THE ECONOMIC STRUCTURE OF INTELLECTUAL PROPERTY LAW 13 (2003); Matthew J. Sag, *Beyond Abstraction: The Law and Economics of Copyright Scope and Doctrinal Efficiency*, 81 TUL. L. REV. 187, 193-94 (2006).

[43] In economic terms, copyright generates deadweight loss: authors can charge prices well above the marginal cost of producing the good (in the case of subsequent copies of goods like songs or novels—especially digital copies—these costs are often close to zero), which are higher than the price that some users would be willing to pay. Sag, *supra* note 42, at 187; Mark A. Lemley*, Property, Intellectual Property, and Free Riding,* 83 TEX. L. REV. 1031, 1058-65 (2005). This immediate frustration of users' access is often thought of as a static inefficiency. Copyright is also accused of creating a dynamic inefficiency by preventing new authors from using existing creative works to create new works. *See* Balganesh, *supra* note 40, at 1578. Another way of conceiving this dynamic inefficiency is

> Unless there is power to exclude, the incentive to create intellectual property in the first place may be impaired. . . . [T]he result is the "access versus incentives" tradeoff: charging a price for a public good reduces access to it (a social cost), making it artificially scarce . . . but increases the incentive to create it in the first place, which is a possibly offsetting social benefit.[44]

To effectuate balance, copyright imposes several built-in limitations to any copyright entitlement. For example, copyright entitlements are time-limited, meaning that works will enter the public domain, available for use by anyone, after a certain amount of time.[45] Armed with these and other built-in limitations, copyright entitlements are expected, according to some, to optimally embody a tradeoff between incentives and access, allowing authors to profit off of their works through the market, while still ensuring that the public and other creators are not unduly restricted from accessing them.[46]

However, copyright law also employs mechanisms designed to bypass market-based transactions through state-imposed transfers. As this Part explains, these mechanisms can be understood as remedying the kinds of market failures that can impede any market from operating efficiently, but they can also be understood as playing a role more closely related to market failures tied to copyright's specific concerns over incentives and access.

A. Compulsory Licenses as a Response to Transaction Costs

Property rights are premised on the assumption that parties will engage in bargaining in the marketplace to facilitate the most efficient

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that IP "privileges initial inventors at the expense of improvers and may therefore actually reduce the size of positive externalities from invention by discouraging the improvements and new uses which generate those externalities." Lemley, *supra* at 1058-65.

[44] LANDES & POSNER, *supra* note 42, at 21.

[45] Brett M. Frischmann & Mark A. Lemley, *Spillovers*, 107 COLUM. L. REV. 257, 285 (2007).

[46] Christopher S. Yoo, *Copyright and Product Differentiation*, 79 N.Y.U. L. REV. 212, 231 (2004) (explaining that copyright presumes that the government will "calibrate the level of copyright protection so as to permit the greatest possible degree of access while still providing sufficient incentives for the work to be created in the first place"); Neil Weinstock Netanel, *Impose A Noncommercial Use Levy to Allow Free Peer-to-Peer File Sharing*, 17 HARV. J.L. & TECH. 1, 28–29 (2003); LANDES & POSNER, *supra* note 42, at 11-36; Joseph P. Liu, *Regulatory Copyright*, 83 N.C. L. REV. 87, 101-02 (2004); *see also* Mazer v. Stein, 347 U.S. 201, 219 (1954) ("The economic philosophy behind the clause empowering Congress to grant patents and copyrights is the conviction that encouragement of individual effort by personal gain is the best way to advance public welfare through the talents of authors and inventors in 'Science and useful Arts.'").

allocation of resources.[47] This private ordering presumption is no less true in the case of entitlements, like copyright, strategically granted for instrumental reasons; indeed, markets are essential to allowing copyright to accomplish its goals.[48] But numerous factors can impede the development of efficient markets, and the law has developed various tools to address these problems. In the classic formulation by Judge Guido Calabresi and Douglas Melamed, the state can protect an entitlement using either "property rules" or "liability rules." Property rules protect the entitlement holder from nonconsensual takings by using tools such as injunctions (designed to undo the taking) or by using deterrence strategies such as punitive damages.[49] These strong remedies are premised on the assumption that the ideal allocation will occur if private parties bargain over resources.[50]

But the state may sometimes govern an entitlement with a "liability rule," namely, a rule that permits the transfer of an entitlement in exchange for a fee set by a court or regulatory body using an "external, objective standard of value."[51] The predominant justification for liability rules is the transaction costs that can impede efficient bargaining in any property regime, both real and intangible.[52] As Mark Lemley and Philip Weiser have noted, the transaction costs concept, as developed by Calabresi and Melamed, actually refers to a range of different phenomena. First, there is the difficulty and expense of contracting with multiple parties; at times these costs of doing business can exceed the value of the actual transaction, preventing it from taking place.[53] Second, there is the potential that property owners will engage in strategic behavior, such as holdout strategies, where they recognize that their bargaining position allows them to charge an inflated price.[54] Holdout problems frequently occur in situations where a buyer must aggregate rights from many different sellers.[55] In both of these types of cases, courts or

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[47] *See* LANDES & POSNER, *supra* note 42, at 414 ("Markets and property rights go hand in hand. Property rights provide the basic incentives for private economic activity and also the starting point for transactions whereby resources are shifted to their most valuable use.")

[48] Gordon, *supra* note 8, at 1604 ("[T]he copyright system creates private property in creative works so that the market can simultaneously provide economic incentives for authors and disseminate authored works.").

[49] Calabresi & Melamed, *supra* note 7, at 1092, 1106.

[50] *See* BJ Ard, *More Property Rules Than Property?: The Right to Exclude in Patent and Copyright*, at 13-14 (draft on file).

[51] *Id*. at 1105-06.

[52] Mark A. Lemley & Philip J. Weiser, *Should Property or Liability Rules Govern Information?*, 85 TEX. L. REV. 783, 786 (2007).

[53] *Id*.

[54] *Id*.

[55] A classic example is a landowner who recognizes her ability to frustrate a large-scale real estate development project and thus holds out for a price higher than what she would otherwise charge. Calabresi & Melamed, *supra* note 7, at 1106-07. Other examples are

regulators can establish a liability rule in order to bypass the market transaction process.[56] The buyer or licensor is able to buy or use the property in question while the owner receives fair compensation, generally based on the hypothetical rate that would otherwise have prevailed in a market free of transaction costs.[57]

The property rules-liability rules divide is frequently discussed in the remedies context, but liability rules can also be applied ex ante through government regulation: a government agency or court sets a compulsory price for use of a certain asset that applies across the board.[58] Such ex ante liability rule regimes are more common in copyright than other forms of intellectual property, where they take the form of the several compulsory license regimes outlined in the Copyright Act.[59]

The Copyright Act's statutory compulsory licenses are frequently justified using transaction cost rationales, and in particular transactions costs caused by the difficulty of contracting with multiple small copyright owner entities..[60] As Kristelia García explains, the conventional understanding is that "compulsory licensing occurs in industries such as sound recordings and cable broadcasting in which individual negotiation with numerous, disparate rights holders would be both time and cost prohibitive." To address such transaction costs, "these industries allows for efficient en masse licensing of content and subsequent scalability of service where individual transactions are not practicable."[61] On this account, compulsory licenses are expected to

common carriers or public utilities, which, by virtue of their monopoly position, can demand high prices from consumers. Richard A. Epstein, *A Clear View of the Cathedral: The Dominance of Property Rules*, 106 YALE L.J. 2091, 2118–20 (1997) (discussing common carriers).

[56] Calabresi & Melamed, *supra* note 7, at 1107.

[57] *See* Ayres & Talley, *supra* note 13, at 1032 (explaining the conventional understanding that, when it comes to determining fair value, "liability rules are 'market-mimicking.'").

[58] *See* Lemley & Weiser, supra note 52, at 829 (discussing "liability rules administered by an agency").

[59] *See* 17 U.S.C. §§ 111, 114, 115, 118. The antitrust consent decrees that govern the performance rights organizations ASCAP and BMI are another form of liability rule used in copyright law, although the structure of these regimes differs from the many of the statutory licenses contained in the Copyright Act. *See supra* Part III.A.2.

[60] *See* sources cited *supra* note 8.

[61] García, *supra* note 9, at 1127. For example, when Congress created the compulsory licensing regime for television programs that are first transmitted via broadcast, the House Report explained that "it would be impractical and unduly burdensome to require every cable system to negotiate [royalties] with every copyright owner" to obtain content for cable retransmissions. H.R. Rep. No. 94-1476, at 89 (1976), *reprinted in* 1976 U.S.C.C.A.N. 5659, 5704; *see also* Liu, *supra* note 46, at 130; Samuelson, *supra* note 8, at 23-24. Compulsory licenses are also occasionally—though, nowadays rarely—used to address market power imbalances, in particular where a party's aggregation of intellectual property interests allows

ensure the most efficient allocation of copyrighted works. Though, as some have argued, they often carry other inefficiencies with them,[62] leading many to believe that private ordering in the marketplace may still be most effective and more desirable.[63]

B. Zero-Price Licenses and the Incentives/Access Tradeoff

Copyright law also employs mechanisms akin to compulsory licenses that can be understood to be focused on goals distinct from the remediation of transaction costs barriers to free market licensing. In particular, copyright's fair use doctrine permits what would otherwise be an infringing use of a copyrighted work. In the context of an infringement lawsuit, a court can find fair use through an inquiry into a set of subjective criteria, most importantly, the "purpose and character" of the defendant's use and the "effect of the use upon the potential market for or value of the copyrighted work."[64] A paradigmatic example of fair use is the use of a work for news reporting or criticism, but fair use has been found in many other contexts.[65]

Fair use can be conceived of as a "zero price" compulsory license. Essentially, a court permits a defendant to use the work for a specific purpose while providing no compensation to the copyright owner.[66] Drawing on this

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them to amass market power and charge above-market prices. *See* 1 HERBERT HOVENKAMP, MARK D. JANIS, MARK A. LEMLEY , CHRISTOPHER R. LESLIE & MICHAEL A. CARRIER, IP AND ANTITRUST: AN ANALYSIS OF ANTITRUST PRINCIPLES APPLIED TO INTELLECTUAL PROPERTY LAW 6-61 – 6-67 (3rd Ed., 2018) [hereinafter IP AND ANTITRUST]; Crane, *supra* note 8, at 269 (2009) (discussing performance right organization consent decrees, which have been partially incorporated into the Copyright Act); *see also infra* Parts III.A.2 (discussing performance rights organizations) and IV.A.2 (discussing the intersection of antitrust and copyright in the compulsory licensing context).

[62] Richard A. Epstein, *A Clear View of the Cathedral: The Dominance of Property Rules*, 106 YALE L.J. 2091, 2093 (1997); Merges, *supra* note 8, at 1311-17.

[63] Merges, *supra* note 8, at 1302–03. *See also infra* Part III.A.2 (discussing Merges' primary example of this trend, the Performance Rights Organizations ASCAP and BMI). Scholars, in recent years, have tried to move past a strict property rules-liability rules divide by noting that efficient private ordering in intellectual property markets can occur even in the face of liability rules. Some have even argued that certain forms of seemingly inefficient liability rules are the most conducive to efficient private ordering because the prospect of the application of an unpalatable liability rule (otherwise known as a penalty default) incentivizes parties to reach agreement when parties are uncertain about whom the penalty default would favor. *See* García, *supra* note 9, at 1163–64.

[64] 17 U.S.C. § 107.

[65] *See* Pamela Samuelson, *Unbundling Fair Uses*, 77 FORDHAM L. REV. 2537, 2544 (2009).

[66] *Cf.* Lemley, *supra* note 3, at 480 ("[Zero price liability rules] are more commonly thought of as exemptions from, or defenses to, copyright liability. They permit the defendant to act, imposing neither an injunction nor damages liability. At the same time, they are not property rules that vest in copyright defendants the right to stop interference with the exercise

conception, a highly influential theory, first advanced by Wendy Gordon, argues that fair use, like the liability rules described above, is primarily concerned with addressing market failures caused by transaction costs.[67] Though the full scope of Gordon's early work in this field is frequently contested, including by Gordon herself,[68] the theory essentially claims that a finding of fair use is most appropriate when secondary users have been unable to engage in a socially valuable use of copyrighted material because transaction costs have prevented market-based licensing from taking place.[69] Gordon's market failure theory appeared to be borne out in the Supreme Court's decision in *Sony Corp of America v. Universal City Studios, Inc.*,[70] in which the Court found fair use when consumers used Betamax video recorders to watch television content after it had aired. The Court thus concluded that the makers of the device should not be liable for contributory copyright infringement. Under a transaction costs remediation account, this outcome makes sense: it would have been impossible for consumers or the Betamax manufacturers to secure permission from the copyright owners of every television work (a huge number of licensees and licensors) to record these works for later watching. As voluntary transactions would have been impeded by transaction costs, the fair use doctrine stepped in to allow consumers to continue recording programs, even without permission from the copyright owners.[71]

An implication of the transaction costs-focused account of fair use, however, is that the setting of a market price might be a preferable way to remedy transactions costs, as the property-liability rules scholarship described above generally takes for granted. Fair use's zero-price approach

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of the right."); Lemley & Weiser, *supra* note 52, at 790 (calling fair use a zero-price liability rule).

[67] Gordon, *supra* note 8, at 1615.

[68] *See, e.g.*, Wendy J. Gordon, *Excuse and Justification in the Law of Fair Use: Transaction Costs Have Always Been Only Part of the Story*, 50 J. COPYRIGHT SOC'Y U.S.A. 149 (2003).

[69] While Gordon does not limit her discussion to market failures caused by transaction costs, this had been the primary interpretation of her theory. *See* Sag, *supra* note 42, at 227 ("Applications of Gordon's market-failure framework have largely concentrated on the role of transaction costs in justifying fair use."); Ben Depoorter & Francesco Parisi, *Fair Use and Copyright Protection: A Price Theory Explanation*, 21 INT'L REV. L. & ECON. 453, 456 (2002) (explaining that under this theory, "the fair-use doctrine effectively 'reallocates' ownership rights in order to minimize the negative efficiency consequences of positive transaction costs in the market"); *see also, e.g.*, Tom W. Bell, *Fair Use vs. Fared Use: The Impact of Automated Rights Management on Copyright's Fair Use Doctrine*, 76 N.C. L. REV. 557, 583 (1998) ("[T]he scope of the fair use defense rises and falls with the transaction costs of licensing access to copyrighted works.").

[70] Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417 (1984).

[71] Abraham Bell & Gideon Parchomovsky, *The Dual-Grant Theory of Fair Use*, 83 U. CHI. L. REV. 1051, 1066–67 (2016).

fits uneasily with this conclusion.[72] A further implication is that fair use would no longer be necessary in situations where transaction costs could be minimized through means other than judicial intervention, such as technologies that make it easier for licensees to transact with licensors.[73] This has led to several arguments that fair use can and will become largely unnecessary as new technology allows for more efficient market transactions.[74]

Seeing these arguments as challenges to fair use's continued existence, many scholars have questioned the transaction costs theory altogether, both in normative and empirical terms. Some argue that, from an economic perspective, an account of market failure focused only on transaction costs is ill-suited to the unique nature of copyright goods. Glynn Lunney, in particular, explains that market failures based on transaction costs are usually most problematic in markets for private goods, which are rivalrous (*i.e.* the consumption of the good by one consumer inherently prevents others from consuming it). In contrast, works of information are public goods, which are inherently non-rivalrous. In private goods markets, the elimination of transaction costs enhances welfare by ensuring the market can efficiently allocate this limited supply of goods.[75] This logic does not necessarily hold true for copyrights, which are specially created property entitlements designed to render non-rivalrous and non-excludable works of information excludable.[76] Even if transaction costs in copyright markets are eliminated, copyright will continue to generate inefficiencies—in particular, what economists call deadweight loss—by allowing authors to charge above marginal cost for their works and excluding consumers who are unwilling to pay this price.[77]

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[72] Gordon's original article dabbled with the idea of replacing fair use, in certain cases, with a liability rule based on a market-mimicking price, but rejected this idea primarily because of concerns about judicial expertise and political unfeasibility. *See* Gordon, *supra* note 8, at 1623.

[73] Gordon, *supra* note 68, at 189; Depoorter & Parisi, *supra* note 69, at 456-57.

[74] Robert P. Merges, *The End of Friction? Property Rights and Contract in the "Newtonian" World of On-Line Commerce*, 12 BERKELEY TECH. L.J. 115, 129 (1997); *see also* PAUL GOLDSTEIN, COPYRIGHT'S HIGHWAY: FROM GUTENBERG TO THE CELESTIAL JUKEBOX 202-03 (2d ed., 2003) (describing transaction costs-reducing technologies); *see also* Frank Pasquale, *Breaking the Vicious Circularity:* Sony*'s Contribution to the Fair Use Doctrine*, 55 CASE W. RES. L. REV. 777, 779 (2005).

[75] Glynn S. Lunney, Jr., *Fair Use and Market Failure: Sony Revisited*, 82 B.U. L. REV. 975, 992-94 (2002).

[76] *Id*. at 1030.

[77] *Id.* at 993–96 ("Because market failure is inevitable, the concept of market failure cannot serve as a useful guide in determining which uses of a copyrighted work should be fair and which uses unfair."). Lunney suggests that if copyright owners were able to perfectly

Lunney recognizes that tolerating this deadweight loss may be warranted to ensure authors have adequate incentive to innovate, as is consistent with the conventional instrumentalist justification for copyright markets.[78] However, he views fair use as a mechanism for renegotiating the incentives/access tradeoff on a case-by-case basis. Seen through this lens, fair use allows a court to directly balance between the public's interest in unimpeded access to certain works with the harm to authors' incentives that might arise from permitting uncompensated use.[79] This analysis may sometimes track the direction that a licensing market free of transaction costs might lead, but it may also support the conclusion that consumers should be allowed free use of a work notwithstanding what a market-based allocation of copyright entitlements would dictate.[80] Thus, under Lunney's theory, cases like *Sony* do not rest on the unfeasibility of licensing markets, but rather the "competing public interests at stake. On one side of this balance, unauthorized time-shifting 'yields societal benefits' by 'expand[ing] public access to freely broadcast television programs.' On the other, unauthorized time-shifting might reduce the supply and variety of original works available by impairing the incentives for their creation."[81]

A similar theory treats fair use as a tool for ensuring that the "spillovers," or positive externalities, generated by uses of copyright goods can occur.[82] Mark Lemley and Brett Frishchmann explain that access to existing copyrighted works can generate a range of such spillovers, including the creation of new works that incorporate existing content and the development of complementary technologies that enhance enjoyment of works for consumers.[83] Like Lunney, Lemley and Frischmann find the transaction costs account of fair use too limiting.[84] Instead, fair use should be understood as a mechanism for balancing between the value of copyright spillovers and the potential loss to copyright's incentive function that would occur through allowing uncompensated use.[85]

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price discriminate (generally understood to be impossible in the real world), this deadweight loss would also be remedied. *See id*. at 995.

[78] Lunney, *supra* note 75, at 993–96; *see also* discussion *supra* notes 41-46.

[79] Lunney, *supra* note 75, at 993–96.

[80] *Id*. at 1030.

[81] *Id*. at 981–82 (2002) (citing *Sony*).

[82] *See* Frischmann & Lemley, *supra* note 45, at 288–89 ("Many paradigmatic uses deemed fair involve use of a work to engage in activities that yield diffuse, small-scale spillovers to a community.").

[83] *Id*. at 285-86.

[84] *Id*. at 288.

[85] *Id*. at 289–90 ("Courts ask whether the defendant's use leads to a substitute expression. . . . To the extent that substitution is likely, there is likely a greater impact on incentives, and this is a social cost to deeming the use fair. If market substitution is unlikely, however, the risk to incentives is smaller.").

The narrow transaction-costs-focused version of fair use and the more expansive approach embraced by Lunney, Lemley and Frischmann, and others[86] rest on different conceptions of how copyright markets fail, though both are grounded in economic theory.[87] The former sees transactions costs as the only meaningful barrier to otherwise efficient allocations of copyright goods in the marketplace, whereas the latter considers factors like deadweight loss and externalities as relevant to fair use's role in ensuring a well-functioning copyright system.[88] Some other scholars avoid economic analysis but share the view that fair use should be conceived of as a tool for directly weighing the incentives provided by copyright against the social goals founded on public access to works, noting that this balancing approach provides a better explanation of the actual fair use case law in recent decades. Barton Beebe, in an empirical study of fair use decisions, explains that "[i]n practice, judges appear to apply [fair use] in the form of a cognitively more familiar two-sided balancing test in which they weigh the strength of the defendant's justification for its use. . . against the impact of that use on the

[86] *See, e.g.*, William W. Fisher III, *Reconstructing the Fair Use Doctrine*, 101 HARV. L. REV. 1659 (1988); Bell & Parchomovsky, *supra* note 71, at 1056 (arguing that "[f]air use helps filter protections to ensure efficient allocation of uses to societally favored users while still fully maintaining the incentive effects of copyright protection for authors"); Depoorter & Parisi, *supra* note 69, at 458 ("Fair-use defenses can be regarded as justifiable and instrumental in minimizing the welfare losses occasioned by the strategic behavior of the copyright holders."); Lydia Pallas Loren, *Redefining the Market Failure Approach to Fair Use in an Era of Copyright Permission Systems,* 5 J. INTELL. PROP. L. 1, 49 (1997).

[87] *See* Sag, *supra* note 42 (distinguishing between the transaction costs approach to fair use and, what the author calls a "cost-benefit" approach advanced by Lunney, Fisher, and other scholars but noting that both are grounded in economic reasoning).

[88] These competing emphases underscore a deeper debate in copyright scholarship about the limits of markets in facilitating copyright's policy goals. As Shyam Balganesh has noted, the transaction costs approach assumes that the "incentive provided by copyright's promise of exclusivity. . . correlate[s] directly with the overall production of creative expression" and couples these "neoclassical assumptions. . . with property ideas." Balganesh, *supra* note 40, at 1580; *see* Bell & Parchomovsky, *supra* note 71, at 1054–55 ("The market-failure theory implicitly presumes that the efficient economic strategy for allocating copyright rights is to grant them in their entirety to the author."). In contrast, a second camp is more skeptical of the possibility that propertization will, in and of itself, yield an optimal distribution of creative works. They generally recognize the importance of markets for incentivizing new works (though some dispute this altogether), but qualify this endorsement with a "concern for copyright's social cost." Accordingly, they "question the desirability of expanding copyright beyond the minimum necessary to provide authors with an incentive to produce." Balganesh, *supra* note 40, at 1580; *see* Neil Weinstock Netanel, *Copyright and A Democratic Civil Society*, 106 YALE L.J. 283, 308 (1996); Frischmann & Lemley, *supra* note 86, at 285-90; *see also* Sag, *supra* note 42, at 226–27 (noting that some analyses of fair use convey a "deep pessimism in the capacity of market institutions to provide the kind of flexibility that the users of copyrighted works require").

incentives of the plaintiff."[89] Similarly, Pamela Samuelson has divided fair use cases into several "policy-relevant clusters" but also explained that the core function of fair use is negotiating copyright's "limited monopoly," by allowing the public to use copyrighted works in situations where the market harm to the copyright owner (and, by implication the harm to her incentive to create) would be low.[90] Neil Netanel has linked this limited monopoly approach to the transformative use conception of fair use introduced by Judge Pierre Leval in an influential 1990 law review article and adopted by the Supreme Court in *Campbell v. Acuff-Rose*.[91] Netanel argues that this approach "overwhelmingly drives fair use analysis in the courts today."[92]

C. Bridging the Gap: Compulsory Licensing as a Tool of Copyright Policy

The last two Sections identified two approaches to liability rules in the copyright system. The Copyright Act's industry-specific liability rules, including the compulsory music licenses, are understood predominantly through the lens of the transaction costs that can impede the development of conventional markets, especially the difficulty and expense of contracting with multiple parties. Fair use, in contrast, is often analyzed through the unique policy objectives that copyright is designed to facilitate, in particular how best to ensure authors have incentives to create while avoiding the social costs (such as deadweight loss or barriers to positive externalities) that can occur when the public's access to creative works is overly restricted.

While the different results of these two approaches are widely acknowledged in the fair use context, scholars generally do not treat the Copyright Act's extant compulsory licensing schemes in copyright-specific

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[89] Barton Beebe, *An Empirical Study of U.S. Copyright Fair Use Opinions, 1978-2005*, 156 U. PA. L. REV. 549, 621 (2008).

[90] Samuelson, *supra* note 65, at 2617; *see also* Pamela Samuelson, *The Relative Virtues of Bottom-Up and Top-Down Theories of Fair Use A Response to Abraham Bell and Gideon Parchomovsky*, 83 U. CHI. L. REV. ONLINE 206, 208–09 (2017) (reiterating the "bottom-up limited monopoly theory").

[91] Neil Weinstock Netanel, *Making Sense of Fair Use*, 15 LEWIS & CLARK L. REV. 715, 736 (2011) (noting that unlike the market failure approach, "[t]he transformative use paradigm views fair use as integral to copyright's purpose of promoting widespread dissemination of creative expression, not a disfavored exception to copyright holders' exclusive rights."); *see also* Campbell v. Acuff-Rose Music, Inc., 510 U.S. 569, 576 (1994); Pierre N. Leval, *Toward a Fair Use Standard*, 103 HARV. L. REV. 1105 (1990).

[92] Netanel, *supra* note 91, at 734; *see also* Bell & Parchomovsky, *supra* note 71, at 1067 (calling *Sony* the "the high-water mark for the market-failure theory" and arguing that the Supreme court and other courts have since embraced the idea that fair use is not an anomaly, only used to address transaction costs, but an "intrinsic and indispensable part of the design of the constitutional copyright system."); Rebecca Tushnet, *Content, Purpose, or Both?,* 90 WASH. L. REV. 869, 883 (2015) (discussing general expansion of fair use in recent year).

terms, instead describing them as addressing more conventional transaction costs-based market failures.[93] The argument of this Article is that the Copyright Act's compulsory licensing regimes are also informed by an impulse similar to fair use: to weigh the importance of public access to creative works against the incentive function provided by market-based licensing. In this respect, just as fair use provides a zero-price compulsory license in order to selectively rebalance the incentives/access tradeoff, so too an industry-wide compulsory license can price royalties at rates explicitly designed to foster access, sometimes meaning copyright owners are compensated less than in open markets. In so doing, these regimes can—and, as the next Parts argue have—attempted to mitigate some of the social costs imposed by copyright's exclusive rights.

Fair use's zero-price approach is of course distinct from the compulsory licensing system's price-setting scheme, which provides some compensation to copyright owners. In this respect, fair use might be

[93] *See supra* note 8. The notion that a compulsory licensing regime *could* be used to renegotiate the incentives/access tradeoff is not a new idea from a theoretical perspective. There are a number of scholars who have proposed hypothetical compulsory licensing schemes, designed to replace the traditional property-based approach to copyright, in order to address the importance of public access to creative works. In particular, when the disruption to copyright industries posed by peer-to-peer file sharing was at its height in the early 2000s, several scholars proposed the creation of a system that would allow consumers to use shared copyrighted music and films without the consent of the copyright owners, in exchange for a fixed fee. William Fisher, for example, proposed an administrative compensation system in which users would receive a compulsory license to reproduce or distribute audio and video recordings over the internet, and copyright owners would be compensated, in proportion to the use of their content, via proceeds from a tax placed on digital recording devices, storage media, and internet services. WILLIAM W. FISHER, PROMISES TO KEEP: TECHNOLOGY, LAW, AND THE FUTURE OF ENTERTAINMENT 203-58 (2004); *see also e.g.*, Netanel, *supra* note 46, at 4 (Netanel essentially proposed that individual consumers be allowed to noncommercially use copyrighted materials distributed via peer to peer file sharing as long as they pay a levy on the "sale of any consumer product or service whose value is substantially enhanced by P2P file sharing . . . [such as] Internet access, P2P software and services, computer hardware, consumer electronic devices." Proceeds from this levy would be used to compensate copyright owners.); *see also* Jessica Litman, *Sharing and Stealing*, 27 HASTINGS COMM. & ENT L.J. 1, 32–38 (2004) (summarizing various proposals). In structuring these compulsory licensing regimes, these scholars invoked an incentives/access-focused conception of compulsory licensing, rather than the transaction costs rationale that is frequently used to explain the Copyright Act's existing compulsory licensing schemes. *See* Netanel, *supra* note 46, at 46; *see also* Raymond Shih Ray Ku, *The Creative Destruction of Copyright: Napster and the New Economics of Digital Technology*, 69 U. CHI. L. REV. 263, 299-324 (2002) (grounding a proposed compulsory licensing scheme in the "incentive-access paradox"). While these scholars were primarily interested in identifying new regimes to *replace* many aspects of copyright's property-centric structure, this Article argues that Copyright Act's *existing* compulsory licenses also serve to facilitate balance in the incentives/access tradeoff.

considered one of several approaches to intervening in copyright markets. The first approach, embodied in fair use, intervenes in situations where there is social value to a new use and little or no risk to the copyright owner's established markets (and, by extension, copyright's incentive function). Because there is no market harm to the copyright owner, fair use provides no compensation. The second approach—the conception of compulsory licensing advanced by this Article—exists outside the limits of fair use, where a use is socially valuable but could harm the copyright owner financially (for example, by providing a plausible substitute to the copyright owner's goods). In such situations, a compulsory licensing regime ensures that the copyright owner receives some compensation, but still allows the use to occur. The specific compensation, however, is calculated with reference to the social value of new use; indeed, as the next Parts explain, rate-setting regulators historically chose rates for new dissemination technologies that were at the lower end of those suggested by market proxies, out of recognition of the importance of these disseminators in facilitating access to copyrighted works. A third approach—the conventional account of compulsory licensing—is not tied to rebalancing the incentives/access tradeoff but instead focused only on remediating transaction costs. This approach would counsel only in favor of trying to mimic the market rates that might prevail but for the transaction costs.

It is important to note that the second approach does not necessarily mean that a compulsory licensing regime cannot also address transaction costs, such as by providing opportunities for bulk licensing.[94] Indeed, the remediation of transaction costs-based market failures can further public access to copyrighted works by allowing an exchange where none could exist before.[95] However, as the fair use scholarship has recognized, an *exclusive* focus on transaction costs limits a compulsory license's application and scope. In contrast, the second approach's focus on the incentives/access tradeoff often councils in favor of more extreme interventions in the market.[96]

As the next Part explores, the second approach—using compulsory licensing to effectuate copyright policy goals—provides the best explanation of the music compulsory licensing regime's origins and original rate-setting regime. In particular, music rate-setting did not try to mimic market-based rates—as would be expected if its only goal was transaction costs

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[94] *See infra* Part III.A (explaining benefits of bulk licensing to digital distributors).

[95] Gordon, *supra* note 8, at 1615.

[96] *Cf.* Sag, *supra* note 42, at 226 (noting that the transaction costs theory of fair use rests "on an initial presumption of efficient private ordering" whereas the alternative approach "manifests a deep pessimism in the capacity of market institutions to provide the kind of flexibility that the users of copyrighted works require"); *see also infra* Part III.B (discussing the differences between a copyright policy-focused rate-setting approach and an exclusively market-mimicking approach).

remediation—and instead used a policy-focused approach designed to identify royalty rates able to meet both the financial needs of copyright owners and the public's interest in access.

II. THE MECHANICAL LICENSE AND COPYRIGHT POLICY

Section 115 of the Copyright Act establishes what is commonly called the "mechanical" compulsory license. When the owner of a musical composition agrees once to allow her composition to be recorded and distributed via a CD, MP3 or any other "mechanically" playable object, she must then agree to license her composition to all additional licensees at a government-set price.[97] Licensees may simply use the copyrighted work and provide notice and payment to copyright owner through the Copyright Office, a regulatory body that administers copyright registrations and other aspects of the copyright system. Licensees and licensors can also bypass this process by reaching direct licensing deals,[98] which they often do via an intermediary known as the Harry Fox Agency.[99] But the shadow of the compulsory licensing regime informs these negotiations, and the compulsory rate often functions as a de facto cap on privately made licensing deals.[100]

This Part argues that the early history of the mechanical license clarifies its role as a tool for negotiating the incentives/access tradeoff. The first Section explains that the license was created as a way of allowing new technologies of dissemination—in particular the player piano and record player—to flourish, while still providing compensation to copyright owners that would allow them to maintain their economic incentive to create new

[97] 17 U.S.C. § 115(a).

[98] 17 U.S.C. § 115(b)-(c).

[99] Sarah Jeong, *A $1.6 Billion Spotify Lawsuit is Based on a Law Made for Player Pianos*, THE VERGE (Mar. 14, 2018), https://www.theverge.com/2018/3/14/17117160/spotify-mechanical-license-copyright-wixen-explainer; Harry Fox Agency, *What Does HFA Do?* https://www.harryfox.com/publishers/what_does_hfa_do.html. It is important to note that the mechanical license now also regulates the digital distribution of existing recorded music. This issue is discussed further in Part III. *See infra* Part III.A.3.

[100] Lemley, *supra* note 3, at 479; *Register's Music Licensing Report, supra* note 1, Chap. 2, 2015 WL 1227760, at *9. In theory, the mechanical license only applies to recordings of compositions that follow the first recording; for this reason, it is occasionally called the "cover license." *See, e.g.*, CHRISTOPHER SPRIGMAN AND KAL RAUSTIALA, THE KNOCKOFF ECONOMY: HOW IMITATION SPARKS INNOVATION 141 (2012); Peter S. Menell, *Adapting Copyright for the Mashup Generation*, 164 U. PA. L. REV. 441, 494 (2016). But the regulatory scope of the license is far more expansive than simply allowing cover songs: the determined rates generally create a de facto ceiling on negotiated licensing rates for any recording of a musical composition, including the first recording. FISHER, *supra* note 93, at 48 (noting this trend).

works. While the mechanical license originally attempted to effectuate this balance using a fixed 2-cent licensing rate, the 1976 Copyright Act replaced this rate with a rate-setting regime governed by policy objectives known as the 801(b) factors. As the second Section explores, these objectives appear to have been designed and implemented to allow for periodic readjustment of the balance of incentives and access in the music marketplace, and in particular to ensure that access-expanding forms of music dissemination could flourish.

A. The Origins of the Mechanical License

United States copyright law has recognized an author's exclusive rights in a written musical composition since 1831.[101] In its early years, this copyright interest was limited to the copying of sheet music and the public performance of musical works, both of which required a license from the copyright owner.[102] In the late 1800s, two new technologies began disrupting this status quo. The first was the record player (originally known as the "talking machine" or phonograph)[103] and the second was the player piano, which utilized a pneumatic system that allowed conventional pianos to mechanically play music from paper rolls with small perforations.[104] Both player piano and record technologies dramatically and quickly increased the availability of music to consumers: by 1899, 2.8 million records were in circulation and, by 1902, at least a million piano rolls had been sold.[105]

Records and piano rolls allowed for the fixation of a copyrighted musical composition into an object capable of playing (and replaying) the song. This was new terrain for U.S. copyright law, which had never been applied to such "mechanical" reproductions before. Some record and piano roll producers began paying precautionary royalties to music publishers,[106] but the law was unsettled as to whether the unlicensed creation of a record or piano roll infringed the musical composition copyright owner's exclusive rights.

The Supreme Court finally addressed the question in *White-Smith Music Pub. Co. v. Apollo Co*,[107] and concluded that piano rolls did not

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[101] Robert P. Merges, *One Hundred Years of Solicitude: Intellectual Property Law, 1900-2000*, 88 CAL. L. REV. 2187, 2195 (2000).

[102] Loren, *supra* note 10, at 683.

[103] Wu, *supra* note 21, at 297.

[104] Loren, *supra* note 20, at 545.

[105] Wu, *supra* note 21, at 298.

[106] Nathan Burkan, 1907 Memorial to Congress, at 2-5 (Jan. 8, 1907), https://archive.org/details/TheChargeThatThePassageOfTheCopyrightBillSenateBill6330WillCreateAMonopolyInTheM.

[107] 209 U.S. 1 (1908).

implicate copyright because they are not "copies within the meaning of the copyright act."[108] The Court, however, invited Congress to extend copyright to mechanical reproductions, if it so chose.[109] Congress accepted this invitation in the 1909 Copyright Act, which explicitly granted copyright owners the right to exclude use "of instruments serving to reproduce mechanically the musical work."[110] The 1909 Act, however, applied a "condition" to this extension of copyright protection: the compulsory licensing scheme that is now known as the mechanical license or Section 115 license, and set the compulsory rate at a fixed 2-cent royalty per copy.[111]

Some scholars believe that the mechanical license was created to address fears that a large piano roll company, the Aeolian Company, would monopolize the piano roll market and shut out competitors.[112] By allowing all comers to make recordings of the composition following the copyright owner's initial choice to do so, the license would prevent any single piano roll manufacturer from becoming the exclusive licensee of musical composition copyright owners. The monopolization explanation makes sense to a point. The Aeolian Company had indeed entered into an exclusive licensing arrangement with a group of music publishers even before Congress or the Supreme Court had determined whether the musical composition copyright extended to mechanical reproduction.[113] In the lead up to the 1909 Act, Congress expressed concern that copyright owners could use their newly secured copyright interests to ally with a single piano roll manufacturer to "monopolize the business of manufacturing [and] selling music-producing machines, otherwise free to the world."[114]

But the monopolization argument does not necessarily provide a full account. As Tim Wu has explained, the early recording industry made a strategic choice to argue against expanding copyright to mechanical reproduction by stoking contemporary fears over trusts.[115] The Aeolian Company, the chosen scapegoat, was painted as the beneficiary of a large global conspiracy designed to further its own wealth, at the expense of the

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[108] 209 U.S. at 17.

[109] *Id*. at 18.

[110] An Act to Amend and Consolidate the Acts Respecting Copyright, ch. 320, § 1(e), 35 Stat. 1075 (March 4, 1909, effective July 1, 1909) [hereinafter 1909 Copyright Act].

[111] *Id*.

[112] *See, e.g.*, Merges, *supra* note 8, at 1309; Abrams, *supra* note 10, at 220; Loren, *supra* note 20, at 548; Loren, *supra* note 10, at 681; Samuelson, *supra* note 8, at 24; *see also Register's Music Licensing Report, supra* note 1, Chap. 2, 2015 WL 1227760, at *7.

[113] Abrams, *supra* note 10, at 219–20; Ralph Oman, *The Compulsory License Redux: Will It Survive in A Changing Marketplace?*, 5 CARDOZO ARTS & ENT. L.J. 37 (1986).

[114] H.R. Rep. No. 60-2222, at 7 (1909), reprinted in 6 LEGISLATIVE HISTORY OF THE 1909 COPYRIGHT ACT pt. S-1 (E. Fulton Brylawski & Abe Goldman eds., 1976); *see also id*. at 8 (discussing concerns about the "possibility of a great music trust in this country").

[115] Wu, *supra* note 21, at 300.

nascent recording industry, songwriters, and the public.[116] But concerns about Aeolian's monopoly practices were likely overblown: fewer than half of active music publishing companies had agreed to its license deal; a large majority were still willing to license to other player piano roll companies after the law was finally settled.[117] Furthermore, both the choice of a compulsory license and the actual structure of the license is odd from the perspective of the legal regime generally devoted to concerns about monopolization: antitrust law. Congress had long resisted the adoption of compulsory patent licensing as an antitrust remedy, [118] and this approach was uncommon until the 1940s (and, even after that, quite rare).[119] In contemporaneous antitrust cases, a more common approach was the simple voiding of contracts that were being used to further monopolization efforts.[120]

Several scholars have argued that the monopolization concerns expressed by Congress belied a deeper issue, and that the mechanical license was in fact created to address particular concerns endogenous to copyright. Jane Ginsburg, for example, views the creation of the mechanical license an effort by Congress to "readjust[] the balance" after *White-Smith* so as to compensate copyright owners while still allowing the new dissemination technologies to flourish. By coupling the extension of copyright to mechanical reproduction with a compulsory licensing scheme, Congress "compensated copyright holders but permitted the development of a recording industry."[121]

In this respect—though not framed as such by these scholars—the birth of the mechanical royalty appears to be an example of Congress reconfiguring the incentives/access tradeoff using a compulsory licensing

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[116] *Id.* (describing contemporary editorials).

[117] Abrams, *supra* note 10, at 219–20; *see also* III RUSSELL SANJEK, AMERICAN POPULAR MUSIC AND ITS BUSINESS: THE FIRST FOUR HUNDRED YEARS: 1900-1984, 22-23 (1988). And the deal, which did not preclude copyright owners from licensing to record manufacturers, may have been entered into by Aeolian, not as an attempt to shut out competitors, but simply out of fear that its huge investments in piano roll factories could be compromised by a Supreme Court decision finding that existing copyright law extended to piano rolls and that all of Aeolian's planned piano roll were unlawful infringements. Burkan, 1907 Memorial to Congress, *supra* note 106, at 2-5.

[118] Hartford-Empire Co. v. United States, 323 U.S. 386, 417, *supplemented*, 324 U.S. 570 (1945) (noting that Congress had frequently declined to adopt a compulsory license system for patents).

[119] *See* IP AND ANTITRUST, *supra* note 61, at 6-61 – 6-69.

[120] *See* Spencer Weber Waller, *The Past, Present, and Future of Monopolization Remedies*, 76 ANTITRUST L.J. 11, 17 n.30 (2009) (citing cases).

[121] Ginsburg, *supra* note 21, at 1627; *see also* Wu, *supra* note 21, at 302-05 (describing the creation of the mechanical license as a "compromise"); Peter Dicola, Matthew Sag, *An Information-Gathering Approach to Copyright Policy*, 34 CARDOZO L. REV. 173, 202 (2012) (same).

regime.[122] Congress created a property entitlement where the Supreme Court had found none existed—a right to exclude secondary users from using musical compositions to create mechanical recordings—but then immediately tempered that entitlement using a scheme requiring licensing to all comers. Under this compromise, the new access-enhancing form of distribution would be allowed to flourish, but the copyright owners would still receive some compensation.

Congress's choice to set the mechanical rate at a fixed 2 cents is important to understanding this regulatory strategy. In prior versions of the 1909 Act, Congress had in fact considered setting the rate using mechanisms that would more closely track market forces,[123] such as a percentage of the record or piano roll retail price,[124] a percentage of the manufacturer's revenue,[125] or through reference to the rates in existing free-market licensing deals.[126] While Congress offered no clear justification for ultimately choosing a fixed rate,[127] this approach makes a little more sense through the lens of copyright policy, as a means of increasing public access to music beyond what market-based ordering might have provided. While the copyright owners were certainly better off than they were after *White-Smith*, when they had no right to royalties for mechanical reproductions at all, the 2-cent rate likely provided them with less compensation than they would have received

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[122] *See supra* Part I.

[123] Other countries that enacted compulsory licenses in this period generally chose to price the license using market proxies. For example, under Germany's compulsory license for musical compositions—created around the same time as the mechanical license—once a copyright owner licensed their work to a recording company, other recording companies would be permitted to ask for a rate based on the preexisting free-market agreement. It was only if an agreement could not be reached that a state authority would step in and impose a government rate, set by examining the free-market deals. *See* WORLD INTELLECTUAL PROPERTY ORGANIZATION, THE BERNE CONVENTION FOR THE PROTECTION OF LITERARY AND ARTISTIC WORKS FROM 1886 TO 1986, 156 (1986). The English Copyright Act of 1911 implemented a compulsory mechanical license for phonorecords with rates based on percentage of retail price, with percentage amount adjustable by the British Board of Trade. Eng. Copyright Act of 1911 § 19(2); *see also* ALFRED M. SHAFTER, MUSICAL COPYRIGHT 238 (1932); David J. Brennan, *The First Compulsory Licensing of Patents and Copyright*, 17 J. LEG. HIST. 1, 33-35.

[124] *See, e.g.*, H.R. 21984, 60th Cong., 1st Sess. (1908) (setting rate of as 10% of the "marked retail price" otherwise); H.R. 22071, 60th Cong., 1st Sess. (1908) (same).

[125] *See, e.g.*, H.R. 27310, 60th Cong., 2d Sess. (1909) ("five per centum of the sum derived bona fide by the manufacturer thereof").

[126] *See, e.g.*, H.R. 21592, 60th Cong., 1st Sess. (1908); H.R. 24782, 60th Cong, 2d Sess. (1908); (*see also* Harry G. Henn, The Compulsory License Provisions of the U.S. Copyright Law, at 4-12 (July 1956) [hereinafter *Henn Study*] (summarizing various bills).

[127] Frederick F. Jr. Greenman & Alvin Deutsch, *The Copyright Royalty Tribunal and the Statutory Mechanical Royalty: History and Prospect*, 1 CARDOZO ARTS & ENT. L.J. 1, 10-11 (1982).

in an open market.[128] The low royalty costs in turn allowed the nascent recording industry to more quickly and cheaply produce records and piano rolls,[129] thus increasing music dissemination. Indeed, some have claimed that the mechanical license scheme was essential to the large amount and wide variety of songs produced by the American recording industry during the twentieth century.[130]

B. The Origins of Policy-Driven Rate Setting

The 1909 Act's 2-cent rate was a blunt instrument; while it certainly restructured the music licensing market to the benefit of access-expanding technologies, its status as a fixed rate, unable to even account for inflation, grew increasingly controversial.[131] As one commentator exclaimed in 1958, the 1909 Act was a "great injustice and [] extraordinary interference with free competition. If the price of butter had been established at a maximum of 15 cents per pound in 1909, one can well imagine the hue and cry which would have been set up in intervening years."[132]

When the Copyright Act was overhauled in 1976, Congress ultimately decided to replace the fixed rate with one administered by a rate-setting entity. In analyzing Congress's decision-making in and leading up to the 1976 Copyright Act, it is necessary to keep in mind Jessica Litman's important observation that the Act "reflects an anomalous legislative process designed to force special interest groups to negotiate with one another."[133] Rent seeking by these groups certainly informed the substance of many of the Act's changes to copyright law, and debates over the mechanical license were

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[128] A fixed two-cent rate was likely lower than what many copyright owners could have charged in 1909. William M. Blaisdell, *The Economic Aspects of the Compulsory License* 110 (October 1958) [hereinafter *Blaisdell Study*]; *see also id*. at 119 (comments of Ralph S. Peer).

[129] While this point is difficult to prove conclusively, it became a frequent argument used by the compulsory license's defenders whenever Congress considered revisions to the license. For example, in the 1950s, one commenter speculated to Congress that the license was directly responsible for the rapid growth of the record industry in the early twentieth century. *Henn Study, supra* note 126, at 77-78 (comments of Ernest S. Meyers). *See also Blaisdell Study, supra* note 128, at 125 (Comments of Ernest S. Meyers).

[130] SPRIGMAN & RAUSTIALA, *supra* note 100, at 141; Menell, *supra* note 100, at 494-95.

[131] *See, e.g.*, ALFRED M. SHAFTER, MUSICAL COPYRIGHT 237, 244-445 (1932) (discussing the economic hardship the 2 cent rate poses for composers and describing the rate as "arbitrary").

[132] *Blaisdell Study*, *supra* note 128, at 119 (Comments of Ralph Peer).

[133] Jessica D. Litman, *Copyright, Compromise, and Legislative History*, 72 CORNELL L. REV. 857, 862 (1987).

likely no exception.[134] Nonetheless, the Act's legislative history, if properly contextualized, can still help illuminate how and why Congress developed the mechanical license's new rate-setting regime. Indeed, if we understand the mechanical license as a means of limiting (but not eliminating) copyright owners' compensation in order to bolster technologies of dissemination, the ultimate rate-setting regime makes sense from the perspective of substantive copyright policy.

After considering proposals to eliminate the license entirely or to maintain it with a higher fixed rate, Congress ultimately chose to create a new administrative entity, the "Copyright Royalty Tribunal," to set rates for the mechanical license every 10 years.[135] The 1976 Act also provided the CRT with instructions on how to arrive at the mechanical royalty rate. The CRT was instructed to attempt to realize four policy criteria, often known as the 801(b) factors or objectives:

> (A) To maximize the availability of creative works to the public;
> (B) To afford the copyright owner a fair return for his creative work and the copyright user a fair income under existing economic conditions;
> (C) To reflect the relative roles of the copyright owner and the copyright user in the product made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, risk, and contribution to the opening of new markets for creative expression and media for their communication;
> (D) To minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices.[136]

It is difficult to determine conclusively where these policy criteria emerged from. The congressional record is sparse, but the seeds of what ultimately became the 801(b) factors appear to have been planted in Senate hearings in 1967. During these hearings, Congress had entertained the notion that music publishers should be regulated along the lines of a public utility.[137]

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[134] *See* Greenman & Deutsch, *supra* note 127, at 15 (describing lobbying by the RIAA to prevent repeal of the mechanical license).

[135] 17 U.S.C. § 804(a)(2)(B) (1976). The CRT, which was also charged with administering the new compulsory licenses created in the 1976 Act, consisted of five "commissioners" appointed by the President with advice and consent by the Senate. *See* Recording Indus. Ass'n of Am. v. Copyright Royalty Tribunal, 662 F.2d 1, 5 (D.C. Cir. 1981).

[136] 17 U.S.C. § 801(b)(1) (1976).

[137] *See, e.g.*, 1967 Senate Hearings at 383, 479. Under U.S. law, firms that provide public goods such as electricity and gas are frequently permitted to function as natural monopolies

Thurman Arnold, counsel for the Recording Industry Association of America, argued that the mechanical license rate needed to be set using the "accepted standards of statutory ratemaking" applied to public utilities. He argued that such standards included ensuring a rate that "divides the rewards for the respective creative contributions of the record producers and the copyright owners of the lead tune equitably between them."[138] Though the music publishers disputed both the analogy and Arnold's proposed standard,[139] Congress eventually determined that mechanical license rate setting would be based on policy criteria similar to those introduced by Arnold.[140]

This rate-setting approach differed dramatically from some of the other compulsory license schemes created in the 1976 Act, which appear to have been designed to remedy more conventional transaction cost problems and, accordingly, instructed regulators to set rates based on market proxies. In particular, the 1976 Act's compulsory license for public broadcasting provides the best contrast to the 801(b) approach. Under this license, non-commercial broadcasters (such as NPR and PBS), may utilize a compulsory license to broadcast copyrighted music and audiovisual works.[141] In establishing this regime, Congress made clear that its primary concern was transaction costs, in particular the "administratively cumbersome and costly 'clearance' problems" encountered by small public broadcasters when seeking to use copyrighted works, rather than any more normative concerns about the importance of public broadcasting.[142] Consistent with a transaction costs-addressing approach, the rate-setting standard was market-mimicking, instructing regulators to set rates based on "rates for comparable

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but are in turn subject to regulation, including price-setting, to prevent the monopoly from exploiting its market power to charge consumers high prices. CHRISTOPHER DECKER, MODERN ECONOMIC REGULATION: AN INTRODUCTION TO THEORY AND PRACTICE 14-28 (2015). The "traditional" approach to such rate-setting is rate-of-return regulation, which sets prices with the goal of allowing firms to only recoup their costs. *Id.* at 104-108.

[138] 1967 Hearings, *supra* note 137, at 469 (Testimony of Thurman Arnold); *see also* 1967 Hearing at 926-27 (Statement of Thurman Arnold).

[139] The music publishers' experts disputed the analogy generally and noted that, even if the analogy was justified, the proposed "reward" sharing standard was not actually a conventional feature of public utility rate-making. *Id.* at 1094 (Testimony of Robert R. Nathan) ("As far as the [] so-called accepted standard is concerned, I have never in all my experience encountered this novel concept of dividing rewards for creative contributions as a meaningful and relevant standard of ratemaking."); *see also Id.* at 333, 1090-94 (Testimony of Robert R. Nathan) (critiquing the public utility analogy generally).

[140] 1976 House Report at 174.

[141] 17 U.S.C. § 118(b)(3) (1976).

[142] 1976 House Report, *supra* note 140, at 117; *see also* Samuelson, *supra* note 8, at 25.

circumstances under voluntary license agreements negotiated" between copyright owners and commercial broadcasters.[143]

In contrast, the 801(b) factors correspond in many respects to an approach to compulsory licensing that emphasizes the incentives/access tradeoff, rather than merely transaction costs remediation. In particular, the first factor emphasizes that the goal of rate-setting regulators should be to maximize the availability of creative works "to the public." As Part I explained, the primary way that copyright maximizes creative content for the public is by providing exclusive rights that allow creators to receive financial rewards for their works, while simultaneously limiting those exclusive rights in order to prevent the public's access from being unduly restricted. The third 801(b) factor makes this balancing approach even more direct by explicitly asking the rate-setting body to *weigh* the contributions and costs of the copyright owner against the contributions and costs of disseminators in making the copyrighted works available to the public.

The third factor's alleged origins in public utility rate-setting principles also bolster this reading. The analogy between music copyright owners and natural monopolies is imprecise;[144] indeed, as the D.C. Circuit noted in an appeal of an early rate-setting decision, the 801(b) factors are quite different from the "cost of service rate-making" utilized for most public utilities.[145] Nonetheless, public utility regulation's historic emphasis on using costs as the primary way of calculating an appropriate rate has parallels in what some believe is the price structure that copyright should aspire to: allowing authors to recover "something close to their persuasion costs, defined as the sum necessary to persuade an author to undertake a given work's creation."[146] The recognition that public utility regulation is justified because of a "special privilege" bestowed by the state—the right to privately administer services that might otherwise fall under authority of the state because of their importance to the public interest—also has parallels in copyright law's grant of a special right to exclude so as to encourage the creation of new creative works.[147]

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[143] 17 U.S.C. § 118(b)(3) (1976).

[144] *See generally* John F. Duffy, *The Marginal Cost Controversy in Intellectual Property*, 71 U. CHI. L. REV. 37, 52-56 (2004) (exploring distinctions between intellectual property and natural monopolies).

[145] Recording Indus. Ass'n of Am. v. Copyright Royalty Tribunal, 662 F.2d 1, 11 (D.C. Cir. 1981); *see also supra* note 137.

[146] Lunney, *supra* note 75, 1015; *see also* Lemley, *supra* note 43, at 1054-58 (arguing that intellectual property rights make sense as a way of allowing creators to recoup their fixed costs, but not as a way of allowing creators to internalize all of the positive externalities their works generate).

[147] FISHER, *supra* note 93, at 178-82 (drawing this link); *cf.* K. Sabeel Rahman, *The New Utilities*, 39 CARDOZO L. REV, 101, 115 (2018) (arguing that, historically, public utility

The first CRT rate-setting proceeding to set the mechanical royalty rate also supports the conclusion that the 801(b) factors can be read to reflect copyright policy goals. This 1980 proceeding pitted a group of music publishers and songwriters (represented primarily by the National Music Publishers Association) against a group of record labels (represented primarily by the Recording Industry Association of America).[148] The primary dispute was whether the mechanical license was allowing "record companies to buy music at a rate that is unfairly cheap" in light of inflation and the significant increase in record label profits. After a 46-day hearing, the CRT chose to raise the statutory rate, though not to a level as high as the copyright owners had sought.[149]

The CRT found overall, that the 801(b) factors supported raising the statutory rate, but cited the third "relative roles" factor when explaining why it declined to make the rate as high as the copyright owners claimed was appropriate. In analyzing this factor, the CRT noted that while upward adjustment of the statutory rate was important to ensuring adequate economic incentives to create, this economic incentive must be weighed against the record labels' role in fostering dissemination. Though songwriters provide the "essential input," in the form of the musical composition, the record labels' role was far greater when it came to opening "new markets for creative expression and media for their communication," in particular through "technological innovation, and through development of new types of music."[150]

This discussion of the third factor is notable because it provides an example of the CRT appearing to set a royalty rate through weighing compensation for copyright owners against the prospect of increased public access through innovative forms of dissemination. Even though, in this case, CRT ultimately chose to raise the royalty rates, its analysis of the third factor provided a blueprint to future rate-setting decision, as explained further below.[151]

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regulation was applied when "a good was of sufficient social value to be a necessity, and where the provision of this necessity was at risk of subversion or corruption if left to private or market forces").

[148] Adjustment of Royalty Payable Under Compulsory License for Making and Distributing Phonorecords; Rates and Adjustment of Rates, 46 FR 10466-02 at 10466.

[149] *Id.* at 10467.

[150] *Id*. at 10480-10481. This "opening of new markets" also occurred "through record clubs, mail order sales and television advertising campaigns" arranged by the labels. *Id*.

[151] *See infra* Part III.B.1.

III. THE EROSION OF POLICY-DRIVEN COMPULSORY MUSIC LICENSING

The last Part argued that the first compulsory music license, the mechanical license, was originally conceived of as a tool for readjusting the incentives/access balance in the music marketplace. This Part examines the trends that have placed pressure on this original role, both in the legislative context and in the regulatory rate-setting context. In the legislative context, various changes to the music copyright system—in particular, the creation of the sound recording copyright and the growing importance of blanket licensing—have furthered a narrative that compulsory licensing's only role should be to remedy transaction costs-based market failures. Consistent with this narrative, policymakers and regulators increasingly maintain that compulsory licensing should attempt to mimic free market rates using market proxies, with no regard for broader copyright policy goals. Most recently, the Music Modernization Act has pushed this narrative even further by applying a willing buyer and willing standard to all future music-related rate setting.

Similar changes have taken place in the rate-setting context. The CRB (the successor to the CRT) originally recognized that the policy-oriented approach of the 801(b) objectives was meant to encourage new forms of music dissemination, such as digital radio. However, rate-setting decisions have begun moving away from this approach and are increasingly focused only on finding market-mimicking royalty rates. The recent CRB rate-setting decision for streaming mechanical royalties illustrates this trend and points to some of the reasons why the shift prevents the compulsory licensing regime from furthering its original goal of maintaining a balanced copyright system.

A. Legislative Context

1. Background: The Sound Recording Copyright

As the last Part explored, the mechanical license was created to regulate the use of copyrighted musical compositions by technologies of music dissemination: the player piano, phonograph, and the record player. For most of the twentieth century, the actual recorded versions of these compositions were not independently copyrightable. That changed in 1971, when Congress provided for limited copyright protection for sound recordings, with the specific goal of preventing "piracy" by companies that were copying recorded music onto records and tapes and selling them to the public.[152] The 1971 Act forbade the copying of a sound recording without

[152] Pub. L. No. 92-140, 85 Stat. 391 (1971) ("Sound Recording Act of 1971").

permission of the copyright owner. As the next Sub-Sections explore further, the sound recording copyright has played an important role in complicating the goals of music dissemination that the mechanical license was designed to regulate, especially as technologies that involve the digital duplication of prior recorded songs for sale to the public have become more ubiquitous.

It is important to note that Congress was aware of these potential problems even in 1971. In the lead up to the 1971 Act, tape manufacturers argued that the mechanical license should be extended to the new sound recording copyright in order to further the public's interest in access to music. In making this argument, they echoed many of the original arguments for the mechanical license; for example, that record companies "will be able to dictate extortionate licensing terms and thus increase the cost of taped music to the consumer."[153] They also explicitly invoked the 1909 Act, claiming that had Congress not imposed a compulsory license in 1909, music publishers would have "demanded exorbitant licensing fees," frustrating development of "the infant record industry."[154] A compulsory license for sound recordings, they argued, would provide "compensation sufficient to encourage" the creation of additional sound recordings, while still allowing the tape reproduction market to flourish.[155] In so doing, consumers would benefit from lower fees, as well as from access to a greater variety of musical works.[156]

Though Congress was sympathetic to these arguments,[157] the record industry effectively painted the tape industry as "pirates" and "parasites" who could not be trusted to abide by the requirements of a compulsory licensing regime. This led Congress to ultimately reject the compulsory license proposal.[158]

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[153] Hrgs. Subcommittee on the Judiciary S. 646 and H.R. 6927 (June 9-10, 1971) At 73 (Statement of Thomas S. Truitt on Behalf of Eastern Tape Corp. et al.); *see also id*. at 82-83 (advocating for compulsory license to prevent "substantial hardship on the purchasing public."); *id*. at 107

[154] *Id*. at 73-74; *see also id*. at 84.

[155] *Id*. at 83-84.

[156] *Id*. at 118.

[157] *Id.* at 74 (support by Senator Hart).

[158] *Id*. at 97 ("The illicit duplicators have seen fit to ignore applicable legal precedents and have conducted their respective business operation in direct violation thereof. There is no reason to believe they will change their tactics and comply with tile pertinent legal requirements of a compulsory licensing system. We believe such a system would only force the legitimate members of the industry to deal with its worst parasites to the substantial detriment of the entire industry."); *see also* Senate Rep. S. 646 (Apr. 20, 1971) at 6 (rejecting compulsory license proposals based on a similar "parasite" argument). In the years following the 1971 Act, some litigants attempted to invoke the mechanical license to excuse copying sound recordings. But the courts uniformly rejected this argument. *See* Joseph P. Fishman, *The Copy Process*, 91 N.Y.U. L. REV. 855, 877-78 (2016).

At the same time, Congress did provide an important exception to the sound recording copyright: no public performance right.[159] This meant that uses that did not involve the actual duplication of a recorded song—including radio broadcasts—did not require permission from the copyright owners. Congress revisited this issue in the 1976 Act and again declined to extend public performance rights to sound recordings.[160] Thus AM/FM radio stations were (and for the most part still are) free to broadcast any sound recording without the consent of the copyright owners, or even payment under a compulsory licensing scheme.

2. Competing Narratives in the Section 114 License

In the years following the 1971 and 1976 Acts, the lack of compulsory licensing for sound recording reproduction rights likely had minimal consequences for the public's consumption of musical works. First and foremost, the lack of public performance rights for sound recordings meant that radio stations were free to play music without seeking the consent of the copyright owners, or even compensating them at all. On the distribution side, record companies continued to be the primary disseminators of recorded music, and technologies involving the duplication of the sound recordings embodied in those records had yet to become pervasive.[161] Congress's refusal to extend the mechanical license to sound recordings certain stifled the burgeoning tape-copying industry, but the reduced quality of analog music reproductions meant that the market for tape-copies was always limited to begin with. Furthermore, other copyright limitations and exceptions came into play in preventing record companies from exerting disproportionate control over music dissemination. In particular, the 1976 Act's codification of the "first sale doctrine" established that the public could distribute or resell lawfully made records, tapes, and CDs without first seeking the consent of copyright owners.[162]

The rise of digital music dissemination—in particular, MP3 music files capable of being played or downloaded via the internet— fundamentally altered this landscape. The 1971 Act's creation of sound recording copyright protection for *duplication* meant that digital retailers of MP3 files—such as iTunes—were required to obtain licenses from record labels before selling music (which, as discussed further below, takes place through free market transactions because of the lack of a compulsory license). But the complete

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[159] Recall that the right to perform a copyrighted work is distinct from the right to duplicate and distribute it. *See supra* discussion accompanying notes 34-39.

[160] García, *supra* note 9, at 1134.

[161] FISHER, *supra* note 93, at 83-84.

[162] 17 U.S.C. § 109(a).

lack of public performance protection for sound recordings meant that digital forms of radio were not obligated to clear licenses, or even pay royalties to record labels at all.

The recording industry grew increasingly concerned about the threat that digital radio posed to its traditional revenue streams[163] and, in 1995, convinced Congress to pass the Digital Performance Rights in Sound Recordings Act (DPRA).[164] The DPRA and follow-on legislation altered the status quo by creating a public performance right in sound recordings performed "by means of a digital audio transmission," such as those provided by satellite and internet radio.[165] The DPRA, however, coupled this grant with a new compulsory licensing regime requiring licensing of sound recordings to any digital radio service.[166]

In many ways, this process paralleled the original creation of the mechanical license. Congress granted copyright interests where none had previously existed in order to ensure authors would be incentivized to continue to create—in fact, the need for financial incentives was a key argument used by the record labels leading up to the DPRA[167]—but tempered this exclusive right with a compulsory license designed to ensure access. Indeed, the Section 114 license took an approach to rate-setting very similar to that of the mechanical license, at least at first. In passing the DPRA, Congress suggested that a goal of this compulsory licensing regime would be to encourage technologies that increase music dissemination, like internet radio, because "these new digital transmission technologies may permit consumers to enjoy performances of a broader range of higher-quality recordings than has ever before been possible."[168] Congress sought to balance this priority against the need for "appropriate copyright protection in the

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[163] *See* Digital Performance Rights in Sound Recordings Act of 1995: Hearing on H.R. 1506 Before the Subcomm. on Courts & Intellectual Prop. of the H. Comm. on the Judiciary, 104th Cong. 34 (1995) (statement of Jason Berman, Chairman and CEO, Recording Industry Association of America) (arguing that "digital delivery would siphon off and eventually eliminate the major source of revenue for investing in future recordings").

[164] 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.)

[165] 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(6) (2006)).

[166] *Register's Music Licensing Report, supra* note 1, Chap. 2, 2015 WL 1227760, at *18.

[167] *See* Digital Performance Rights in Sound Recordings Act of 1995: Hearing on H.R. 1506 Before the Subcomm. on Courts & Intellectual Prop. of the H. Comm. on the Judiciary, 104th Cong. 34 (1995) (statement of Jason Berman, Chairman and CEO, Recording Industry Association of America) (warning that "[o]ver time [the lack of public performance protection for sound recordings] would lead to a vast reduction in the production of recorded music.").

[168] 1995 DPRA, S. Rep. 128 (Aug. 4, 1995).

digital environment [to incentivize] the creation of new sound recordings and musical works."[169]

Presumably to best facilitate this balance, Congress chose to use the 801(b) factors to govern rate-setting for the new Section 114 license. As the next Section explores, early rate-setting decisions under the 801(b) factors explicitly accounted for internet and satellite radio's access-expanding effects, as weighed against the importance of providing economic incentives to sound recording copyright owners.

In 1998, however, Congress altered the Section 114 license in the Digital Millennium Copyright Act ("DMCA"). The DMCA's revisions were ostensibly designed to correct an "oversight" in the DPRA: the fact that *non-subscription* digital services were grouped together with existing terrestrial radio and thus not required to pay sound recording copyright owners anything.[170] The DMCA extended the obligation to pay royalties, as well as the ability to use the Section 114 compulsory license, to all digital radio stations, regardless of whether they operate using subscription or non-subscription models. But the DMCA also created a bifurcated rate-setting standard. For any digital radio service established after the passage of the DMCA in 1998, the regulators were tasked with establishing rates "that most clearly represent the rates [] that would have been negotiated in the marketplace between a willing buyer and a willing seller."[171] However, satellite radio services and internet radio services that "preexist[ed]" passage of the DMCA would have their rates set using the 801(b) policy objectives.[172]

The DMCA's switch to a "willing buyer and seller" standard for any new digital radio services was never explained. It may have simply been a product of lobbying by the record labels; indeed, it was added shortly before the bill was passed. But it also may have reflected a belief that the Section 114 compulsory license should primarily regulate transaction costs-based market failures and would best do so using the market-mimicking rate-setting approach more frequently used when a compulsory license's sole goal is to address such issues.[173]

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[169] *Id.*; *see also* FISHER, *supra* note 93, at 104.

[170] Dicola & Sag, *supra* note 121, at 224.

[171] 17 U.S.C. § 114(f)(2)(B) (2012). The DMCA also clarified that ad-supported internet radio services would be covered by the compulsory licensing regime. *See* García, *supra* note 9, at 1164–69.

[172] See 17 U.S.C. §§ 114(f)(1), 801(b)(1) (2012); *See also Register's Music Licensing Report, supra* note 1, Chap. 2, 2015 WL 1227760, at *21

[173] *See supra* Part I.B. Though the legislative history of the DMCA is silent on this issue, it may be possible to glean some insight from Congressional hearings on contemporaneous copyright-related legislation. On October 30, 1997, Congress held hearings regarding whether to switch the existing cable rebroadcast compulsory license to a "fair market value" rate-setting standard. *See* Hrg. Comm. Judiciary, Copyright Licensing Regimes Covering

This reading is bolstered by the fact that the Section 114 compulsory license, after its creation, increasingly took on a role focused on resolving transaction costs barriers to efficient mass licensing by digital radio stations. To understand this role, a little additional background is in order. Recall that even though radio stations were free to play sound recordings without a license, they have historically still been required to receive permission from the *musical composition* copyright owner before playing a song. The process of clearing licenses for public performance of musical compositions has raised transaction costs concerns since the early history of radio. In particular, the number of licenses, volume of plays, and difficult of tracking plays made it effectively impossible for radio stations to enter into individual licenses with musical composition copyright owners.[174] In the early twentieth century, copyright owners began addressing this problem by forming performance rights organizations ("PROs"). The PROs aggregate copyright interests to make it logistically easier for public performance licensees, such as radio stations, bars and restaurants, and TV stations, to license musical compositions for public performance.[175] The two largest PROs, ASCAP and BMI, together manage the vast majority of these works. These entities frequently provide blanket licenses for a flat fee or percentage of revenue, and then ensure distribution of the royalties to the many copyright owners whose works are implicated, saving all parties significant time and money.[176] While the PROs were originally structured exclusively through contract law, a series of antitrust consent decrees have made them increasingly regulated in a manner similar to a compulsory licensing regime.[177] Most notably, the PROs must only grant nonexclusive licenses and must license to all comers.[178] Additionally, licensees unsatisfied with a proposed royalty rate may petition courts in the Southern District of New York for a court-determined rate.[179]

Retransmission of Broadway Signal (Oct. 30, 1997) at 1-9. In explaining the benefits of a fair market value standard, some testimony noted that "The term 'fair market value,' of course, has a clear and long-settled meaning: the rate a willing buyer would pay to a willing seller'" and argued that a fair market value-driven "compulsory license may be necessary in the short run [in markets where there are] transaction cost problems." *Id*. at 174-75.

[174] *Register's Music Licensing Report, supra* note 1, Chap. 2, 2015 WL 1227760, at *11

[175] Merges, *supra* note 8, at 1329.

[176] Kristelia A. García, *Facilitating Competition by Remedial Regulation*, 31 BERKELEY TECH. L.J. 183, 194 (2016).

[177] Wu, *supra* note 21, at 310–11 (noting the de facto compulsory license established via the consent decrees).

[178] *Register's Music Licensing Report, supra* note 1, Chap. 2, 2015 WL 1227760, at *13; GLYNN LUNNEY, COPYRIGHTS EXCESS: MONEY AND MUSIC IN THE U.S. RECORDING INDUSTRY 65 (2018).

[179] *Id*. at 65.

The PROs' rights aggregation represents a significant example of a transaction costs-saving licensing technique (one originally created via private ordering but now also overseen by the government via antitrust consent decrees) and appeared to have provided an important model for how digital radio stations and copyright owners use the Section 114 compulsory licensing regime. Indeed, shortly after passage of the DMCA, the Recording Industry Association of America created an entity known as SoundExchange, which was later spun off into its own non-profit.[180] SoundExchange essentially functions like a PRO: it facilitates blanket licensing of Section 114 licenses and also enables royalty payments to disparate rightsholders.[181] In 2002, Congress explicitly incorporated SoundExchange into the architecture of the Section 114 licensing scheme,[182] and it is now the sole entity entrusted to collect and distribute Section 114 royalties to copyright owners and artists.[183]

The increased use of the Section 114 license as a tool for efficient rights aggregation and payment, via SoundExchange, might similarly account for Congress's decision to replace the 801(b) factors with a willing buyer and willing seller standard in the DMCA. An approach to compulsory licensing solely focused on transaction costs generally attempts to approximate free market rates, as discussed above.[184] For this reason, some of the Copyright Act's other compulsory licensing regimes, such as the regime for cable television and public broadcasting, have historically utilized market proxies during rate-setting.[185] Similarly, the district courts that engage in rate-setting for the PROs "attempt to approximate the 'fair market value' of a license—what a license applicant would pay in an arm's length transaction."[186] In creating the willing buyer and willing seller standard, Congress may have been trying to more clearly model the section 114 license after these other regimes.

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[180] Dicola & Sag, *supra* note 121, at 230.

[181] García, *supra* note 9, at 1183, n.1.

[182] Small Webcasters Settlement Act of 2002, PL 107–321, December 4, 2002, 116 Stat 2780.

[183] Dicola & Sag, *supra* note 121, at 230.

[184] *See supra* Part I.

[185] *See supra* notes 61 (discussing cable and satellite) and 142 (discussing public broadcasting).

[186] In re Pandora Media, Inc., 6 F. Supp. 3d 317, 353 (S.D.N.Y. 2014), *aff'd sub nom*. Pandora Media, Inc. v. Am. Soc. of Composers, Authors & Publishers, 785 F.3d 73 (2d Cir. 2015); *see also Register's Music Licensing Report, supra* note 1, Chap. 2, 2015 WL 1227760, at *16.

3. Interactive Streaming's Exclusion from the Section 114 License

While the DPRA established that satellite radio and internet radio services (also known as webcasters or non-interactive streaming services) could take advantage of the Section 114 compulsory license in order to license sound recording public performance rights from records labels, the DPRA provided an important exception to this regime for one class of digital distributors: "interactive" streaming services. In essence, a non-interactive service (for example, the original version of Pandora) provides a service akin to radio: consumers can listen to music stations but cannot directly choose a specific song. In contrast, interactive services (for example, the original version of Spotify) provide on-demand music, allowing consumers to choose specific songs to stream.[187]

Interactive streaming technology was not yet in existence when the DPRA was passed, though its emergence was understood to be imminent. Congress appeared to be convinced that the technology would pose such an extreme threat to the traditional markets of record labels (CD sales and the like) that subjecting it to a compulsory license would unfairly deprive copyright owners of revenue.[188] In contrast, non-interactive streaming was understood to pose only some risks of substitution because consumers could not choose songs on-demand, prompting Congress to create the Section 114 license.[189] As Part IV explores in more detail, this distinction (and the logic that underlies it) has proven misguided over time.

Because interactive streaming services cannot take advantage of the Section 114 sound recording compulsory license, services like Spotify must negotiate free market licenses with sound recording copyright owners.[190] Sound recording copyright owners also can pull their songs from streaming services, as Taylor Swift has famously done on several occasions.[191]

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[187] LUNNEY, *supra* note 178, at 67; FISHER, *supra* note 93, at 104; Peter DiCola, *Copyright Equality: Free Speech, Efficiency, and Regulatory Parity in Distribution*, 93 B.U. L. REV. 1837, 1854 (2013) *Register's Music Licensing Report, supra* note 1, Chap. 2, 2015 WL 1227760, at *20. Pandora and Spotify each now operate both interactive and non-interactive services.

[188] *See* S. REP. 104-128 at 15-16, 1995 U.S.C.C.A.N. 356, 362.

[189] FISHER, *supra* note 93, at 104-05. Another explanation offered was that non-interactive streaming could in fact increase record sales by promoting recording artists to the public. This has been a frequent explanation for why terrestrial radio has consistently been excluded from having to pay royalties to sound recording copyright owners. *Id.*

[190] There is one minor caveat: under the DPRA, copyright owners may only enter into exclusive licenses with interactive distributors for 12 months at a time. In enacting this requirement, Congress appeared to believe it would be sufficient to prevent copyright owners from frustrating public access. *See* 2 Nimmer on Copyright § 8.22[E] (2019).

[191] *See* Kaitlyn Tiffany, *A history of Taylor Swift's odd, conflicting stances on streaming services*, THE VERGE (June 9, 2017), https://www.theverge.com/2017/6/9/15767986/taylor-

4. The Gradual Transformation of the Mechanical License

While the DPRA and the DMCA made significant changes to the sound recording copyright interest in the aftermath of the digital revolution, other aspects of the music copyright regime received less Congressional scrutiny, at least at first. This included the mechanical license, which remained mostly unchanged from the 1976 Act until very recently. That being said, the rise of digital distribution also significantly affected how the mechanical license was used by the new digital distributors, potentially encouraging a narrative that the mechanical license should only be considered a transaction costs-remedying tool.

In the aftermath of the rise of digital music file distribution, record labels lost their status as the primary source of music purchases for consumers; instead, third-party digital distribution platforms, like Apple's iTunes service, became increasingly important in selling recorded music to consumers in the form of downloadable files. Unlike a radio public performance, the selling of an MP3 file clearly implicated sound recording copyright owners' exclusive rights, and digital distributors were thus required to enter into licensing agreements with record labels permitting the distributor to sell MP3 versions of their sound recordings to the public.

The authority of a record label to license a sound recording copyright was obvious, but it remained somewhat uncertain how a digital sale of a sound recording by a third-party distributor would implicate the musical composition copyright (owned by publishers and/or composers) also embodied in the sound recording. Record labels did not necessarily have the authority to grant secondary distributors the authority to use the musical composition embodied in a sound recording even if the label has received a lawful mechanical license to make the recording.

The DPRA addressed this issue by explicitly amending Section 115 to establish that the digital reproduction and distribution of a sound recording (otherwise known as a "digital phonorecord delivery" or "DPD") required the payment of mechanical royalties to the musical composition copyright owner.[192] In making this change, Congress, for the first time, evoked transaction costs justifications when considering the continued importance of the mechanical license. Congress appeared to recognize that requiring digital

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swift-apple-music-spotify-statements-timeline (discussing Taylor Swift's decision to pull her recordings from Spotify). In contrast, the compulsory licensing regime does not give recording artists this option when it comes to non-interactive services.

[192] Statement of Marybeth Peter, Register of Copyrights, before the Subcommittee on Intellectual Property, Committee on the Judiciary, Music Licensing Reform (July 12, 2005), https://www.copyright.gov/docs/regstat071205.html.

distributors to negotiate with two sets of copyright owners could be burdensome, and explained that expanding the license to DPDs would allow digital distributors who received permission to distribute sound recording to bypass direct negotiations with the owners of musical composition copyrights.[193]

At the same time, however, the DPRA did not fundamentally alter the architecture of the mechanical license. The individualized notice requirement for invoking the license remained in place, which impeded the ability of digital distributors to engage in efficient bulk licensing of content.[194] More importantly, the DPRA left the 801(b) factors in place, implicitly suggesting that the policy objectives reflected in those factors remain relevant to rate-setting. As explained further below, this has created some confusion at the CRB as to what goals should be reflected when applying the mechanical license in the digital music space.

The DPRA also failed to clarify how new forms of music dissemination, such as interactive streaming, would be affected by the mechanical license. As explained above, interactive streaming services, like Spotify, were exempted from the new Section 114 license and must therefore negotiate sound recording licenses directly with record labels. But it remained unclear how the use of such sound recordings by interactive services implicate the musical composition copyrights also embodied in these recordings. The Copyright Office, in 2008, determined that because interactive streaming services must make server copies in order to stream a song, their operations implicate the copyright reproduction right.[195] Under this interpretation, interactive services must pay mechanical royalties (either via the compulsory license or via direct negotiation) to musical composition copyright owners whenever a song is streamed.[196] Though some streaming services have attempted to dispute that streaming implicates mechanical reproduction,[197] a CRB-approved 2009 settlement established mechanical

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[193] S. Rep. 104-128, 37, 1995 U.S.C.C.A.N. 356, 384 ("[T]he changes to section 115 are designed to minimize the [license negotiation] burden on transmission services").

[194] *See infra* Part III.A.4 (discussing this issue).

[195] In the recently passed Music Modernization Act, discussed further below, Congress adopted this interpretation.

[196] Compulsory License for Making and Distributing Phonorecords, Including Digital Phonorecord Deliveries, 73 Fed. Reg. 66,173, 66,174 (Nov. 7, 2008); *see also Register's Music Licensing Report, supra* note 1, Chap. 2, 2015 WL 1227760, at *8.

[197] *See* Robert Levine, *How Spotify's Argument in Copyright Lawsuit Could Upend the Music Industry's Newfound Recovery*, BILLBOARD (Sep. 13, 2017), https://www.billboard.com/articles/business/7964869/spotify-mechanical-rights-legal-argument-upend-music-industry-recovery (reporting that Spotify has argued in, other contexts, that streaming does not implicate any of copyright's exclusive rights except public performance).

royalty rates to be paid by streaming services to the owner of musical composition copyrights.[198]

The ways in which streaming services now use the mechanical license has further reinforced a narrative that the regime should be understood as primarily transaction costs-remediating: they have increasingly used the mechanical license to avoid the costs of having to identify and negotiate with musical composition copyright owners after having cleared sound recording rights in a song.[199] At the same time, the mechanical license's cumbersome individual licensing process proved highly inefficient for this task; without the ability to engage in blanket licensing—such as the PROs and SoundExchange provide—services were still required to individually notify specific copyright owners about their intent to use the compulsory regime.[200] As explained further below, recent changes to the mechanical license seem designed to remedy these inefficiencies but, in so doing, have pushed the mechanical license even further into the transaction costs narrative.

5. Reform and the Music Modernization Act

Thus, by the early 2000s, government regulation of the music marketplace had dramatically shifted. For most of the twentieth century, the government's main intervention was the mechanical license, which regulated the relationship between musical composition copyright owners and distributors of recorded music, primarily record labels. But thanks to the

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[198] *See infra* Part III.B.1; *see also Register's Music Licensing Report, supra* note 1, Chap. 2, 2015 WL 1227760, at *8. Even more confusingly, because it is widely understood that interactive streaming implicates copyright's public performance rights, services must pay musical composition owners both mechanical royalties and public performance royalties (generally via the PROs) for the same works. *Register's Music Licensing Report, supra* note 1, Chap. 4, 2015 WL 1227762, at *19. The redundancy of requiring payments under both the mechanical reproduction and performance rights has increasingly led to private contracts that bundle these two rights together. Moreover, the CRB, in the most recent streaming rate-setting proceeding describe below, established an "all-in" mechanical rate—*i.e*. a rate that is designed to explicitly encompass whatever performance royalty amount must be paid by a streaming service. *Phonorecords III*, Initial Determination, *supra* note 26, at 5-6.

[199] Jeong, *supra* note 99.

[200] See *Register's Music Licensing Report, supra* note 1, Chap. 3, 2015 WL 1227761, at *24–25 (discussing inefficiencies of the song-by-song licensing and payment scheme); R. Anthony Reese, *Copyright and Internet Music Transmissions: Existing Law, Major Controversies, Possible Solutions*, 55 U. MIAMI L. REV. 237, 255 (2001) (same). This also spawned a number of lawsuits in which musical composition copyright owners alleged a streaming service failed to abide by the statutory licenses' formalities and/or failed pay necessary mechanical royalties. As failure to abide by the mechanical license regime renders the use of a musical composition an infringement, these lawsuits often seek huge amounts of statutory damages under the Copyright Act's infringement regime. *See* Jeong, *supra* note 99 (discussing lawsuits).

dramatic technological changes to music distribution—and partial attempts to address these changes in the DPRA and the DMCA—this regulation became significantly more complex and inconsistent. Most notably, similar forms of dissemination (such as non-interactive vs. interactive streaming) did not have access to the same compulsory licensing options and/or were subject to different rate-setting standards (the 801(b) factors vs. a willing buyer and willing seller standard).[201]

As discontent with this convoluted regime grew, the Copyright Office began to study the problem. In 2015, it released a report that advocated for various changes designed to promote greater fairness, efficiency, consistency, and transparency.[202] In laying out its vision, however, the Report tacitly rejected the original guiding principles of the mechanical license and Section 114 license as tools for balancing copyright's policy objectives.[203] Instead, the Report concluded that "compulsory licensing should exist only when clearly needed to address a market failure."[204] While the Report questioned whether compulsory music licensing was still necessary at all, it ultimately concluded that transaction costs in the licensing of musical works by digital music distributors made some form of compulsory system necessary.[205] But it proposed several changes seemingly designed to further the regime's transformation into an exclusively transaction costs-remediating tool. Most notably, the Report advocated that the 801(b) factors be replaced across the board with a "willing buyer and willing seller" standard "designed to achieve to the greatest extent possible the rates that would be negotiated in an unconstrained market."[206] Using the model of the PROs and SoundExchange, the Report also suggested that a collective be created to handle blanket licensing of musical composition mechanical rights to streaming services.[207]

Congress implemented many of these suggestions in the recently passed Music Modernization Act ("MMA"). Among other things, the Act addresses the "inconsistent" rules that govern compulsory music licensing by replacing the 801(b) factors with the "willing buyer and willing seller" standard, previously only used for internet radio stations created after the

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[201] *See infra* Parts III.A.2-3.

[202] *Register's Music Licensing Report, supra* note 1, Chap. 4, at *2.

[203] *Id*. at *3 ("To the extent our policies require copyright owners to subsidize certain business models through reduced royalties, as copyright owners claim, this is not the result of a present-day judgment that it is a fair way to treat creators, or promotes the values of our copyright system.").

[204] *Id.* at *21.

[205] *Id.* at *20-21.

[206] *Id*. at *8.

[207] *Id*. at *22-24, *27.

DMCA.[208] This means that, in future rate-setting proceedings, the rates of both the mechanical license and the Section 114 license will be set using an ostensible market-mimicking standard.[209]

The MMA also furthers a transactions costs-focused approach to compulsory licensing by addressing the Copyright Office's concerns about the inefficiencies of the individualized mechanical licensing procedures. Digital distributors—including those that sell individuals music files or operate an interactive streaming platform—will soon be able to receive a special blanket compulsory license to utilize the musical compositions embodied in any sound recording that the service is authorized to distribute. This process, and payment to copyright owners, will be managed by a new "mechanical licensing collective," very similar to SoundExchange.[210] Congress was explicit that this new system will decrease the need for "[s]ong-by-song licensing negotiations [and their associated] transaction costs."[211]

B. Rate-Setting Context

The last Section explored how legislative and industry changes in the 1990s furthered the narrative that compulsory copyright licensing should primarily be used to address transaction costs. An implication of this narrative—one made explicit in the MMA—is that rate-setting regulators should only strive to mimic market prices when setting rates, without regard to any broader policy goals. This Section explores a similar shift in narrative within the CRB's rate-setting decisions even before passage of the MMA. In the past, the CRB (and its predecessors) often chose royalty rates informed by the policy goals of the 801(b) factors. The factors often led the CRB to depart downward from ostensible market-based rates in order to encourage technologies that facilitate music dissemination. In recent rate-setting decisions, however, the CRB moved away from the policy objectives as a source of rate-making guidance in favor of relying almost exclusively on free-market benchmarks. This shift has significantly increased the royalties that streaming services must pay to musical composition copyright owners.

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[208] Report and Section by Section Analysis of H.R. 1551 by the Chairmen and Ranking Members of Senate and House Judiciary Committees at 2 (Oct. 19, 2018), https://www.copyright.gov/legislation/mma_conference_report.pdf.

[209] Music Modernization Act, *supra* note 25, § 102 (codified at 17 U.S.C. § 115(c)), § 103 (codified at 17 U.S.C. § 114(f)).

[210] *Id*. at § 102 (codified at 17 U.S.C. §§ 115(b), 115(d)). Individuals may still receive a compulsory license to make sound recordings of specific musical compositions, which means artists/record labels will still be able to utilize the license to make cover songs with relative ease. *Id*.

[211] Report and Section by Section Analysis of H.R. 1551, *supra* note 208.

1. The 801(b) Factors in the Digital Era

In the 1980s and 1990s, the mechanical license royalty rates were primarily chosen via industrywide settlements,[212] which meant that music rate-setting proceedings were relatively infrequent in the decades following the 1976 Act. This began to change following passage of the DPRA and DMCA in the 1990s; the CRB and its predecessor, the Copyright Arbitration Review Panel or "CARP" (which had replaced the CRT system described in Part II),[213] were now confronted with a range of new compulsory licensing regimes related to digital distributors of music. As explained above, these included the Section 114 sound recording public performance license for satellite radio and "preexisting" internet radio services (set under the 801(b) factors) and for all other internet radio services (set under a willing buyer and willing seller standard). In addition, the expansion of the mechanical license to digital distribution meant that several new industries (digital MP3 sellers and streaming services) were now covered by the existing mechanical license, which continued to be set under the 801(b) factors.[214]

During this period, the CARP/CRB relied on a two-part process for setting rates under the 801(b) factors. First, the judges identified a range of rates based on marketplace "benchmarks" derived from licensing deals in analogous free-market licensing contexts.[215] Second, the judges chose a rate from within this range that would be most conducive to realizing the 801(b) policy goals.[216] This approach has little grounding in the statutory text, which does not require any consideration of analogous market-based rates at all, a point that has frequently been reinforced in rate-setting decisions and by the D.C. Circuit, which reviews such decisions.[217] Indeed, the CARP noted that

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[212] *See* 52 Fed. Reg. 22637 (June 15, 1987) (settlement governing 10-year rate for mechanical royalties); 63 Fed. Reg. 7288 (Feb. 13, 1998) (same).

[213] In 1993, Congress abolished the CRT and replaced it with a system of ad hoc copyright arbitration royalty panels (CARPs). *See* Copyright Royalty Tribunal Reform Act of 1993, Public Law No. 103-198, 107 Stat. 2304. In 2004, Congress abolished the CARP system and replaced it with the Copyright Royalty Board (CRB). *See* Copyright Royalty and Distribution Reform Act of 2004, Public Law No. 108-419, 118 Stat. 2 341.

[214] *See supra* Parts III.A.2 and III.A.3.

[215] Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings, 63 FR 25394-01 (May 8, 1998) [hereinafter *1998 CARP Proceeding*]. This first stage also often involved choosing a rate structure (such as a per-unit price vs. a percentage of revenue), in addition to an actual rate.

[216] *1998 CARP Proceeding*, *supra* note 215, 63 FR 25394-01.

[217] Recording Indus. Ass'n of Am. v. Librarian of Cong., 176 F.3d 528, 533 (D.C. Cir. 1999) ("Section 801(b)(1) requires only that arbitration panels set 'reasonable copyright royalty rates.' The statute does not use the term 'market rates,' nor does it require that the term 'reasonable rates' be defined as market rates."); Determination of Royalty Rates and Terms for Ephemeral Recording and Webcasting Digital Performance of Sound Recordings

a rate set under the 801(b) factors "need not mirror a freely negotiated marketplace rate—and rarely does—because it is a mechanism whereby Congress implements policy considerations which are not normally part of the calculus of a marketplace rate."[218] Nonetheless, the CARP/CRB consistently used this two-part process when setting rates.[219]

Despite starting its inquiry with marketplace evidence, the CARP/CRB often found that the 801(b) factors required the selection of rates at the lower end of the range suggested by benchmark evidence in order to further the 801(b) policy objectives. In the first rate-setting proceedings applying the 801(b) objectives to the new Section 114 compulsory license, the CARP explicitly adopted a "low rate favoring the [digital radio] Services" in light of the 801(b) objectives.[220] The CARP relied in particular on the third factor (the relative roles of the copyright owner and distributor in making works available to the public), focusing on the services' technological innovations in "opening a new avenue for transmitting sound recordings to a larger and more diverse audience, including the creation of technology to uplink the signals to satellites and transmit them via cable; technology to identify the name of the sound recording and the artist during the performance; and technology for programming, encryption, and transmission of the sound recording."[221] While the record labels argued that "only [] the creation of the sound recordings" should be relevant to the third factor's emphasis on making music available to the public, the Register of Copyrights, in reviewing the CARP decision, rejected this argument. She agreed with the CARP that the services' work in creating "a new industry that expands the offerings of the types of music beyond that which one receives over the radio, through live performances, and other traditional means of public performance" supported a lower statutory rate that would allow the internet radio services to thrive.[222]

This interpretation of the third factor is consistent with what the last Parts identified as the traditional purpose of the compulsory music licensing

(*Web IV*), 81 Fed. Reg. 26,316, 26,391 (May 2, 2016) ("[U]nder th[e Section 801(b)] standard '[t]he Copyright Act permits, but does not require, the Judges to use market rates to help determine reasonable rates.'"); *1998 CARP Proceeding*, *supra* note 215, 63 FR 25394-01 ("Unlike a marketplace rate which represents the negotiated price a willing buyer will pay a willing seller, reasonable rates are determined based on policy considerations.").

[218] *1998 CARP Proceeding*, *supra* note 215, 63 FR 25394-01 at 25409.

[219] This approach appears to have emerged from the fact that market benchmarking is a routine feature of regulatory rate-setting in other contexts. *See* 1980 Adjustment of the Royalty Rate for Coin-Operated Phonorecord Players, 46 FR 884-01 (making this point).

[220] *Id.*

[221] *Id.* at 25,407.

[222] The Register of Copyrights slightly raised the CARP's chosen rate, from 5% to 6.5% of gross revenue, primarily because of disagreements over the CARP's interpretation of market benchmark evidence. *Id.*

regime and the 801(b) objectives: to weigh copyright owners' incentives to create new works against disseminators' roles in furthering access. Indeed, in affirming the CARP's interpretation of the third factor, the Register of Copyrights noted that the record labels had, in the past, themselves taken advantage of this interpretation in order to receive mechanical license rates lower than those that would likely prevail in an open market.[223]

In the years following the 1998 CARP decision, the CRB, on several other occasions, recognize that the 801(b) factors required lower royalty rates for innovative technologies of dissemination. For example, when setting sound recording performance rates for satellite radio in 2008, the CRB found that the third factor (relative roles) and fourth factor (industry stability) together warranted a rate "that is lower than the upper boundary most strongly indicated by marketplace data" because of satellite radio services' technology-related expenses.[224] When revisiting these rates in 2012, the CRB again found that the third factor counseled in favor of a rate at the lower end of marketplace benchmarks because of the costs to satellite radio services in maintaining their "proprietary music distribution system."[225] The CRB also occasionally cited the third factor when choosing to maintain rates based on an expiring settlement agreement, despite the demands of copyright owners that the rates be raised. For example, the CRB chose to maintain prior rates for the mechanical license in 2009, despite complaints from copyright owners that the rates were too low, concluding that the prior rates reflected the "balance of the contributions made by the parties."[226]

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[223] Specifically, the Register of Copyrights noted that the first CRT decision applying the 801(b) objectives in setting the mechanical license rate had factored in the labels' role in encouraging dissemination of musical works through "technological innovations" and new business models. *Id*.

[224] Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services (*SDARS I*), 73 FR 4080-01 at 4096-4098.

[225] Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services (*SDARS II*), 78 FR 23054-01 at 23069

[226] Mechanical and Digital Phonorecord Delivery Rate Determination Proceeding (*Phonorecords I*), 74 FR 4510-01 at 4524-4525. The CRB has also cited the first factor (maximization of availability of music to the public) in justifying the maintenance of prior rates, noting somewhat tautologically, that in the absence of evidence that copyright owners and services had reduced their offering under the prior rates, it was safe to presume that the availability of music to the public was being maximized. *See, e.g.*, *Phonorecords I*, *supra*, 74 FR 4510-01 at 4523-4524 (noting that digital distributors "like Apple's iTunes, provides an important avenue for enhancing the public's access to creative works" but finding that the current rates were allowing these services to function appropriately); *SDARS II*, *supra* note 225, 78 FR 23054-01 (citing first factor to support maintaining prior rate for sound recording performance rights for digital radio on the grounds that neither digital radio services nor record labels had "reduced [their] music offerings or contemplated exiting the business" under the prior rate).

2. Phonorecords III

In earlier rate-setting decisions, the CRB appeared to understand its role as policy-driven, concluding that the 801(b) factors, in particular the third factor, required lower rates for music distributors in situations where an innovative technology had facilitated music access for the public through innovative technological developments. But in the recent *Phonorecords III* proceeding, which, among other things, set the mechanical royalty rate for interactive streaming, the CRB appeared to abandon this approach. Instead, the CRB privileged analyses ostensibly designed to replicate free market-driven royalty rates and treated the 801(b) objectives as an afterthought.

As explained above, the question whether interactive music streaming even implicates the mechanical license has been contested,[227] but the music industry nonetheless entered into two settlements governing mechanical royalty rates for streaming: *Phonorecords I* in 2009[228] and *Phonorecords II* in 2013.[229] In the 2017 *Phonorecords III* proceeding, the CRB was tasked with setting mechanical rates for January 2018 through December 2022.[230] No settlement was reached,[231] meaning that the CRB was, for the first time, required to identify an appropriate musical composition royalty rate for the entire interactive streaming industry. A hearing was conducted from March 8, 2017 through April 13, 2017, including the NMPA and NSAI, representing the interests of songwriter and publisher copyright owners, and Amazon Digital Services, LLC, Apple Inc., Google, Inc., Pandora Media, Inc., and Spotify USA Inc. representing the interests of interactive streaming services.[232]

The *Phonorecords I* and *II* settlements had set the interactive streaming mechanical royalty amounts using a complicated formula primarily focused on percentages of the services' revenue, with different calculations used depending on the streaming service's business model. For example, different formulas were used for subscription services vs. services that provided free access to consumers and only derived revenue from advertising ("freemium" platforms).[233] The theory behind this system appears

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[227] *See supra* note 197.

[228] *Phonorecords I, supra* note 226, 74 Fed. Reg. 4510 at 4514.

[229] *Phonorecords II, supra* note 226, 78 Fed. Reg. 67,938. Prior to 2009, earlier settlements had established that digital downloads would be governed by the same rates as physical phonorecords. *See* 64 Fed. Reg. 6221 (Feb. 9, 1999).

[230] 81 Fed. Reg. 255 (Jan. 5, 2016).

[231] *See* 82 Fed. Reg. 15297 (Mar. 28, 2017).

[232] *Phonorecords III*, Initial Determination, Majority Opinion *supra* note 26, at 5.

Phonorecords III, Initial Determination, Majority Opinion *supra* note 26, at 10, 27; *Phonorecords III*, Initial Determination, Dissent, *supra* note 26, at 26-30; see also HARRY FOX AGENCY, RATE CHARTS, https://www.harryfox.com/find_out/rate_charts.html.

to be that it would allow for greater price discrimination—services operating freemium plans were generally required to pay less than services operating subscription plans—and, accordingly, for more consumers to be reached.

The *Phonorecords III* CRB judges, however, decided to abandon the "Rube-Goldberg-esque complexity" of the settlement-developed system[234] instead adopting a rate structure applicable to all forms of streaming, with no variation based on business model. This across-the-board rate structure would be calculated by looking both at a service's revenue and its "total content costs." Total content costs or "TCC" is essentially the payments made by streaming services to record companies *for sound recording rights* under their free-market licensing deals.[235] In including a TCC calculation, the judges sought to "import" the free-market rates from the unregulated sound recording licensing market and thus "influence [] directly" the ratio of sound recording royalties to music composition royalties, which, the judges believed, were not in line with the ratio that would prevail if both licensing markets were free.[236]

The actual rate chosen by the judges, expressed as both revenue percentages and TCC percentages (whichever amount ends up being higher controls), were also calculated to parallel the unregulated sound recording licensing market. Utilizing a complicated economic model, coupled with record label, publisher, and streaming service financial data,[237] the judges attempted to model the entire market structure that gives rise to music streaming—both the record label/sound recording side and publisher/musical composition sides—based on the total revenue, costs of all parties, and their

[234] *Phonorecords III*, Initial Determination, Majority Opinion *supra* note 26, at 11.

[235] *Id.* at 13 n.37, 40. This is essentially a greater-of calculation: a service must pay whichever number is higher based on a calculation of percentage of revenue and percentage of TCC.

[236] *Id.* at 36. The judges noted that a pure percentage of revenue calculation was unsuitable to achieve an accurate picture of rates that would prevail in an unrestrained market because streaming "services [] seek to engage to some extent in revenue deferral in order to promote their long-term growth strategy," meaning their revenue may be artificially low, leading to artificially lower royalty rates for copyright owners. The inclusion of the TCC prong was designed to provide an alternative metric that would ensure copyright owners would be compensated if this happened. *Id. See also supra* Part III.A.3 (explaining how interactive services pay sound recording royalties under free market agreements).

[237] This specific model used by the judges is called the Shapley value. It "models bargaining processes in a free market by considering all the ways each party to a bargain would add value by agreeing to the bargain and then assign[ing] to each party their average contribution to the cooperative bargain." *Id.* at 64. A full discussion of this model, and whether judges applied it accurately, is outside the scope of this Article but it bears mentioning that the applicability of the model and its utility for drawing conclusions about the musical composition market from data in the sound recording market was significantly contested during the *Phonorecords III* proceeding. *See id.* at 64-68.

bargaining positions.[238] From this model, the judges arrived at a range of possible mechanical royalty rates.

Having established a range of possible market-derived rates, the judges then turned to the 801(b) factors to assess their options. While prior rate-setting decisions had made clear that market benchmarking is only the "starting point for establishing an appropriate rate" to be followed by assessment in light of the 801(b) goals,[239] the judges, in an unusual step, declined to weigh the factors' policy objectives in an inquiry separate from their free-market benchmarking inquiry. They instead declared that the 801(b) objectives simply "provide[] further support for the[] findings" of their earlier analysis.[240] After making this cursory conclusion, the judges ultimately chose rates at the higher end of the range they had identified, failing to explain why these rates were chosen over the other options.[241]

CRB judge David Strickler, in a lengthy dissenting opinion, identified some of the problems with majority's approach. While Judge Strickler did not frame his dissent with explicit reference to the policy-oriented approach to compulsory licensing discussed above, his analysis points to many of the reasons the *Phonorecords III* decision should be considered a dramatic departure from the traditional approach.

Most importantly, the dissent noted that majority's rate structure has the effect of "tying" the mechanical royalty rate to the unregulated sound recording licensing market, which means that "whenever the record companies demand and obtain a higher sound recording royalty rate, under the majority's rate structure, the services' section 115 mechanical royalty rate must increase as well."[242] By simply "pegging the regulated mechanical

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[238] *Id*. at 64-72.

[239] *1998 CARP Decision*, *supra* note 215, 63 FR 25394-01.

[240] *Phonorecords III*, Initial Determination, Majority Opinion *supra* note 26, at 80. In so doing, the judges explicitly distinguished D.C. Circuit precedent holding that the 801(b) inquiry is distinct from a willing buyer-willing seller inquiring, concluding that to the "extent market factors may implicitly address any (or all) of the four itemized factors, the reasonable, market-based rates may remain unadjusted." *Phonorecords III*, Initial Determination, Majority Opinion *supra* note 26, at 80. For example, even while acknowledging that "Congress included Factors B and C [respectively, fair returns/income and relative roles] in section 801(b)(1) to establish a legal standard for the Judges to use to move their determination of new rates for existing licenses beyond a strictly market-based analysis," the judges nonetheless concluded that these factors could be realized "through" the analysis of the sound recording licensing market described above. *Id*. at 87-88.

[241] *Id*. at 89.

[242] *Phonorecords III*, Initial Determination, Dissent, *supra* note 26, at 3 & n.5. As discussed further below, this approach is particularly inconsistent with copyright policy goals because it allows the mechanical royalty rate to reflect the market power imbalances in the unregulated sound recording licensing market. *Id*. at 4; *see also infr*a Part IV.A.2.

royalty rate to the unregulated sound recording royalty rate" the judges had failed to perform their rate-setting responsibilities under section 801(b).[243]

Instead, Judge Strickler engaged in his own independent rate-setting analysis and concluded that the record and the 801(b) objectives counseled in favor of maintaining the statutory rate structure and rates established in the *Phonorecords I* and *II* settlements.[244] Judge Strickler's alternative analysis took a remarkably different approach from the majority in considering the CRB's role in regulating the music marketplace. Rather than treating market proxies as the be-all-and-end-all of the rate-setting inquiry, the dissent considered the unique realities of the music marketplace through the lens of the goals of the copyright system.

In particular, Judge Strickler recognized that copyright aims to find the right "balance between access and incentives."[245] He noted that:

> [a]t the theoretical extremes are two unacceptable approaches to rate-setting: (1) setting price equal to the marginal physical cost of copying, which is zero; and (2) setting price on a per unit basis that exceeds marginal physical cost. In the chasm between these two inadequate approaches exist many alternative rate structures with varying rates for various segments of the market. In general terms, these alternative rate-setting structures are forms of 'price discrimination.'[246]

While acknowledging that perfect price discrimination is not possible, Judge Strickler gravitated towards the existing settlement rate structure because its approach enables a form price discrimination—in particular by allowing services to operate "freemium" plans—that allows a greater number of consumers to be reached.[247] The settlement structure enabled services to "segregate[e] listeners according to [willingness to pay] – still allowing them to 'experience' interactive streaming, while, second, still providing royalties to Copyright Owners." It thus provided the best way of ensuring balance between incentives and access of all of the options on the table.[248]

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[243] *Phonorecords III*, Initial Determination, Dissent, *supra* note 26, at 10, 26.

[244] *Id*. at 12.

[245] *Id.* at 33-35. More specifically, Judge Strickler discussed how copyright has aspects of a public good and copyright owners' ability to price above marginal cost yields a deadweight loss that must be weighed against the need for incentivizing authors to create. *Id*.

[246] *Id*. at 38.

[247] *Id*. at 50-51. Copyright scholars have noted that price discrimination, where feasible, can sometimes be an effective tool in facilitating maximum access to copyrighted works without compromising copyright owners' ability to monetize those works. *See* FISHER, *supra* note 93, at 167.

[248] *Id*. at 56. It is important to note that Judge Strickler framed this conclusion as emerging from "market"-based inquiry, while also noting that the 801(b) factors "provide further support" for it. *Phonorecords III*, Initial Determination, Dissent, *supra* note 26, at

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Though not framed as such by the majority or dissent, the *Phonorecords III* disagreement can be understood as reflecting the tension between the two approaches to rate-setting described in the last Parts. The majority's insistence on treating free-market proxies as the be-all-and-end-all of rate-setting led them to tether the streaming royalty rate to the unregulated sound recording licensing market without any broader policy inquiry. In contrast, Judge Strickler's more nuanced understanding of the unique features of copyright licensing markets led him to prefer a model that would enable services to reach a larger number of consumers while still ensuring that copyright owners received compensation.

In more concrete terms, the majority's approach will likely prove problematic for streaming services. Looking only at the percentage of revenue component of the new rate structure, the mechanical royalty rates paid by services are expected to increase 44% over the next few years.[249] The overall higher rates—and the cost they impose on distributors—will likely be borne by consumers.[250] For example, the new rates may make it unfeasible for services to operate free, ad-supported plans, may require services to charge more for subscription plans generally, and may shut out new entrants to the streaming industry generally.[251]

In this respect, *Phonorecords III* clarifies the stakes of a copyright policy-sensitive approach to compulsory licensing as compared to one focused exclusively on transaction costs and market mimicking. To be clear, the argument of this Article is not that transaction costs minimization cannot or should not also be a primary consideration in the architecture of the Copyright Act's compulsory licensing regimes. Digital services and copyright owners both benefit from the ability to blanket license entire catalogues of music, and this reduction in transaction costs certainly allows for more works to reach the public. However, an *exclusive* focus on transaction costs—and, by extension, an exclusive focus on market proxies—

121-22. As discussed below, this framing has important implications for future rate-setting proceedings. *See infra* Part IV.B.

[249] *Major Victory For Songwriters as U.S. Streaming Royalty Rates Rise* MUSIC BUSINESS WORLDWIDE (Jan. 27, 2018), https://www.musicbusinessworldwide.com/major-victory-songwriters-us-mechanical-rates-will-rise-44-2018/.

[250] *See* DiCola, *supra* note 187, at 1875 (explaining generally why "an increase in [music] royalty costs will increase prices and reduce quantity sold [by music distributors] to some extent.").

[251] Rhett Jones, *Bigger Streaming Royalties Sound Like Trouble for Spotify*, GIZMODO (Jan. 29, 2018), https://gizmodo.com/bigger-streaming-royalties-sound-like-trouble-for-spoti-1822516333.

prevents the regime from also serving the policy goals at the heart of American copyright law. The next Part explores, in more detail, how streaming implicates these policy goals, in particular the incentives/access tradeoff, and why compulsory licensing remains an important tool for ensuring these goals are not compromised.

IV. Policy-Driven Compulsory Licensing in the Age of Streaming

The last Part examined the growing conflict surrounding the role of compulsory licensing in the copyright system. Over the past few decades, policymakers have begun treating compulsory licensing as only a tool for remedying transaction costs-based market failures. In furthering this new approach, Congress has inconsistently applied compulsory licensing to new forms of music dissemination: non-interactive streaming is subject to the Section 114 compulsory license for sound recordings, but interactive streaming is not. Congress and regulators now also see free-market proxies as the most appropriate guidelines for rate setting. This is a departure from the original understanding of compulsory licensing as a tool for recalibrating the balance between copyright's policy goals, in particular by facilitating innovative technologies of music dissemination, such as the player piano and the record player.

This Part argues that this shift is problematic and seeks to make a normative case for copyright policy-centered compulsory licensing regimes. To make this case, I focus on music streaming. The first Section outlines the arguments in favor of consistently applying compulsory licensing to all new forms of music dissemination, including interactive streaming. The second Section argues that rate setting should once again attempt to actively further copyright policy goals, rather than only seeking to identify ostensible free market proxies. The third Section highlights some ways that the CRB could do so, even under the "willing buyer and willing seller" rate-setting standard now used throughout the existing compulsory music licensing regime.

A. Why Compulsory Licensing?

As Part III explored, compulsory licensing is now applied inconsistently in the music marketplace. While non-interactive services can take advantage of the Section 114 compulsory license for sound recordings, interactive services are only partially covered: they must negotiate free market rates for sound recording copyrights but can utilize the mechanical compulsory license for musical composition copyrights. Despite its efforts to create greater consistency in the music licensing landscape, the MMA did not alter this status quo. This Section argues that a compulsory licensing regime

for all forms of streaming would be most consistent with the historic approach to compulsory licensing and would best facilitate substantive copyright policy aims. To make this case, I focus on two issues in particular: the innovative nature of interactive and non-interactive streaming in facilitating unprecedented access to music for the public and the evidence that pathologies in the music marketplace allow copyright owners to extract unduly high licensing fees, potentially frustrating streaming services' ability to reach consumers. While free-market licensing is unlikely to account for these issues, a policy-sensitive compulsory licensing regime could ensure that copyright owners receive sufficient financial incentives, while also ensuring that the streaming industry can continue to expand public access to music.

1. Access-Enhancing Innovation

The advent of music streaming is likely the most important technological innovation for facilitating dissemination of music since the invention of recording technology. Streaming services provide users with instantaneous access to vast amounts of recorded music, with the potential to someday deliver every single recorded song ever commercially released.[252] As William Fisher presciently argued in 2004, streaming has the unique potential to "satisfy consumers' desires more fully, rapidly, and precisely" than any other form of music dissemination ever created.[253]

In addition to providing access, both interactive and non-interactive streaming services also enhance consumers' experience of music. Many interactive services employ sophisticated algorithms designed to recommend new songs to consumers based on a variety of data, as well as features that allow users to curate detailed compilations and share them across social media communities.[254] Similarly, non-interactive services provide innovative music discovery tools, which make these services far more customizable than

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[252] In this respect, streaming represents the arrival of the "celestial jukebox" that copyright scholars and policymakers have discussed for decades. *See* GOLDSTEIN, *supra* note 74, at 187.

[253] FISHER, *supra* note 93, at 25; *see also Phonorecords III*, *supra* note 26, Witness Statement of Will Page at 2-19, https://www.crb.gov/rate/16-CRB-0003-PR/statements/spotify/testimony-will-page.pdf (discussing ways that Spotify has expanded music access); Reese, *supra* note 200, at 238 (discussing how on-demand music services expand access).

[254] *See Phonorecords III*, *supra* note 26, Witness Statement of David Dorn at 12-21 https://www.crb.gov/rate/16-CRB-0003-PR/statements/apple/testimony-david-dorn.pdf (discussing Apple Music services); *Phonorecords III*, *supra* note 26, Witness Statement of Paul Joyce at 5, https://www.crb.gov/rate/16-CRB-0003-PR/statements/google/statement.pdf (discussing Google Play services); *Phonorecords III*, *supra* note 26, Witness Statement of Will Page at 29-41 https://www.crb.gov/rate/16-CRB-0003-PR/statements/spotify/testimony-will-page.pdf (discussing Spotify services).

traditional radio.[255] Together, these technologies have dramatically changed the ways consumers utilize music in their day-to-day lives, with more changes likely to come.[256]

Recent trends in fair use case law can help clarify why streaming's ability to expand consumers' access to and experience of music is socially valuable and thus important from the perspective of copyright policy. As Part I argued, it is useful to understand compulsory licensing regimes, like the music compulsory licenses, as being part of the same family as the fair use doctrine, which is considered one of the most important exceptions to copyright's grant of exclusive rights. Just as fair use allows courts to impose a zero-price compulsory license to rebalance authors' financial incentives against the public's interest in access, so too a compulsory licensing scheme can engage in similar balancing in the rate-setting context.[257]

Much fair use case law deals with the use of existing copyrighted material in follow-on expressive works. But recent cases have increasingly applied the doctrine in situations "where the defendant's use does not add any new insights to the work, but rather presents it in a new technological or functional context."[258] The Ninth Circuit, for example, has repeatedly held that the creation of thumbnail images of copyrighted content for search engine purposes is fair use.[259] The Second Circuit found that Google's mass digitization of millions of copyrighted books was fair use when this archive was provided to the public for certain search purposes.[260] Recently, a Second Circuit opinion by Judge Pierre Leval reflected on this line of cases and noted that they all involved uses that "expand[ed the] utility" of the original work, including by "deliver[ing] [] content in more convenient and usable form[s]."[261]

Consistent with the limitations of the fair use doctrine—in particular, the market harm factor—many of these decisions took care to note that the

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[255] *See* Xiyin Tang, *Defining the Relevant Market in Fair Use Determinations* at 41-42 (Nov. 2, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3264238 (discussing Pandora's music genome project and arguing that these tools could even be transformative enough to warrant a fair use finding).

[256] John Seabrook, *Revenue Streams* NEW YORKER (Nov. 24, 2014), https://www.newyorker.com/magazine/2014/11/24/revenue-streams (discussing Spotify's technological ambitions).

[257] *See supra* Part I.C.

[258] Jacqueline D. Lipton & John Tehranian, *Derivative Works 2.0: Reconsidering Transformative Use in the Age of Crowdsourced Creation*, 109 NW. U. L. REV. 383, 413 (2015); *see also* Tang, *supra* note 255, at 19 (discussing the line of "functionally transformative" cases).

[259] Perfect 10, Inc. v. Amazon.com, Inc., 508 F.3d 1146, 1167 (9th Cir. 2007); Kelly v. Arriba Soft Corp., 336 F.3d 811, 817 (9th Cir. 2003).

[260] Authors Guild v. Google, Inc., 804 F.3d 202, 214 (2d Cir. 2015).

[261] Capitol Records, LLC v. ReDigi Inc., 910 F.3d 649, 661 (2d Cir. 2018).

secondary user had not "merely retransmitted [the works] in a different medium,"[262] but had transposed the works into a context where they could be used for a different *function* (in many of these cases, search-related). But the cases still underscore that a non-expressive secondary use of preexisting works that expands their "utility" for the consuming public[263] can implicate basic questions of copyright's ideal balance, even if, as in the Google Books case, the secondary use essentially involves an entire industry's worth of content.[264]

Streaming's ability to enhance users' basic relationship to music consumption is similar to these kinds of utility-expanding innovative uses. Indeed, the social cost-reduction justifications for fair use discussed in Part I also help clarify why streaming is an important technological development. In particular, the understanding of access to copyrighted works as generative of spillovers (positive externalities)—and fair use as preventing copyright owners from overly internalizing the value of such spillovers—can provide some insight into why the increased access, discovery tools, and customizability options offered by music streaming are worth fostering.[265] In particular, these features increase the public's enjoyment of musical works, as well as enable later musicians and songwriters to encounter existing works and draw on them in new works.[266]

All of this is not to say that streaming services' use of copyrighted musical compositions and sound recordings would constitute fair use. Despite the innovative nature of streaming, the market harm to copyright owners would likely be too great to sustain a finding that services could use copyrighted works without providing *any* compensation, as fair use allows.[267] However, as future work will explore more fully in the fair use context,[268] we might understand compulsory licensing as operating in the space outside the limits of fair use, where the market harm to copyright owners is great enough that a zero price license is inappropriate, but where the social value of the use

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[262] Kelly v. Arriba Soft Corp., 336 F.3d 811, 819 (9th Cir. 2003).

[263] Authors Guild v. Google, Inc., 804 F.3d 202, 214 (2d Cir. 2015).

[264] *See also supra* Part I.B (discussing the alternative reading of *Sony* that sees the case as grappling with the tension between author incentives and the public's interest in access to content).

[265] *See supra* discussion accompanying notes 82-85.

[266] Frischmann & Lemley, *supra* note 45, at 285-86 (describing enhanced enjoyment and follow-on creation as examples of positive externalities related to copyrighted works).

[267] *Cf.* Fox News Network, LLC v. Tveyes, Inc., 883 F.3d 169, 180–81 (2d Cir. 2018) (denying fair use to news aggregations service even though the use was "at least somewhat transformative in that it renders convenient and efficient access to a subset of content" because the service had "usurped a function for which [the copyright owner] is entitled to demand compensation under a licensing agreement."); *see also* Capitol Records, LLC v. ReDigi Inc., 910 F.3d 649, 660-64 (2d Cir. 2018) (denying fair use under similar reasoning).

[268] *See* Jacob Victor, *Utility-Expanding Fair Use* (draft on file with the author).

still supports a compulsory license at a royalty rate calculated to promote the new use.

Seen through this lens, the original creation of the mechanical license provides an important parallel to understanding why a policy-sensitive compulsory license regime is important for the burgeoning streaming industry. As Part II explained, the mechanical license was originally created to prevent copyright owners who had previously relied on a specific form of dissemination—sheet music publishing—from frustrating the development of a new, spillover-generating form of dissemination: the player piano and record player.[269] The streaming industry's conflict with publishers and record labels has much in common with this early story, except now *two* separate copyright owner stakeholders—the publishers and record labels—are threatened by the risk that streaming will "cannibalize" their CD sales and other traditional revenue streams.[270] Congress created the mechanical license to ensure that copyright owners, when faced with such risk, could not use their exclusive rights to frustrate the development of new dissemination forms by refusing to license or by charging disproportionate royalties. In setting a low fixed rate, later replaced by the 801(b) factors' policy-sensitive adjustable rate, the original mechanical license facilitated access to musical works by bolstering the developing industries. But by using a compulsory licensing scheme—rather than by simply declaring that music composition copyright owners had no interest in mechanical reproductions of their work at all, as the Supreme Court had done—Congress ensured that copyright owners would still receive compensation sufficient to incentivize the creation of new works.[271]

Though the 1995 DPRA rejected applying the Section 114 compulsory license to the (then hypothetical) interactive streaming industry because of concerns over its threats to recording industry revenue (and, by implication, copyright's incentive function),[272] this decision is difficult to justify in light of the historical role that compulsory licensing has played. The streaming industry may indeed pose a threat to copyright owners' entrenched revenue sources—just as the player piano once did—but compulsory licensing has, in the past, been able to effectively moderate this conflict.[273] Indeed, some have speculated the decision to require interactive services to engage in market-based licensing slowed the growth of the burgeoning

[269] *See supra* Part II.A.

[270] *Phonorecords III*, Initial Determination, Dissent, *supra* note 26, at 70-71 (discussing streaming cannibalization argument); *see also* DiCola, *supra* note 187, at 1881 (critiquing cannibalization arguments generally).

[271] *See supra* Part II.

[272] *See supra* Part III.A.3.

[273] *See supra* Parts II, III.A.2.

industry by enabling record labels to attempt to block the emergence of the technology through withholding licensing or demanding high royalties.[274] Subjecting the use of sound recording copyrights by interactive services would put interactive streaming on the same footing as other innovative forms of music dissemination, ensuring that it is able to continue expanding music access for the public, while still ensuring copyright owners' receive compensation.

2. The Distorting Effects of Market Power

As copyright law strives to find balance in the incentives/access tradeoff, streaming's access-expanding effects must also be considered alongside the financial incentives provided by market-based licensing.[275] As this Sub-Section explains, aspects of the music copyright system—in particular, market power imbalances between copyright owners and streaming services, as well as the potential that music's dual copyright will allow music publishers to engage in holdup strategies—support the conclusion that market-based licensing will not adequately balance between incentives and access. Subjecting music copyright owners to a policy-sensitive form of compulsory licensing has the potential to account for these problems and restore the balance.

The CRB has repeatedly noted that the music licensing marketplace—both on the musical composition side and the sound recording side—is characterized by market power imbalances. Only four publishers control

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[274] FISHER, *supra* note 93, at 105 & n.50; DiCola, *supra* note 187, at 1839; *see also, e.g.*, Maura Johnston, *Spotify's U.S. Launch Delayed Again*, ROLLING STONE (Dec. 8, 2010), https://www.rollingstone.com/culture/culture-news/spotifys-u-s-launch-delayed-again-245549/ (discussing how Spotify's attempts to enter the U.S. market were delayed by record labels' licensing demands).

[275] In the past several years, some scholars have questioned whether copyright is truly necessary in order to encourage authors to produce new creative works. *See, e.g.*, Julie E. Cohen, *Copyright As Property in the Post-Industrial Economy: A Research Agenda*, 2011 WIS. L. REV. 141, 143 (2011) ("[T]he incentives-for-authors story is wrong as a descriptive matter. Everything we know about creativity and creative processes suggests that copyright plays very little role in motivating creative work."). In recent work, Glynn Lunney has applied this lens to the music industry and demonstrated that increases in music industry revenue have had little correlation with the production of new, high-quality musical works, suggesting that copyright's incentive function may be overstated. LUNNEY, *supra* note 178, at 122-56. While these analyses may provide additional support to the argument that compulsory licensing should be applied to the music industry, they are generally outside the scope of this Article, which, consistent with the incentives/access paradigm described above, takes for granted that copyright is necessary to provide some financial incentive to creators. *See supra* Part I.

almost all of the most important musical composition copyrights,[276] and only three record labels control almost of the most important sound recording copyrights.[277] As consumers expect a streaming service to provide access to nearly all commercially available recorded music, a streaming service must license all of the major publishers' catalogues and all of the major record labels' catalogues in order to remain competitive. Thus, both of these licensing markets can be described as complementary oligopolies: "large publishing houses [and] major record labels control large swaths of the market, and their products are 'must haves'" for the services.[278] This complementary oligopoly power allows publishers and labels to extract "supranormal" licensing rates in open markets.[279] There is evidence that this occurs regularly in the unregulated sound recording licensing market for interactive streaming.[280]

While the market power of the labels and publishers is clear, how and why this market power should give rise to government intervention is more complex. Indeed, this issue raises difficult questions about the intersection of antitrust and intellectual property, a full discussion of which is outside the scope of this Article. Suffice it to say that most scholars agree that the exclusive grant provided by IP rights does not inherently give IP owners market power that would sound in antitrust law.[281] Rather, antitrust law is primarily concerned with "anticompetitive *conduct* designed to achieve market power."[282] Ownership of an intellectual property interest (or, more

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[276] *Phonorecords III*, Initial Determination, Majority Opinion, *supra* note 26, at 9 ("The four largest publishers —Sony/ATV, Warner/ Chappell, Universal Music Publishing Group, and Kobalt Music Publishing —collectively accounted for just over 73 percent of the top 100 radio songs tracked by Billboard as of the second quarter in 2016."); Ed Christman, *Publishers Quarterly: Big Lead for Sony/ATV at No. 1*, BILLBOARD (May 4, 2018), https://www.billboard.com/articles/business/8454566/publishers-quarterly-top-ten-sony-atv-warner-chappell-universal.

[277] *Phonorecords III*, Initial Determination, Dissent, *supra* note 26, at 36, n. 67; *Register's Music Licensing Report, supra* note 1, Chap. 2, 2015 WL 1227760, at *5.

[278] *Phonorecords III*, Initial Determination, Dissent, *supra* note 26, at 36 n. 69; *see also Phonorecords III*, Initial Determination, Majority Opinion, *supra* note 26, at 48; *Web IV*, *supra* note 217, at 26348.

[279] *Phonorecords III*, Initial Determination, Dissent, *supra* note 26, at 36 n. 69.

[280] *Phonorecords III*, Initial Determination, Majority Opinion, *supra* note 26, at 75; *Phonorecords III*, Initial Determination, Dissent, *supra* note 26, at 3.

[281] IP AND ANTITRUST, *supra* note 61, at 1-12; 4-9 – 4-13; Michael A. Carrier, *Unraveling the Patent-Antitrust Paradox*, 150 U. PA. L. REV. 761, 791 (2002) ("[P]atents typically do not demonstrate market power, and the set of technological substitutes that cannot be practiced because of the patent grant often has little overlap with the set of products that consumers view as economic substitutes.").

[282] IP AND ANTITRUST, *supra* note 61, at 1-13 (emphasis added); U.S. Department of Justice and Federal Trade Commission, *Antitrust Guidelines for the Licensing of Intellectual Property*, at § 2.2, https://www.justice.gov/atr/IPguidelines/download ("As with any other

likely, a group of them) may give rise to an antitrust violation under certain circumstances, but this assessment requires additional evidence regarding the antitrust defendant's market position.[283] In the music industry's case, antitrust law may be inapposite in understanding whether the relationship between digital services and publishers/record labels should be regulated. As Kristelia García has additionally noted, even if the aggregation of music copyrights by labels and publishers may create market power that could be problematic from the perspective of antitrust law,[284] it is still unlikely that the actions of the copyright owners are sufficiently grave to warrant application of the usual tools of antitrust enforcement, such as merger review and consent decrees.[285]

But even if the market power imbalances in the music licensing market may be of unclear consequence from the perspective of antitrust law, they are still significant from the perspective of copyright.[286] Neil Netanel has explained that copyright law should account for "copyright industries' market structure" because situations in which "a small number of firms holding vast inventories of copyrighted works enjoy oligopolist and oligopsonistic dominance of their sectors" can lead to practices that "exacerbate" the ways that copyright already limits dissemination.[287] Judge Strickler, in his copyright policy-sensitive dissenting rate-setting decision described above, evoked similar reasoning in arguing that adjusting market benchmarks to correct for market power imbalances would be consistent with the compulsory licensing regime's policy goals because such an adjustment would ensure that copyright owners did not earn royalties that far exceed their costs in producing new works.[288]

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asset that enables its owner to obtain significant supracompetitive profits, market power (or even a monopoly) that is solely 'a consequence of a superior product, business acumen, or historic accident' does not violate the antitrust laws.").

[283] IP AND ANTITRUST, *supra* note 61, at 4-13 (discussing these considerations).

[284] García, *supra* note 176, at 239 ("Most individual copyrights (for example, a copyright to a single song) are not viewed as conferring market power on individual owners, but in the aggregate they may—for example, a music publisher with rights to millions of songs.").

[285] *Id*. at 230-42.

[286] Indeed, as one treatise notes, market power is often assessed through the lens of copyright policy goals, rather than antitrust, in several other contexts, including copyright misuse. IP AND ANTITRUST, *supra* note 61, at 3-67 – 3-73.

[287] Netanel, *supra* note 46, at 24–27; *see also* FISHER, *supra* note 93, at 181-82 (discussing how entertainment copyright owners' market power relates to the copyright policy in warranting regulation); *cf.* Depoorter & Parisi, *supra* note 64, at 460-68 (exploring how market power leads to deadweight loss in copyright markets and advocating for the use of fair use to remedy this problem).

[288] *Phonorecords III*, Initial Determination, Dissent, *supra* note 26, at 138-39; *see also id.* at 35 (discussing interplay between market power and copyright policy goals in more general terms). Indeed, market structure has been interwoven with the copyright policy goals at issue in music dissemination since the creation of the mechanical license in 1909; recall

Seen through this lens, the publishers' and labels' complementary oligopoly power is problematic because it creates an imbalance in the incentives/access tradeoff by allowing copyright owners to extract licensing fees that likely exceed the level necessary to incentivize authorship, while simultaneously imposing costs on services that prevent them from facilitating access to works.[289]

While both the record labels and music publishers possess problematic complementary oligopoly power, the musical composition copyright owners also possess a different strategic tool for extracting outsized royalties from streaming services in open markets. As Judge Strickler noted in his *Phonorecords III* dissent, the unusual (and possibly unique) dual nature of music copyright—that a single stream, music file, CD, or record embodies independent copyrights in both the underlying musical composition and the sound recording[290]—means that once a musical composition "has been incorporated into a recording [] it has become essential. . . [and] its uniqueness allows the owner of the input to demand a disproportionate share of the revenue in royalties." In this respect, the music market is vulnerable to holdup problems. Holdup problems, frequently discussed in the patent context, occur when, for example, a "patentholder[] demand[s] royalties from a defendant. . . after it has implemented a technology. The patentholder 'holds up' the seller, prompting a settlement driven by the timing of the demand, rather than its merits."[291] Because a license from the sound recording copyright owner alone is not sufficient to allow a song to be played, musical composition copyright owners can find themselves with a similar ability to hold up license clearance for particularly popular songs. Compulsory licensing remedies this risk by removing musical composition rightsholders' ability to deny or withdraw permission to use their copyrights.

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The conclusion that copyright owners should receive less revenue than what they can demand in open markets might seem surprising in light of the evidence that many recording artists and composers receive little

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that the potential for monopoly in the burgeoning player piano role industry was used as a way of framing justifications for the mechanical license. *See supra* Part II.A

[289] Moreover, copyright owners, to the extent their traditional revenue streams rely on forms of technology threatened by streaming, like CDs, have the incentive to use their market power to frustrate the growth of streaming services. *See* Mark A. Lemley, *IP In A World Without Scarcity*, 90 N.Y.U. L. REV. 460, 498 (2015) ("It may well be rational for record companies and movie studios to fight the digital transition.").

[290] García, *supra* note 176, at 192.

[291] Colleen V. Chien, *Holding Up and Holding Out*, 21 MICH. TELECOMM. & TECH. L. REV. 1, 3 (2014).

compensation from royalties. Many blame compulsory licensing for this problem,[292] but there is little empirical support for this argument.[293] Indeed, the sound recording sector has been characterized by similar undercompensation problems for most recording artists, even though sound recordings operate in an unregulated market with respect to digital downloads and interactive streaming.[294]

A more likely culprit for this underpayment is the basic structure of the music industry and the ways in which royalties are allocated therein. Record labels—which, recall, were among the original music disseminators that the mechanical license helped foster—have always claimed the largest share of music industry revenue.[295] At a time when the barriers to entry for new artists were high, this made sense; record labels could front the large costs associated with music distribution. But digitization has eliminated the need for the "brick-and-mortar world of paper, plastic, trucks, and warehouses."[296] As the creation of another digital copy is essentially costless, now the main costs are only those associated with the creation and marketing of the work itself, which, for music (unlike film and television), are relatively low.[297] Although record labels play a valuable role in promoting and marketing new works, their revenue allocation arrangements with recording artists (and the fact that they usually own the entire sound recording copyright) may still reflect the pre-digital-distribution reality.[298] Thus, many believe that the financial troubles of artists have less to do with underpayment

[292] *Register's Music Licensing Report, supra* note 1, Chap. 3, 2015 WL 1227761, at *3–*5 (explaining this argument).

[293] Indeed, both record and label publisher revenue has gone up consistently over the last four years. *See* Tim Ingham, *How Much Money is the U.S. Music Publishing Industry Making? A Billion Dollars More Than It Was 4 Years Ago*, MUSIC BUSINESS WORLDWIDE (June 16, 2019), https://www.musicbusinessworldwide.com/how-much-money-is-the-us-music-publishing-industry-making-a-billion-dollars-more-than-it-was-four-years-ago/.

[294] FISHER, *supra* note 93, at 77-78.

[295] *Id*. at 19-20, 55-56, 76-77; Michael A. Carrier, *Copyright and Innovation: The Untold Story*, 2012 WIS. L. REV. 891, 921 (2012); *Register's Music Licensing Report, supra* note 1, Chap. 3, 2015 WL 1227761, at *5-*6.

[296] Raymond Shih Ray Ku, *The Creative Destruction of Copyright: Napster and the New Economics of Digital Technology*, 69 U. CHI. L. REV. 263, 301, 305-06 (2002); *see also* Lemley, *supra* note 289, at 469.

[297] *Id.*

[298] *Register's Music Licensing Report, supra* note 1, Chap. 3, 2015 WL 1227761, at *5-*6 (discussing lack of transparency in royalty sharing arrangements); Ku, *supra* note 296, at 305-306; Carrier, *supra* note 295, at 922-23; Ben Sisario, *A New Spotify Initiative Makes the Big Record Labels Nervous*, N.Y. TIMES (Sept. 6, 2018) https://www.nytimes.com/2018/09/06/business/media/spotify-music-industry-record-labels.html.

by digital distributors, and far more to do with the music industry's outdated royalty distribution practices.[299]

Indeed, a well-structured compulsory licensing regime could actually increase payments to artists. For example, the Section 114 compulsory license for digital radio allocates a percentage of royalty revenue to the recording artists regardless of whether they or a record label own the sound recording copyright.[300] Expanding this arrangement to a music industry-wide compulsory licensing regime—covering both musical composition and sound recordings and all forms of streaming—could ensure that songwriters and recording artists receive sufficient royalty payments irrespective of the ownership of the copyrights in their creations.[301]

B. Why Policy-Driven Rate Setting?

The previous Section argued in favor of applying compulsory licensing to *all* forms of music streaming within *both* the sound recording and musical composition licensing markets. Such a regime would still provide the transaction costs-addressing benefits that many have understood as the primary rationale behind compulsory licensing. But it could also potentially allow compulsory licensing to achieve some of the copyright-specific goals that it has historically achieved.

As Part III explored, the increasing prevalence of the assumption that compulsory licensing should only exist to remedy transaction costs-based market failures has led both Congress and CRB to depart from the 801(b) policy-oriented approach to rate setting and instead assume that a compulsory license should only attempt approximate free market rates (*i.e.* the rate that willing licensors and licensees would pay in a market free of transaction

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[299] Josh Constine, *The Truth About Streaming: It Pays Labels A Lot, They Don't Pay Musicians*, TECHCRUNCH, https://techcrunch.com/2015/09/23/mo-users-mo-money/; *Register's Music Licensing Report, supra* note 1, Chap. 3, 2015 WL 1227761, at *5-*6; David Nelson, Note, *Free the Music: Rethinking the Role of Copyright in an Age of Digital Distribution*, 78 S. Cal. L. Rev. 559, 568-70 (2005); Jessica Litman, *Sharing and Stealing*, 27 HASTINGS COMM. & ENT L.J. 1, 32–38 (2004); Ian Morris, *Technology Is Destroying The Music Industry, Which Is Great For The Next Taylor Swift*, FORBES (Nov. 17, 2014), https://www.forbes.com/sites/ianmorris/2014/11/17/technology-is-destroying-the-music-industry-which-is-great-for-the-next-taylor-swift/#44ae4c44236b.

[300] 17 U.S.C. § 114(g)(2); *see also Register's Music Licensing Report, supra* note 1, Chap. 2, 2015 WL 1227760, at *19. The PROs often arrange for similar direct-to-songwriter payments in their licensing deals. *Register's Music Licensing Report, supra* note 1, Chap. 4, 2015 WL 1227762, at *13 (discussing these arrangements).

[301] For such a system to work effectively, however, the statute would need to establish that parties that circumvent the compulsory license through private licensing deals would still need to abide by the same distribution scheme. *See* García, *supra* note 9, at 1151–52 (proposing this type of amendment to the Section 114 compulsory license).

costs). This Section argues against this trend for two reasons. First, rate-setting that weighs public access against copyright's incentive function is more consistent with the historical purpose of compulsory licensing, and remains necessary to ensure that the compulsory licensing regime can allow access-expanding technologies of dissemination to succeed. Second, from a more practical standpoint, attempts by rate-setting entities to find free market rates in regulated licensing markets is inherently subjective. When regulators fail to use policy criteria to guide their analyses, instead privileging market mimicking for its own sake, they leave these proceedings potentially vulnerable to strategic manipulation by the parties.

1. Rate Setting and the Incentives/Access Tradeoff

In order for compulsory licensing to best serve copyright's normative aims, the policy considerations identified in the last Section—in particular, the access-enhancing nature of technologies like streaming—must also be explicitly factored into rate-setting decisions.

As Part II explained, the 801(b) policy objectives were crafted based on the assumption that market mimicking alone would not necessarily facilitate an ideal balance between public access and copyright owners' financial incentives, especially when a new dissemination technology is in its infancy. Accordingly, the factors encouraged regulators to depart from market benchmarks through explicit consideration of the interests of those external to the specific licensing deal between rightsholders and disseminators: the consuming public. The early 801(b) rate-setting decisions pointed to the importance of compensating music disseminators for their work in innovating new forms of music access, even if this required a reduction in royalties to copyright owners. The first mechanical license rate-setting proceeding noted that records labels were "opening [] new markets" through technological innovation, and a later CARP proceeding explicitly used royalty rates at the lower of end of those suggested by free-market proxies because innovations by internet radio providers had expanded "the offerings of the types of music beyond that which one receives over the radio."[302]

In contrast, rate setting for internet radio sound recording royalties following the DMCA—which, recall, established a willing buyer and willing seller rate-setting standard in lieu of the 801(b) criteria for the majority of internet radio services—set high royalty rates for services.[303] These rates were in fact so high that Congress chose to intervene on several occasions,

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[302] *See supra* Part III.B.1.

[303] Dicola & Sag, *supra* note 121, at 228-38 (discussing *Webcasters I* and *Webcasters II*).

suspending the rates and creating mechanisms to facilitate negotiated settlements.[304] As explained further below, these high rates were not inevitable (and were partially the result of gamesmanship by copyright owners), but Matthew Sag and Peter DiCola have argued that they emerged because the CRB failed to consider the economic reality faced by burgeoning internet radio services.[305] The result was a slowdown in the growth of internet radio services.[306] Had these proceedings been governed by the 801(b) factors, the outcome might have been different.

That said, the CRB also eventually began setting rates in 801(b)-governed proceedings that were potentially ill-equipped to ensure that new technologies of dissemination can facilitate access to copyrighted works. As discussed above, the *Phonorecords III* decision tethered mechanical royalty rates to unregulated sectors of the music licensing market and failed to grapple with the 801(b) objectives, thus leading to a dramatic increase in royalty rates for services.[307] Had the CRB considered the importance of consumer access it might have—as Judge Strickler's dissent suggested—maintained the prior settlement rates, which provided lower royalty rates generally, and different rates for services offering free ad-supported streaming to consumers.

These examples suggest that compulsory license rate-setting for streaming must remain policy-oriented in order to effectively allow access-expanding technologies to flourish. That being said, this Article's argument is not that streaming services should always receive a "discount" simply because they facilitate access.[308] As Part III.B explained, compulsory license

[304] *Id*. (discussing Small Webcaster Settlement Act of 2002, Webcaster Settlement Act of 2008, and Webcaster Settlement Act of 2009).

[305] *Id*. at 240 ("The rates that were ultimately decreed by the various groups of arbitrators were far too high and too inflexible to realistically allow webcasting to survive. As a result, the industry was largely stifled.").

[306] *Id*.; *see also* DiCola, *supra* note 187, at 1877 (noting that venture capital has avoided investing in internet radio because of high royalty costs).

[307] *See supra* Part III.B.2.

[308] Copyright owners have sometimes argued that streaming services are seeking a discounted rate even though they are "highly profitable." *Phonorecords III*, *supra* note 26, Witness Statement of David Israelite 36-37, https://www.crb.gov/rate/16-CRB-0003-PR/statements/copyright-owners/volume1.pdf. Whether the music streaming market is profitable is disputed to begin with. *Phonorecords III*, Initial Determination, Majority Opinion, *supra* note 26, at 8l; *Phonorecords III*, Initial Determination, Dissent, *supra* note 26, at 12 (citing the "conflicting evidence about whether the market for streaming services is faring poorly financially or performing about the same as other emerging industries"). But profitability should not necessarily be the most important (and certainly not the only) question from the perspective of copyright law and policy. The real issue, as many of the early 801(b) rate-setting decisions recognized, is to weigh "the contributions of the [services] in creating and expanding the market" against the contribution of copyright owners in supplying the copyright good to the public. *1998 CARP Decision*, *supra* note 215, 63 FR

regulators rely predominantly on complex economic models and financial data in order to arrive at appropriate rate structures and rates. Identifying the ideal rate structure and rate for streaming would require economic analyses that are beyond the scope of this Article. Rather, the argument here is that rate-setters should *consider* this access-encouraging role, as weighed against the need for financial incentives when setting rates. It is of course possible that a rate that factors in these policy goals would be no different from an exclusively market-proxy-derived rate. But any such determination requires a policy-focused inquiry of the kind the CRB has appeared unwilling to provide in recent decisions like *Phonorecords III*.

2. **The Subjectivity of Market-Mimicking Rate Setting for Regulated Licensing Markets**

A policy-oriented approach to rate setting would also be able to more clearly identify the assumptions that will inevitably define any attempt to identify ostensible free market rates for compulsory licenses. Several scholars have noted that attempting to find free market rates in markets that have always been regulated, like mechanical royalties or sound recording performance royalties, is something of a contradiction in terms.[309] As explained above, rate-setting entities like the CRB must use market benchmarks from other contexts in order to arrive at rates that might prevail in an ostensibly free market. But this benchmarking approach is highly subjective; the CRB must choose from a range of different benchmarks offered by the parties from similar, though not identical, licensing contexts and then use them to construct a hypothetical rate for the regulated market.[310]

25394-01; *cf.* In re Pandora Media, Inc., 6 F. Supp. 3d 317, 369 (S.D.N.Y. 2014), *aff'd sub nom.* Pandora Media, Inc. v. Am. Soc. of Composers, Authors & Publishers, 785 F.3d 73 (2d Cir. 2015) (declining to factor in Pandora's alleged commercial success when setting musical composition performance rates pursuant to the ASCAP consent decree). This analysis is independent of the question whether the services can profit when their innovations prove successful. Indeed, fair use case law has moved soundly past the idea that a defendant's secondary use of a copyright good cannot be fair use simply because the defendant is able to profit when its use is successful. Authors Guild v. Google, Inc., 804 F.3d 202, 219 (2d Cir. 2015).

[309] Dicola & Sag, *supra* note 121, at 245 ("[A] decision rule premised on discovering the price that would be set by a hypothetical willing buyer-willing seller market is likely to generate arbitrary results"); García, *supra* note 9, at 1140–45; Lemley & Weiser, *supra* note 52, at 833–34.

[310] *See, e.g.*, *Web IV*, *supra* note 217, at 26335-26392 (considering various licensing deals between record labels and interactive streaming services and record labels and non-interactive streaming services).

The benchmarks offered by the parties often dictate sharply different royalty rates.[311]

The subjectivity of this process has made it susceptible to manipulation. For example, in *Webcasters I*, the first proceeding for post-DMCA digital radio sound recording royalties set under the newly created willing buyer and willing seller standard, a CARP (the CRB's predecessor) found evidence that record labels had entered into inflated licensing deals in other sectors of the music market in order to influence the benchmarking inquiry.[312] While the CARP ultimately found one benchmark to be untainted, this benchmark still yielded royalty rates too high for internet radio stations to be able to function.[313] Congress chose to intervene, suspending the established rates and allowing SoundExchange, the sound recording rights management entity, to negotiate new rates.[314]

Even in the absence of explicit manipulation by the parties, the benchmarking process may also be affected by pathologies in the markets from which the benchmarks are drawn, in particular market power imbalances. As discussed above, the music licensing landscape is characterized by market power imbalances stemming from the small number of records labels and music publishers. As the licensing deals used in benchmark analysis may themselves be the product of market power, simply importing them into the compulsory regime, without any additional analysis, only serves to recreate the imbalance in the regulated market.[315] This issue emerged in *Web IV*, the most recent CRB proceeding setting sound recording performance royalties for internet radio services. In that decision, the CRB determined that the use of free-market licensing agreements would not be sufficient when setting rates under the willing buyer and willing standard; rather, the judges had to "determine whether the proffered rates reflect a

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[311] *See, e.g.*, *id*. at 26334 (noting the "wide disparity" between different rates suggested by benchmarks).

[312] *See* Beethoven.com LLC v. Librarian of Cong., 394 F.3d 939, 943 (D.C. Cir. 2005), *as amended* (Feb. 4, 2005) ("RIAA strategy was targeted at supra-competitive licensing fees to conform with its view of the 'sweet spot' for the royalty rates. RIAA then would only close deals that hit its 'sweet spot' to create a favorable record."); Dicola & Sag, *supra* note 121, at 226-8. This issue has emerged recently in rate setting under the PROs' consent decrees. See *Register's Music Licensing Report, supra* note 1, Chap. 4, 2015 WL 1227762, at *14; García, *supra* note 9, at 215–16.

[313] *See* Dicola & Sag, *supra* note 121, at 228-30; Lemley & Weiser, *supra* note 52, at 833–34.

[314] *Register's Music Licensing Report, supra* note 1, Chap. 2, 2015 WL 1227760, at *22 (discussing Webcaster settlement legislation); Dicola & Sag, *supra* note 121, at 230-31; *Register's Music Licensing Report, supra* note 1, Chap. 4, 2015 WL 1227762, at *8.

[315] *See supra* Part III.B.2 (describing why *Phonorecords III* failed to account for this problem).

sufficiently competitive market, *i.e.*, an 'effectively competitive' market."[316] The judges found that a freely negotiated licensing agreement from the interactive streaming market was suspect because of the market power imbalances in that market (namely, the complementary oligopoly problem described above).[317] Thus, the rate derived from that benchmark required adjustment "to render it. . . usable as an 'effectively competitive' rate in. . . the noninteractive subscription market."[318]

Copyright owners challenged this determination on appeal, arguing that the willing buyer and willing seller standard "compels the Board to adopt rates that would be negotiated in the *actual* market, without any adjustment to account for how the rates might vary if the market were effectively competitive."[319] The D.C. Circuit disagreed, and affirmed the CRB's determination. The court concluded that the "willing buyer and willing seller" language was ambiguous and that CRB's choice to read an effective competition requirement into the statutory language was reasonable. Importantly, the court rejected the copyright owners' argument that effective competition cannot be considered under the willing buyer and willing standard because it is a "policy objective." The court held that the willing buyer and willing seller standard's subjectivity means that normative economic considerations will invariably be factored into its application.[320]

The D.C. Circuit's decision provides support for the continued relevance of policy-oriented rate setting in compulsory licensing regimes. If determining a "willing buyer and willing seller" in a regulated licensing market will always require some normative inquiry, it makes sense to continue ensuring that this inquiry reflects the policy aims of copyright. The now-abolished 801(b) objectives certainly provided a helpful push in this direction though, as *Phonorecords III* made clear, these factors were never

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[316] *Web IV*, *supra* note 217, at 26,332.

[317] *Id.* at 26,343–44, 26,353. As explained above, effective competition (or lack thereof) can have direct consequences on copyright policy goals, including incentives/access. *See supra* Part IV.A.2. Indeed, Judge Strickler has noted that determining how to model perfect or effective competition in intellectual property markets will inevitably implicate the "classic IP pricing conundrum" of balancing incentives and access. *See* David R. Strickler, *Royalty Rate Setting for Sound Recordings by the United States Copyright Royalty Board*, 12 REVIEW OF ECONOMIC RESEARCH ON COPYRIGHT ISSUES 1, 7 (2015).

[318] *Web IV*, *supra* note 217, at 26,344, 26,404–05. In applying this analysis, the CRB ultimately *lowered* the rates paid by subscription webcasters. This was the first time the CRB lowered a rate in a "willing buyer and willing seller" proceeding. *See* Glenn Peoples, *D.C. Sets New Webcasting Rates: Free Streams Up, Paid Streams Down (With an Asterisk)*, BILLBOARD (Dec. 16, 2015), https://www.billboard.com/articles/business/6812915/new-webcasting-rates-free-streams-up-paid-streams-down-pandora.

[319] SoundExchange, Inc. v. Copyright Royalty Bd., 904 F.3d 41, 56 (D.C. Cir. 2018).

[320] *Id.*

alone sufficient to ensure rates consistent with copyright policy objectives.[321] Restoring these factors, or providing other focused guidance to the CRB, would make it more likely that future rate-setting decisions reflect achieve reasonable rates.

Even in the absence of such guidance, the D.C. Circuit's decision that the willing buyer and willing seller standard is ambiguous potentially opens the door for regulators to consider copyright policy goals even within the existing statutory framework, as the next Section explores.

C. Furthering Copyright Policy Goals Under the Willing Buyer and Willing Seller Standard

This Section argues that legislative change may be unnecessary to facilitate at least one of this Article's recommendations: restoring the use of copyright policy goals in rate-setting proceedings in the existing compulsory music licensing regime. Despite the MMA's abolition of the 801(b) factors, there are paths available for the CRB to account for these goals when setting mechanical license and Section 114 license rates, even under the market-driven willing buyer and willing seller standard now applicable to all the compulsory music licenses.

As an initial matter, it is important to note that the willing buyer and willing seller standard articulated in the MMA (and in earlier legislation like the DMCA) is not entirely a free-market standard, at least on its face. Rather, in the case of the mechanical license, the CRB is instructed to "establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller," but also to consider "the relative roles of the copyright owner and the compulsory licensee in the copyrighted work and the service made available to the public with respect to the relative creative contribution, technological contribution, capital investment, cost, and risk."[322] The statute's reference to the "relative roles" of the copyright owners and licensees uses language very similar to the third 801(b) factor. As explained above, the CRB, in the past, has interpreted this factor as requiring rates that allow new technologies of dissemination, like internet and satellite radio, to reach a broad range of consumers.[323] This suggests that prior decisions applying the third 801(b) factor could potentially inform rate setting even under the willing buyer and willing seller standard.

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[321] *See supra* Part III.B.2 (discussing how the CRB avoided serious inquiry into the 801(b) objectives in *Phonorecords III*).

[322] PL 115-264, 2018 HR 1551, PL 115-264, October 11, 2018, 132 Stat 3676.

[323] *See supra* Parts II.B and III.B.

That being said, past CRB decisions interpreting the willing buyer and willing seller standard have not taken this approach (or even mentioned the "relative roles" sub-factor at all). Indeed, the conventional wisdom is that the willing buyer and willing seller standard yields rates that are higher than the rates produced under the 801(b) factors.[324] This was certainly true in some of the earlier proceedings setting rates for sound recording public performance licenses for internet radio.[325]

But these high rates were not necessarily mandated by the statutory text of the willing buyer and seller standard. As discussed above, the lack of an objective metric for free-market rates in markets that have always been regulated also means that application of the willing buyer and seller standard will always require the CRB to consider how copyright licensing markets *should* operate and use these assumptions to guide its benchmarking inquiry.[326] As the D.C. Circuit noted in the *Web IV* appeal, the "inherent ambiguity in the statute's mandate" means that the CRB maintains discretion to "identify the relevant characteristics of competitiveness on which to base its determination of the statutory royalty rates."[327]

The willing buyer and willing seller standard is thus potentially capacious enough to accommodate a more a nuanced conception of copyright markets that is sensitive to the incentives/access tradeoff, and in particular the value of access-expanding technology and the realities of market power in music licensing markets. In fact, there is already some evidence that courts and regulators have taken such policy goals into account when setting rates under ostensible market-mimicking standards.

In re Pandora. Such an approach has begun to inform the rate-setting proceedings in the Southern District of New York under the consent decrees that govern the performance rights organization ASCAP.[328] Like the CRB, the rate court must set a rate reflecting "the price that a willing buyer and a willing seller would agree to in an arm's length transaction."[329] In recent rate-setting decisions, however, Judge Cote (who, until recently, had sole jurisdiction over ASCAP rate-setting proceedings) has recognized that this inquiry implicates basic questions of incentives/access balancing:

> The task at hand is to determine the fair market value of a blanket license for the public performance of music. The challenges of that task include discerning a rate that will give composers an economic incentive to keep enriching our lives

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[324] García, *supra* note 9, at 1140–45.
[325] *See* Dicola & Sag, *supra* note 121, at 228-38.
[326] *See supra* Part IV.B.2.
[327] SoundExchange, Inc. v. Copyright Royalty Bd., 904 F.3d 41, 56 (D.C. Cir. 2018).
[328] For a discussion of ASCAP's role, see *supra* Part III.A.2
[329] United States v. Broad. Music, Inc., 316 F.3d 189, 194 (2d Cir. 2003).

> with music, that avoids compensating composers for contributions made by others either to the creative work or to the delivery of that work to the public.[330]

In practical terms, Judge Cote has been willing to set rates favorable to disseminators, especially when presented with evidence that copyright owners have attempted to extract more than their reasonable share of royalties. For example, in a recent proceeding setting a musical composition performance royalty rate, Judge Cote set a rate that many believe benefits Pandora. Among other things, the court rejected ASCAP's proffered benchmark licensing agreements on the grounds that, in those agreements, publishers had used "their considerable market power to extract supra-competitive prices" inconsistent with the balanced approach that copyright strives for.[331]

Judge Cote also rejected ASCAP's argument that Pandora's alleged success entitles copyright owners to a higher royalty fee, concluding that Pandora's success is "attributable not just to the music it plays. . . , but also to its creation of [a special Music Genome Project, a database and algorithms designed to predict users' musical interests,] and its considerable investment in the development and maintenance of that innovation."[332] As with the fair use case law discussed above, a subtext of this conclusion is that copyright owners are not entitled to the value generated by innovations designed to enhance the public's access to existing copyrighted works. Under Judge Cote's reasoning, even a free market-mimicking rate-setting inquiry can support this finding.

Phonorecords III Dissent. An important example of a copyright-policy-sensitive approach to a free market benchmark inquiry can also be found in Judge Strickler's dissent in *Phonorecords III*, discussed above. Although *Phonorecords III* was governed by the 801(b) objectives, both the majority opinion and Judge Strickler's dissent engaged in independent free market benchmark inquiries, as was typical even in 801(b) rate-setting

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[330] In re Application of MobiTv, Inc., 712 F. Supp. 2d 206, 209 (S.D.N.Y. 2010), *aff'd sub nom.* Am. Soc'y of Composers, Authors & Publishers v. MobiTV, Incorporation, 681 F.3d 76 (2d Cir. 2012); In re Pandora Media, Inc., 6 F. Supp. 3d 317, 321 (S.D.N.Y. 2014), *aff'd sub nom*. Pandora Media, Inc. v. Am. Soc. of Composers, Authors & Publishers, 785 F.3d 73 (2d Cir. 2015) (rearticulating this point).

[331] In re Pandora Media, Inc., 6 F. Supp. 3d 317, 357 (S.D.N.Y. 2014), *aff'd sub nom*. Pandora Media, Inc. v. Am. Soc. of Composers, Authors & Publishers, 785 F.3d 73 (2d Cir. 2015). In recent work, Xiyin Tang has argued that this decision sounds in fair use principles and that, in the absence of the consent decrees, Pandora could have potentially employed the fair use defense. Tang, *supra* note 255, at 40-44.

[332] In re Pandora Media, Inc., 6 F. Supp. 3d 317, 369 (S.D.N.Y. 2014), *aff'd sub nom.* Pandora Media, Inc. v. Am. Soc. of Composers, Authors & Publishers, 785 F.3d 73 (2d Cir. 2015).

proceedings.[333] These benchmark inquiries were essentially no different than the kind of inquiry that occurs under the willing buyer and willing seller standard.[334] When Judge Strickler arrived at the conclusion that the previous rates for streaming should be maintained, he did so *exclusively* through this benchmark inquiry, without relying on the 801(b) factors.[335] What is particularly interesting about *Phonorecords III*, then, is that both the majority and the dissent purported to rely on a free market benchmark inquiry in deriving their rate structures and rate. And yet, as explained above, the majority's approach of tethering the rate to the unregulated sound recording licensing market yielded significantly higher rates for streaming than Judge Strickler's approach of relying on the prior settlement rates.

Judge Strickler's dissent implicitly points to some of the disagreements about the nature of copyright markets that underlie this divergence. In contrast to the majority, Judge Strickler grounded his analysis in the particular "market at issue in this proceeding," recognizing the need to balance "between the competing goals of ensuring access to intellectual property at a price equal to marginal cost and providing incentives for the production of information."[336] A free market benchmark inquiry sensitive to these considerations counseled in favor of adopting a rate structure that would allow streaming services to operate tiers catered to consumers' willingness to pay (including a free ad-supported tier),[337] as well as rates significantly lower

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[333] *Id.*

[334] As explained above, the 801(b) factors are generally used after a benchmark inquiry to select rates from within a zone of reasonable rates derived from benchmarks. In contrast, the willing buyer and willing seller standard does not require this second step.

[335] As he explained, "to the extent that market factors may implicitly address any (or all) of the four itemized factors, the reasonable, market-based rates may remain unadjusted" and, in this case, the factors merely provided "further support" to the conclusions drawn from the free market benchmark inquiry. *Phonorecords III*, Initial Determination, Dissent, *supra* note 26, at 121-22.

[336] *Id*. at 33-35; *see supra* Part III.B.3; *see also* Strickler, *supra* note 318, at 4 (bemoaning that "economists who testify [at the CRB and] do not necessarily emphasize the economic nuances of copyright issues"). Judge Strickler also noted that, in the streaming market, the difficulty of achieving this balance is magnified by the "additional complexity" of the publishers' market power. *Phonorecords III*, Initial Determination, Dissent, *supra* note 26, at 35-37.

[337] *See supra* Part III.B.3 (discussing Judge Strickler's belief that multiple rate-structures is conducive to beneficial price discrimination). It is important to note that in *Web IV*, the CRB, applying the willing buyer and seller standard, also established different rates for subscription, non-subscription/ad-supported, and educational webcasters, presumably to allow greater price discrimination. *Web IV*, *supra* note 217, at 26405; *see also* SoundExchange, Inc. v. Copyright Royalty Bd., 904 F.3d 41, 58 (D.C. Cir. 2018) (affirming CRB's authority to set different rates for different business models). This shows that a rate structure that differs with respect to different streaming services' business model is compatible with the willing buyer and willing seller standard.

than those adopted by the majority. Thus, by treating questions of incentives and access as endogenous to the CRB's market-mimicking inquiry, Judge Strickler's dissent potentially points to ways that these considerations could play a role in future proceedings, even under a willing buyer and willing seller rate-setting standard.

CONCLUSION

Many see the Copyright Act's unusual and complex compulsory music licensing regime as outdated. It is either nothing more than a historical relic, developed in response to long-forgotten concerns about piano player monopolies, or a limited solution to transaction costs-related market failures. On these accounts, the gradual erosion of this regime makes sense. Declining to extend compulsory licensing to new forms of music dissemination (Congress's decision not to create a sound recording compulsory license for interactive streaming services) or pushing the existing licenses' rates closer to free-market proxies (the CRB's recent *Phonorecords III* determination and the MMA's elimination of the 801(b) factors) ensures that compulsory licensing will remain a limited exception to copyright's otherwise market-oriented approach. Indeed, the logical culmination of these trends is the complete dismantling of the compulsory music licensing regime, especially if private ordering-based solutions could be found to address any remaining transaction cost problems.

As this Article has argued, these arguments miss the main justification for compulsory copyright licensing, both descriptively and normatively. Rather than being seen exclusively through the lens of property rules and liability rules, the compulsory music licensing regime should be considered alongside copyright's particular social and cultural policy goals. Seen through this lens, compulsory licensing can be understood as ensuring that copyright's market-based approach towards providing creators with adequate financial incentives does not overwhelm the value of access to expressive works. Like other copyright-specific limitations—fair use, the first sale doctrine, term limits, and the idea-expression dichotomy, to name a few—compulsory licensing should be considered an important tool for ensuring balance within the copyright system.

In this respect, the approach historically taken by the music compulsory licensing regime could serve as a model for addressing innovative technologies that enhance access to existing copyrighted works, especially as these new forms of dissemination come into tension with the entrenched interests of copyright owners. This notion, however, points to a question looming in the background of this Article: what, if anything, makes music different? Why has music been subject to such an intricate regime of

compulsory licensing while few other copyright industries are similarly regulated? One answer is that music has experienced periodic industrywide changes in methods of dissemination for far longer than most other creative industries. From the player piano to digital radio, new technologies that enhance access to existing copyrighted works have emerged in the music sector frequently over the last century, galvanizing Congress to create an industry-specific compulsory licensing regime capable of facilitating balance.

In contrast, the methods for disseminating other copyright goods have remained relatively constant. That, of course, has changed with the rise of digital forms of dissemination, which have impacted nearly all copyright industries. As future work will explore more fully,[338] the many new fair use cases involving a new technology making use of existing copyrighted content—from television news aggregators to massive book digitization projects—perhaps shows that music merely had a head start in addressing the problems that emerge when conventional licensing markets are expected to allow a new access-enhancing technology to flourish.[339] Moreover, the copyright limitations and exceptions that have traditionally been used to further access-related goals in other copyright markets, such as the first sale doctrine and fair use, increasingly appear to be ill-equipped, on their own terms, to ensure that digital dissemination technologies are able to thrive.[340] Copyright law's long-running experiment with compulsory music licensing could thus serve as an important model for dealing with other industries, as well as a cautionary tale about how such regimes should be managed.

[338] *See* Jacob Victor, *Utility-Expanding Fair Use* (draft on file with the author).

[339] *See supra* discussion accompanying notes 267-268.

[340] *See* Capitol Records, LLC v. ReDigi Inc., 910 F.3d 649, 660-64 (2d Cir. 2018) (finding that first sale doctrine is not applicable to digital goods and declining to find fair use).