RECONSIDERING COMPULSORY COPYRIGHT LICENSING

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ABSTRACT

United States copyright law generally assumes that by providing property entitlements in creative works, the free market will create balance between two competing priorities: incentivizing authors to produce new content and providing the public with access to creative works. Nonetheless, lengthy provisions of the Copyright Act outline compulsory licensing schemes that require music copyright owners to license their works to all comers at government-mandated prices. This Article provides a new account of the history and current status of the compulsory music licensing regulatory regime, arguing that this regime plays an important and underexplored role in furthering copyright policy objectives by strategically limiting the compensation of copyright owners so as to allow innovative forms of music dissemination to flourish.

Consistent with broader scholarship on property rules and liability rules, scholars have tended to treat compulsory copyright licensing as a way of addressing the transaction costs that can prevent any market from operating efficiently. But this exclusive focus on transaction costs is belied by a closer examination of the compulsory music licensing regulatory regime, and in particular its approach to rate setting. Unlike liability rules designed to address transaction costs, where regulators generally try to mimic market rates using market proxies, music rate setting has traditionally used a policy-oriented set of criteria (known as the "801(b) objectives"), designed to ensure that royalty rates reflect the "relative roles" of licensors and licensees in providing the public with access to music. Like copyright-specific limitations such as the fair use doctrine, the compulsory music licenses can be understood as tools, not only for addressing transaction costs-related market failures, but for directly renegotiating the balance at the heart of copyright between creators' economic incentives and the public's interest in access.

Seen through this lens, the compulsory music licensing regime can be understood as, historically, ensuring that music copyright owners were forced to price their licenses using rates explicitly designed to allow technologies that enhance access to musical works—like the player piano and record player in the early twentieth century and digital radio more recently—

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to flourish. In recent years, however, this access-fomenting role has begun to conflict with an approach that sees compulsory licensing as only justified in the face of transaction costs-based market failures and, accordingly, sees market mimicking as the best way to price a compulsory license. This tension can be seen in both legislative changes to the Copyright Act attempting to address new digital technologies of dissemination and in recent rate-setting decisions by the Copyright Royalty Board ("CRB"), the entity that administers the Copyright Act's compulsory music licenses. The recently passed Music Modernization Act ("MMA") brought this tension to a head by replacing the 801(b) policy-driven rate-setting criteria with a market-mimicking "willing buyer and willing seller" standard.

The trend away from policy-driven rate-setting is problematic. Compulsory licensing still has an important role to play in ensuring an ideal balance between authors' incentives and public access, especially in the burgeoning streaming industry. The history of compulsory music licensing, recent trends in fair use case law, and evidence that music copyright owners are able to extract unreasonably high licensing fees in open markets, all suggest that the relationship between streaming services and copyright owners should be regulated through a policy-driven compulsory licensing regime. The MMA complicates regulators' ability to address these issues within the existing compulsory music licensing landscape, but the malleability of the new rate-setting standard may provide ways for the CRB to further an access-fomenting approach in future rate-setting proceedings.

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INTRODUCTION

In the United States, the licensing of songs by distributors is heavily regulated. Considering that music copyright is notoriously complex, it is best to start with an example. Spotify, as an "interactive streaming service" (a service that allows users to select and play music on demand) and Pandora, as a non-interactive streaming service (essentially, an internet-based radio service) must obtain licenses for all the songs that they stream. The distribution of a song in fact 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.[1] Thus, if Spotify or Pandora wants to stream Celine Dion's 1996 hit "It's All Coming Back to Me Now" it would need to obtain (or "clear") licenses for *both* the copyright in the sound recording (co-owned by Dion's record labels Columbia Records and Epic Records) as well as the copyright in the underlying musical composition (co-owned by composer Jim Steinman and music publisher Universal Music Publishing Group).[2]

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 to whom to license and negotiate a price.[3] But when Spotify or Pandora want to clear musical composition or sound recording licenses in order to stream a song like "It's All Coming Back to Me Now," they can take advantage of several compulsory licenses outlined in the Copyright Act.[4] These schemes share an essential feature: they allow all comers to license a work without permission of the copyright owner for a predetermined rate, set periodically by a regulatory body known as the Copyright Royalty Board ("CRB").[5]

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[1] *See 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] 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.

[3] 17 U.S.C. § 106 (copyright owners' exclusive rights).

[4] 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).

[5] 17 U.S.C. § 801. As explained further below, the specific compulsory licensing schemes apply inconsistently across types of uses of sound recordings and musical composition copyrights (including uses that might otherwise seem analogous). *See infra* Part III.A (discussing different rules for digital retailers like iTunes, broadcast radio stations, digital radio stations like Pandora, and interactive streaming services like Spotify). They are also not comprehensive; many distributors nowadays must also negotiate some free market

The music compulsory licensing regulatory regime is an outlier in the U.S. copyright system. As the Copyright Office noted in a recent report "[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."[6] The Copyright Act's music compulsory licensing regimes has nonetheless expanded its scope over the years and has taken on increased importance with the rise of music streaming. The regime implicates billions of dollars of royalty payments, and the adversarial rate-setting proceedings conducted by the CRB are a huge source of risk for rapidly expanding music companies, like Spotify.[7] At the same time, the copyright owners (on the musical composition side, songwriters and the music publishers that frequently own these copyrights and, on the sound recording side, recording artists and record labels) frequently complain that they are undercompensated under the current system, and many have started advocating for the complete deregulation of the music marketplace.[8]

Despite the increased importance of the statutory compulsory music licenses, there is little clarity as to why they exist, what they are designed to accomplish, and how they relate to broader debates in copyright law. This Article seeks to fill this gap by providing a new account of the history of the compulsory copyright licensing regulatory regime, as well as a defense of its continued relevancy as an important tool of copyright policy.

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licenses in order to fully clear a song. *See infra* Part III (discussing lack of compulsory license for the use of sound recordings by interactive streaming services). Additionally, they are not mandatory; many distributors forego the compulsory licensing regime and negotiate licenses directly with copyright owners or via intermediaries, albeit at rates usually determined by the shadow of the statutory rates. *See Register's Music Licensing Report, supra* note 1, Chap. 2, 2015 WL 1227760, at *9 ("While copyright owners and users are free to negotiate voluntary licenses that depart from the statutory rates and terms, in practical effect the CRB-set rate acts as a ceiling for what the owner may charge."); Mark A. Lemley, *Contracting Around Liability Rules*, 100 CAL. L. REV. 463, 479 (2012) (noting the same phenomenon).

[6] *Register's Music Licensing Report*, *supra* note __, Chap. IV 2015 WL 1227762, at *9; *see also* Aloe Blacc et. al., *A Sustainable Music Industry for the 21st Century*, 101 Cornell L. Rev. Online 39, 47 (2016) (arguing that "[w]e let owners of every other kind of copyrighted work negotiate their own market prices.").

[7] *See, e.g.*, Spotify Form F-1, https://www.sec.gov/Archives/edgar/data/1639920/000119312518063434/d494294df1.htm#rom494294_7 ("[I]f our business does not perform as expected or if the [compulsory license] rates are modified to be higher than the proposed rates, our content acquisition costs could increase and impact our ability to obtain content on pricing terms favorable to us, which could negatively harm our business, operating results, and financial condition and hinder our ability to provide interactive features in our services, or cause one or more of our services not to be economically viable.").

[8] *See* John Seabrook, *Will Streaming Music Kill Songwriting?* NEW YORKER (Feb. 8, 2016), https://www.newyorker.com/business/currency/will-streaming-music-kill-songwriting.

To the extent scholars inquire into what role the compulsory music licenses serve, many group them with the small handful of other industry-specific compulsory licensing schemes outlined in the Copyright Act, which regulate some other forms of content distribution, such as cable and satellite television.[9] As a species of liability rule,[10] a compulsory copyright license is often thought of as transaction costs-saving: by allowing licensees to bypass direct negotiations, compulsory licensing can address market failures caused by the difficulty and expense of contracting with multiple parties or the potential that copyright owners will use hold out strategies (or other strategic behavior) in order to charge above-market prices. This is the dominant explanation of why the Copyright Act's various compulsory license schemes exist.[11] On this account, Spotify and Pandora can take advantage of compulsory licensing regimes so that they can bypass expensive individual negotiations with a large number of music copyright owners.[12] While some suggest that private ordering would still provide better solutions to such

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[9] 17 U.S.C. §§ 111, 117.

[10] In its most general sense, a liability rule permits someone to force use of another's entitlement for a government-set price. For the definitive account of property rules vs. liability rules, see 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.

[11] *See, e.g.*, 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."); Robert P. Merges, *Contracting into Liability Rules: Intellectual Property Rights and Collective Rights Organizations*, 84 CAL. L. REV. 1293, 1311 (1996); Yafit Lev-Aretz, *The Subtle Incentive Theory of Copyright Licensing*, 80 BROOK. L. REV. 1357, 1378 (2015); 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); Robert Merges, *Compulsory Licensing vs. the Three "Golden Oldies" Property Rights, Contracts, and Markets*, CATO (Jan. 15, 2004) at 1, 4-5; Kristelia A. García, *Private Copyright Reform*, 20 MICH. TELECOMM. & TECH. L. REV. 1, 39 (2013); Mark A. Lemley & Philip J. Weiser, *Should Property or Liability Rules Govern Information?*, 85 TEX. L. REV. 783, 825 (2007); Pamela Samuelson, *Justifications for Copyright Limitations & Exceptions* (Feb. 2015) at 23-27, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2476669; 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); *see also Register's Music Licensing Report*, supra note __, Chap. IV., 2015 WL 1227762, at *20 ("[C]ompulsory licensing should exist only when clearly needed to address a market failure.").

[12] 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 and cable broadcasting in which individual negotiation with numerous, disparate rights holders would be both time and cost prohibitive.").

transaction costs problems,[13] the market failure theory remains the dominant explanation of why copyright, more so than any other form of intellectual property,[14] tolerates compulsory licensing.

This Article argues that the transaction costs story is alone insufficient to account for the unique history and current role of compulsory music licensing. A better way of understanding compulsory music licensing is through the lens of copyright law's specific policy concerns. Seen through this lens, the regime does not simply exist to address the types of transaction costs that characterize conventional markets, but rather it provides a mechanism for renegotiating the tension, at the heart of copyright, between incentivizing creative works and providing access to these works to the public (known by many scholars as the "incentives/access tradeoff").[15] More specifically, compulsory music licensing should be understood as part of a more than 100-year-old regulatory strategy of limiting the control and compensation of music copyright owners so as to allow innovative technologies of music dissemination to flourish, in order to benefit the public.

Part I engages with these competing rationales for compulsory copyright licensing in theoretical terms. A core assumption of copyright law is that granting property entitlements in creative works will allow the market to moderate a proper balance between incentives for authors and public access. At the same time, copyright employs a number of limitations that allow for use of specific copyright interests notwithstanding the direction free market licensing would lead. One of the most famous of these limitations is the frequently discussed fair use doctrine.[16] In certain iterations, fair use can

[13] *See, e.g.*, Robert P. Merges, *Contracting into Liability Rules*, *supra* note 11, 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).

[14] 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" at determined by the Court of Federal Claims).

[15] As explained further in Part I, copyright is traditionally justified on utilitarian grounds: copyright provides authors with exclusive rights information in order to economically incentivize them to produce these works. In the absence of this incentive, works of information would be underproduced. *See infra* Part I.A. 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.

[16] 17 U.S.C. § 107.

be conceived of as a compulsory license—albeit a "zero-price" license—imposed by courts in situations where a user has engaged in a novel use of a copyrighted work as long as the market for the original work is not disproportionately harmed.[17] While fair use can also be thought of as a solution to transaction costs-related market failures, many have argued that it is better understood in more copyright-specific terms, as a tool for directly recalibrating the incentives/access trade-off on a case-by-case basis, 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.[18] The Copyright Act's compulsory music licensing regime can be understood as engaging in similar balancing on an industrywide scale, providing compensation to copyright owners at rates lower than those that would likely prevail in an open market at times when the public's interest in access becomes particularly salient.

In this respect, when examining the Copyright Act's compulsory licensing regimes, the regulatory context, and rate-setting in particular, is key. The conventional understanding of compulsory licensing holds that, because the compulsory license is meant to remedy transaction costs-based market failures, regulators should seek to mimic prices that would otherwise prevail between willing buyers and sellers.[19] In compulsory music license rate-setting, however, regulators historically used a more policy-oriented set of objectives, codified at 17 U.S.C. § 801(b) (the "801(b) objectives" or "801(b) factors"), designed, among other things, to identify the royalty amount that would reward copyright owners and disseminators commensurate to their role in providing access to creative works to the public.[20] In contrast to a market-mimicking approach to rate setting, the 801(b) objectives map onto copyright policy goals by essentially instructing regulators to set rates that

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[17] *See* Mark A. Lemley & Philip J. Weiser, *Should Property or Liability Rules Govern Information?*, 85 TEX. L. REV. 783, 790 (2007) (describing fair use as a zero price liability rule); *see also* Lemley, *supra* note 5, 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 of the right.").

[18] *See infra* Part I.C (identifying the debate over whether fair use is a solution to market failure and applying this debate to industry-specific compulsory licensing).

[19] *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 not meant to defray the licensing costs, in whole or in part, but to compensate the copyright owner for the value of his property. . . . The fee thus 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.'").

[20] 17 U.S.C. § 801(b)(1) (2012).

balance between maintaining an adequate level of financial incentives for creators and the needs of disseminators in providing the public with access.

Part II argues that the history of compulsory licensing, in particular its origins in the 1909 Copyright Act, shows that this regime emerged from concerns over incentives and access, rather than transaction costs. The original compulsory music license regulated the reproduction of sheet music into "mechanically" playable forms like player piano rolls and records.[21] Under this licensing regime, known today as the "mechanical license" or "Section 115 license," musical composition copyright owners are required to license their commercially available works to licensees—generally recording artists, record labels, and music distributors—at a government-set price.[22] While sometimes understood as an early form of antitrust regulation,[23] several scholars have instead argued that the license was created as an intentional compromise to allow innovative technologies of music dissemination—the player piano and phonograph—to flourish, while still ensuring copyright owners, whose predominant source of income was sheet music sales, could continue to receive some compensation.[24] While not framed as such by these scholars, this account provides important grounding for understanding the incentives/access-focused approach that mechanical license rate-setting has historically taken. Throughout most of the twentieth century, the license allowed the burgeoning record industry to produce recorded songs at costs lower than those that would have prevailed in an open licensing market, likely enhancing the supply of easily accessible musical work for the public.[25] In the 1976 Copyright Act, Congress refined the

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[21] *See infra* Part II.A.

[22] 17 U.S.C. § 115(a). In theory, the mechanical license only applies to recordings of compositions that follow the first recording, like cover songs; 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, 493 (2016). But the regulatory scope of the license is far more expansive: the statutory rates generally create a de facto ceiling on negotiated licensing rates for any recording of a musical composition, including the first recording. WILLIAM W. FISHER, PROMISES TO KEEP: TECHNOLOGY, LAW, AND THE FUTURE OF ENTERTAINMENT 48 (2004) (When a publisher first licenses a song to a record label "they would be free as a matter of law to pick any price they wanted. In practice, however, the amount they select would will be heavily influenced by [the mechanical compulsory license]."); *see also infra* _____.

[23] *See, e.g.*, Abrams, *supra* note 13, at 220 (explaining the conventional understanding that the license was created over fears that the Aeolian Company, 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* ____ (arguing that the antitrust account is too simplistic).

[24] *See, e.g.*, Timothy Wu, *Copyright's Communications Policy*, 103 MICH. L. REV. 278, 297 (2004); Jane C. Ginsburg, *Copyright and Control over New Technologies of Dissemination*, 101 COLUM. L. REV. 1613, 1627 (2001).

[25] Several scholars have noted that the mechanical license has also enriched the quantity and quality of American music by allowing artists to easily cover songs. *See, e.g.*, SPRIGMAN

regime by replacing a fixed licensing rate with an adjustable rate informed by the 801(b) factors, discussed above, thus allowing for a more balanced inquiry into what rate would ideally embody copyright's objectives.[26]

Compulsory licensing's role in regulating music dissemination was complicated by the rise in digital distribution technologies—including sellable MP3 files, digital radio, and streaming. As Part III explores, over the last two decades the original access-fomenting role of compulsory music licensing has come into tension with a narrative that sees compulsory licensing as exclusively a tool designed to address transaction costs-related market failures. This tension that has given rise to uneven and normatively inconsistent application of compulsory licensing to the current music marketplace. Most importantly, when Congress created a new compulsory license for digital radio services in the mid 1990s ("the Section 114 license"), it appeared to recognize the importance of allowing digital radio to flourish, and accordingly, applied the 801(b) factors to the new license's rate-setting regime. But Congress revised this license in the late 1990s and added a new market-mimicking "willing buyer and seller" standard, implying that the true goal of this compulsory license was to address transaction costs-based market failures, in particular those related to digital distributors' need to engage in bulk licensing of copyrighted content.

A similar market proxy-privileging narrative has also taken hold in the rate-setting context. While the CRB in the past recognized that copyright policy would be best served by identifying rates designed to allow technologies like internet radio and satellite radio to flourish, the CRB has recently moved away from a policy-focused approach and increasingly relied solely on ostensible free-market proxies. In its most recent rate-setting proceeding, which set the musical composition royalty rates for streaming services, the CRB arrived at rates around 50% higher than the current rates[27] by tethering the royalty rate calculation to unregulated sectors of the licensing market.[28] The new rates will likely make it difficult for streaming services to

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& RAUSTIALA, *supra* note 22, at 141; LAWRENCE LESSIG, THE FUTURE OF IDEAS: THE FATE OF THE COMMONS IN A CONNECTED WORLD 108-09 (2001); Peter S. Menell, *Adapting Copyright for the Mashup Generation*, 164 U. PA. L. REV. 441, 494 (2016). My argument is different. Cover songs are a relatively small component of the markets that the mechanical license regulates, both historically and at present. The mechanical license has in fact exerted a shadow over the entire musical composition licensing market that arguably allows disseminators greater flexibility in providing all music to consumers. *See infra* Part II.A.

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

[27] 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/.

[28] A dissenting judge explicitly criticized the decision along these lines. *See Phonorecords III*, Initial Determination, Dissent at 10 ("[P]egging the regulated mechanical royalty rate to the unregulated sound recording royalty rate. . . leaves the statutory mechanical rate indeterminate."); *see also infra* Part III.B.2.

continue to offer free ad-supported services along with paid services, thus reducing the public's access to copyrighted musical works.

The trend towards a purely transaction costs-limiting approach to compulsory licensing has come to a head in the recently passed Music Modernization Act ("MMA"). While many of the MMA's reforms are important and timely,[29] it also replaced the 801(b) policy-oriented factors with a market-based "willing buyer and willing seller" rate-setting standard in all future music compulsory license rate-setting proceedings.[30] This change would seem push the music compulsory licensing regime even further away from its access-fomenting origins towards a more conventional transaction costs-addressing liability rule regime.

Part IV argues that, despite these changes, compulsory music licensing should still be recognized as a tool for negotiating the incentives/access trade-off and should continue to play a role in enabling access to music by encouraging the development of innovative technologies of dissemination. In fact, the current music marketplace has much in common with the marketplace at the time of the creation of the first compulsory music license. In particular, an innovative technology of dissemination—streaming—remains in its early stages, but its growth is potentially threatened by the licensing demands of music copyright owners. Rate-setting decisions and some recent fair use cases[31] can help point to reasons why the use of both musical compositions and sound recordings copyrights by digital services should be subject to compulsory licenses and why the compulsory rates should be chosen with an eye towards balancing the incentives/access tradeoff. In particular, regulators should account for streaming's ability to enhance access to music for the public, the evidence that problems with the music copyright system appear to allow copyright owners to extract royalties that exceed the level necessary to incentivize new works, and the outsized market power that copyright owners appear to wield.[32]

However, considering that legislative change is unlikely anytime soon, any such approach would likely need to be implemented through the existing rate-setting regime. While the MMA's replacement of the 801(b) factors with a willing buyer and seller standard will complicate these efforts,

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[29] For example, the MMA eliminates the cumbersome individualized compulsory licensing procedure and instead provides a central clearinghouse for licensing, significantly reducing costs for streaming services providers and making it easier for songwriters to be paid. *See* Jordan Bromley, *The Music Modernization Act: What Is It & Why Does It Matter?*, BILLBOARD (Feb. 23, 2018), https://www.billboard.com/articles/business/8216857/music-modernization-act-what-is-it-why-does-it-matter-jordan-bromley.

[30] *See* Music Modernization Act, PL 115-264, October 11, 2018, 132 Stat 3676.

[31] Recent cases have noted the applicability of fair use to technologies that enhance the "utility" of existing works. *See* Authors Guild v. Google, Inc., 804 F.3d 202, 214 (2d Cir. 2015); *see also infra* Part IV.A.

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

there may still be paths available to the CRB for incorporating copyright policy goals into future rate-setting decisions. As Part IV also explains, decisions in analogous rate-setting contexts have pointed to the difficulty of identifying ostensible free market rates in markets that have never been free[33] and thereby opened the possibility that even the willing buyer and willing seller standard may be capacious enough to lead to rates capable of ensuring that streaming services can facilitate access to musical works for the public.

I. Two Uses for Compulsory Licensing in the Copyright System

This Part provides a theoretical and descriptive overview of the roles that liability rules appear to play in the copyright system. While industry-specific compulsory licensing regimes, like compulsory music licensing, are predominantly understood to be a solution to transaction costs-related market failures, I argue that they can also be understood through the lens of a special "zero price" compulsory license unique to copyright: fair use. Though some believe that fair use is also a solution to transaction costs, the predominant account now understands fair use as a tool for selectively renegotiating the balance between incentives and access at the heart of the copyright property entitlement. I argue that industry-specific compulsory licensing regimes can also be understood as filling this role. Whereas a transaction costs-focused regime will try to mimic market rates in price setting, an incentives/access-focused regime will employ copyright policy-sensitive rate-setting criteria. The Parts that follow explore how compulsory music licensing can indeed be understood, historically, through the lens of the incentives/access trade-off, while also exploring how and why this regime has been pushed away from this role, towards a more transaction costs-focused approach, in recent years.

A. Copyright as Property: An Overview

Copyright is predominantly understood as an "instrumentally driven entitlement" designed to incentivize the creation of cultural works.[34] While this is certainly not the only account of why the law recognizes property rights in information,[35] it is one of the most ubiquitous in American law and legal scholarship. According to the instrumentalist explanation, by granting authors property entitlements in their creations, copyright law allows authors to charge for access. This ensures that authors are motivated to invest the

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[33] *See, e.g.*, SoundExchange, Inc. v. Copyright Royalty Bd., No. 16-1159, 2018 WL 4440299, at *10 (D.C. Cir. Sept. 18, 2018) (noting "the inherent ambiguity" in the willing buyer and willing seller standard); *see also infra* Part IV.B.

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

[35] *See supra* note 15 (discussing alternative theories, which are generally outside the scope of this article).

time and money necessary to create new works without concern that free riding by the public will leave them without any reward for their efforts.[36] Put another way, copyright addresses a public goods problem. The expressive material covered by copyright is by its nature non-excludable and non-rivalrous.[37] 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.[38]

At the same time, copyright law recognizes that propertization has the potential to allow copyright owners to charge a premium for works, frustrating the public's access to these works. 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.[39]

This tradeoff is a central concern of copyright law. As Judge Richard Posner and William Landes explain:

> 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.[40]

To effectuate balance, copyright imposes several built-in limitations to any copyright entitlement. For example, copyright entitlements are time-

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[36] Jeanne C. Fromer, *Market Effects Bearing on Fair Use*, 90 WASH. L. REV. 615, 620–21 (2015).

[37] 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 (2006).

[38] Sag, *supra* note 37, at 194.

[39] Sag, *supra* note 37, at 187; *see also* Oren Bracha & Talha Syed, *Beyond the Incentive-Access Paradigm? Product Differentiation & Copyright Revisited*, 92 TEX. L. REV. 1841, 1843–44 (2014). Copyright's immediate frustration of users' access is often thought of as a static inefficiency. But copyright is also accused of creating a dynamic inefficiency by preventing new authors from using existing creative works—a practice that many argue is inherent to the creative process—to create new works. *See* Balganesh, *supra* note 34, at 1578.

[40] LANDES & POSNER, *supra* note 37, at 21.

limited, meaning that works will enter the public domain, available for use by anyone, after a certain amount of time.[41] Armed with these and other built-in limitations, copyright entitlements are expected to optimally embody a tradeoff between incentives and access, allowing authors to profit of their works through the market, while still ensuring that the public and other creators are not unduly restricted from accessing them.[42] At least according to some, by setting such limited entitlements in information, the free market will provide an optimal balance in the incentives/access trade-off.[43]

B. Compulsory Licensing as a Solution to Transaction Costs-Related Market Failures

Property rights are premised on the assumption that parties will engage in bargaining in the marketplace to facilitate the most efficient allocation of resources.[44] The private ordering presumption is no less true in the case of entitlements, like copyright, strategically granted to address a public goods problem; indeed, markets are essential to allowing copyright to accomplish its goals.[45] But numerous factors can often 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.[46] These strong remedies are premised on the assumption

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[41] Christopher Sprigman, *Copyright and the Rule of Reason*, 7 J. TELECOMM. & HIGH TECH. L. 317, 320 (2009).

[42] 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).

[43] *See* LANDES & POSNER, *supra* note 37, at 11-36; *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.'").

[44] *See* LANDES & POSNER, *supra* note 37, 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.")

[45] Gordon, *supra* note 11, 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.").

[46] Calabresi & Melamed, *supra* note 10, at 1092, 1106.

that the most efficient ordering will occur if private parties are forced to bargain over resources.

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."[47] The predominant justification for liability rules is the transaction costs that can impede efficient bargaining in any property regime, both real and intangible.[48] As Mark Lemley and Philip Weiser note, the transaction costs concept, as developed by Calabresi and Melamed, actually refer to a range of different phenomena. First, there is the difficulty and expense of contracting with multiple parties; at time these costs of doing business can exceed the value of the actual transaction, preventing a transaction from taking place.[49] 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 above-market price.[50] Holdout problems frequently occur in situations where a buyer must aggregate rights from many different sellers. Classic examples include landowners who can frustrate a large-scale real estate development project by holding out for a price higher than what she otherwise would charge.[51] Another example are common carriers or public utilities, which, by virtue of their monopoly position, can demand high prices from consumers.[52] In these cases, courts or regulators can establish a liability rule in order to bypass the market transaction process.[53] Thus the buyer or licensor is able to buy or use the property in question while the owner receives fair compensation, generally based on the rate that would otherwise have prevailed in a market free of transaction costs.[54]

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.[55] Such ex ante liability rule regimes are more common in copyright then other forms of intellectual

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

[48] Lemley & Weiser, *supra* note 17, at 786.

[49] *Id*.

[50] *Id*.

[51] Calabresi & Melamed, *supra* note 10, at 1106-07.

[52] 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).

[53] Calabresi & Melamed, *supra* note 10, at 1107.

[54] *See* Ayres & Talley, *supra* note 19, at 1032 (explaining the conventional understanding that, when it comes to determining fair value, "liability rules are 'market-mimicking.'").

[55] *See* Lemley & Weiser, supra note 17, at 829 (discussing "liability rules administered by an agency").

property, where they take the form of the several compulsory license regimes outlined in the Copyright Act.[56]

The Copyright Act's statutory compulsory licenses are frequently justified using the same transaction cost rationales identified by Calabresi and Melamed.[57] 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."[58] 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.[59] Compulsory licenses are also occasionally—though, nowadays rarely[60]—used to address market power imbalances, in particular where a party's aggregation of intellectual property interests allows them to amass market power and charge above-market prices.[61]

As a replacement for the bargaining that would otherwise occur in the free market, compulsory copyright licenses, like other liability rules, are expected to attempt to approximate a free market licensing rate.[62] But a frequent criticism of these regimes—and of liability rules generally—is that regulators are bad at setting prices, meaning that liability rules frequently undercompensate rightsholders. Robert Merges, for example, has argued that compulsory license rates are frequently untethered from any actual market proxies.[63] More generally, Richard Epstein has argued that courts and

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[56] *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 differ from the many of the statutory licenses contained in the Copyright Act. *See supra* _____.

[57] *See* sources cited *supra* note 11.

[58] García, *supra* note 12, at 1127.

[59] H.R. Rep. No. 94-1476, at 89 (1976), *reprinted in* 1976 U.S.C.C.A.N. 5659, 5704; *see also* Joseph P. Liu, *Regulatory Copyright*, 83 N.C. L. REV. 87, 130 (2004); Samuelson, *supra* note 11, at 23-24.

[60] *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].

[61] *See* Crane, *supra* note 11, at 269 (2009) (discussing performance right organization consent decrees, which have been partially incorporated into the Copyright Act); *see also infra* ____ (discussing performance rights organizations) and ____ (discussing the intersection of antitrust and copyright in the compulsory licensing context).

[62] *See supra* note 19.

[63] Merges, *supra* note 11, at 1311.

regulators struggle to set prices accurately—in particular, they tend to undercompensate property owners—leading to rent-seeking behavior that negates any efficiency benefits that might otherwise arise from maintaining a liability rule.[64] Scholars also note that the costs of administering a compulsory license or other liability rules, including costly adversarial proceeding, can generate costs equal to or greater than the transaction costs that would occur in a free market.[65] Finally, important work by Merges has noted that parties can sometimes find (better) solutions to transaction costs through private ordering.[66]

It should be noted, however, that the concerns of these critics (as well as those who favor private ordering), is generally the licensing of copyrighted material with minimal transaction costs. As explained the next sub-section, copyright law also employs compulsory licenses that can be understood to be focused on goals distinct from this conception of efficiency.

C. Zero Price Compulsory Licenses and the Incentives-Access Trade-Off

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."[67] A paradigmatic examples of fair use is the use of a work for news reporting or criticism, but fair use has been found for numerous forms of use.[68]

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.[69] For this reason, a highly influential theory, first advanced by Wendy Gordon, argues that fair use, like the liability rules described above, is primarily concerned with

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[64] Richard A. Epstein, *A Clear View of the Cathedral: The Dominance of Property Rules*, 106 YALE L.J. 2091, 2093 (1997).

[65] Merges, *supra* note 11, at 1317.

[66] *Id.* at 1302–03. *See also infra* ___ (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 12, at 1163–64.

[67] 17 U.S.C. § 107.

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

[69] Lemley & Weiser, *supra* note 17, at 790.

addressing the market failures caused by transaction costs. Though the full scope of Gordon's early work in this field is frequently contested, including by Gordon herself,[70] the theory essentially claims that a finding of fair use is most appropriate when secondary users have been unable to engage in socially valuable use of copyrighted material because transaction costs have prevented market-based licensing from taking place.[71] 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.*,[72] in which the Court held that consumers engaged in fair use when they used Betamax video recorders to watch television content after it aired and, accordingly, the makers of the device should not be liable for contributory copyright infringement. Under a market failure theory, 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.[73]

A corollary of the fair-use-as-market-failure approach, however, is that the setting of a market-price (rather than no price) might be a better tool for addressing transactions costs, as the property-liability rules scholarship described above generally takes for granted.[74] A further implication of the market failure approach 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.[75] This has led to several arguments that fair use can and will become largely unnecessary as new technology allows

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[70] *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).

[71] Gordon, *supra* note 11, at 1615. 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 37, at 227 ("Applications of Gordon's market-failure framework have largely concentrated on the role of transaction costs in justifying fair use."); 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.").

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

[73] Bell & Parchomovsky, *supra* note 84, at 1066–67.

[74] Gordon's original article also 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 11, at 1623.

[75] Gordon, *supra* note 70, at 189.

for efficient market transactions that would have otherwise been impeded by transaction costs.[76]

Seeing these arguments as challenges to fair use's continued existence, many scholars have questioned the market failure theory altogether, both in normative and empirical terms, primarily for its failure to adequately grapple with the public policy goals of copyright. Glynn Lunney 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, as explained above, 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 could most efficiently allocate this limited supply of goods.[77] This logic does not necessarily hold true for copyrights, which, as explained above, are specially created property entitlements designed to render non-rivalrous and non-excludable works of information excludable.[78] Even if transaction costs in copyright markets are eliminated, copyright will continue to generate deadweight loss by allowing authors to charge above marginal cost for their works, excluding consumers who are unwilling to pay the copyright owner's price.[79]

Lunney recognizes that tolerating this deadweight loss is warranted to ensure authors have adequate incentive to innovate.[80] 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.[81] This analysis may sometimes track the direction a licensing market free of transaction costs might lead, but it may also lead to the conclusion that consumers should be allowed free use of a work notwithstanding what a market-based allocation of copyright entitlements

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[76] 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).

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

[78] *Id*. at 1030.

[79] *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 price discriminate (generally understood to be impossible in the real world), this deadweight loss would also be remedied. *See id*. at 995. Other scholars, however, have suggested that a price discrimination system, if feasible, could frustrate the production of new creative works because of the inherent unpredictability of the creative process. *See* Julie E. Cohen, *Copyright and the Perfect Curve*, 53 VAND. L. REV. 1799 (2000).

[80] Lunney, *supra* note 77, at 993–96.

[81] *Id*.

would dictate.[82] Thus, under Lunney's theory, cases like *Sony* do not hinge 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."[83]

Put another way, the market failure approach to fair use treats the initial copyright interest as static (and presumably optimally set to provide an adequate balance between incentives and access), and thus treats fair use as a tool only to facilitates efficient allocation of copyrighted goods in areas where markets have been impeded by transaction costs.[84] Lunney's theory, in contrast, treats fair use as a tool for directly renegotiating the scope of the original entitlement so as to provide an appropriate incentives/access balance irrespective of the direction that a market based on the initial copyright entitlement might lead.

Many scholars agree that fair use should be conceived of as a tool for directly renegotiating the incentives provided by copyright against the public's interest in access to works (sometimes expressed through the lens of other normative commitments, like free speech).[85] Some have noted that this balancing approach provides a better explanation of the actual fair use case law in recent decades.[86] Barton Beebe, in an empirical study of fair use decisions, noted 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 incentives of the plaintiff."[87] Similarly, Pamela Samuelson has divided fair use cases into several "policy-relevant clusters"

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[82] *Id*. at 1030.

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

[84] *See* Bell & Parchomovsky, *supra* note 84, 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.").

[85] *See, e.g.*, William W. Fisher III, *Reconstructing the Fair Use Doctrine*, 101 HARV. L. REV. 1659 (1988); Bell & Parchomovsky, *supra* note 84, 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."); *see also* Sag, *supra* note 37 (distinguishing between the market failure approach to fair use and, what the authors call a "cost-benefit" approach advanced by Lunney, Fisher, and other scholars).

[86] See Bell & Parchomovsky, *supra* note 84, 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 market failures, but an "intrinsic and indispensable part of the design of the constitutional copyright system.").

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

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 works) would be low.[88] 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*.[89] Netanel has argued that this approach "overwhelmingly drives fair use analysis in the courts today."[90]

D. Bridging the Gap

The last two Sections identified two distinct 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, such as the difficulty and expense of contracting with multiple parties or the problems posed by strategic behavior of licensors and licensees.[91] Fair use, in contrast, while also understood in transaction-cost terms, is now predominantly analyzed through the unique policy objectives that copyright is designed to address, in particular how best to maintain the proper balance between authors' incentives to create and the public's access to creative works.

The competing emphases on transaction costs, on the one hand, and the incentives/access trade-off, on the other, underscore a deeper debate in copyright scholarship about the limits of markets in facilitating copyright's policy goals. As Shyamkrishna 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 in an effort to minimize the transaction costs that the system entails."[92]

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[88] Samuelson, *supra* note 68, 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").

[89] 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).

[90] Netanel, *supra* note 89, at 734.

[91] *See supra* _____.

[92] Balganesh, *supra* note 34, at 1580; *see also* Neil Weinstock Netanel, *Copyright and A Democratic Civil Society*, 106 YALE L.J. 283, 308 (1996). Balganesh also notes that this

In the analogous patent context, Amy Kapczynski and Talha Syed have argued that this camp believes it possible to create a "global optimum through the fine-tuned expansion of [intellectual property] rights" and therefore believe that intellectual property rights "should be strengthened, that transaction costs can or should be reduced, and that. . . property-based allocative signals, while attenuated, are still fundamentally aligned with social value."[93] 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 emphasize that copyright carries with it some of the problems of monopoly pricing, and they question the desirability of expanding copyright beyond the minimum necessary to provide authors with an incentive to produce."[94] These approaches are both grounded in economic reasoning, but, as explained above, come to very different conclusions about the circumstances in which copyright limitations like fair use should be applied.[95]

The goal of this article is certainly not to resolve this debate, but rather to point out that the implications of these two approaches should play an important explanatory role in understanding copyright's industry-specific compulsory licensing regimes and the normative commitment that underlie them.

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 access-fomenting terms,[96] instead describing them as addressing more conventional market

approach can be conceived of as "'Demsetzian' turn in copyright law, a reference to the seminal work by Professor Harold Demsetz describing the evolution of ownership and property rights as mechanisms to minimize transaction costs and internalize both positive and negative externalities associated with certain actions." Balganesh, *supra*, at 1633 n.33.

[93] Amy Kapczynski, Talha Syed, *The Continuum of Excludability and the Limits of Patents*, 122 YALE L.J. 1900, 1912–14 (2013).

[94] Netanel, *supra* note 92, at 309; *see also* Sag, *supra* note 37, at 226–27 (noting that proponent of an incentives/access balancing approach to 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").

[95] Sag, *supra* note 37, at 226–27 ("These approaches share a common foundation in law and economics, and yet they reach very different conclusions as to how judges should apply the fair use doctrine.").

[96] Some scholars have gestured at this but provided little additional elaboration of how this process has played out historically or at present. *See*, *e.g.*, Jane C. Ginsburg, *Creation and Commercial Value: Copyright Protection of Works of Information*, 90 COLUM. L. REV. 1865, 1926 (1990) ("The effect, and, I would argue, the real purpose of a compulsory license is to reduce the extent to which copyright ownership of the covered work conveys monopoly power, so that the copyright owner must make the work available to all who wish to access and exploit it."); *see also* sources discussed *infra* notes ____ (describing the creation of the

failures.[97] That being said, the notion that an industry-wide compulsory license regime *could* be used to renegotiate the incentives/access trade-off is not a new idea from a theoretical perspective. There are a number of scholars who have proposed hypothetical levy schemes, designed to replace the traditional property-based approach to copyright in order to address the public's interest in access to creative works. Though not always framed as compulsory licenses, these schemes shared much in common with a liability rule approach. 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 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.[98] 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.[99] 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.[100]

These scholars were primarily interesting in identifying new regimes to *replace* many aspects of copyright's property-centric structure. My argument, however, is that the Copyright Act's *existing* compulsory licensing regimes are also informed by a similar impulse: to weigh the public's interest in 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 (according to many scholars) rebalance the incentives/access tradeoff, so too an industry-wide compulsory license can

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mechanical license as a compromise designed to allow innovative dissemination technologies to succeed).

[97] *See supra* ____.

[98] *See, e.g.*, Netanel, *supra* note 42, at 4 (Netanel essentially proposed that individual consumers be allowed to noncommercially use copyrighted materials distributed via peer to peer file sharing (i.e. they would be granted a compulsory license to use these materials) 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 (such as CD burners, MP3 players, and digital video recorders)." 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).

[99] FISHER, *supra* note 22, at 203-258.

[100] Netanel, *supra* note IMPOSE LEVY, 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").

foster access by pricing the compulsory license at rates explicitly designed to foster access, sometimes meaning copyright owners would be compensated at rates lower than what they might have received in an open market. Like fair use, these compulsory regimes have always existed alongside copyright's predominantly property-centric approach, even though the access-fomenting goals of these regimes are often antithetical to market-driven outcomes.

As the next Part explains, this lens clarifies important aspects of music compulsory licensing's origins, as well as the unique policy-sensitive rate-setting criteria that eventually came to be used in this regime. It also helps identify that there is some tension between treating the Copyright Act's compulsory licensing regimes as purely transaction costs-addressing and treating them as tools for renegotiating the incentives/access tradeoff. The locus of this tension is rate-setting. From the perspective of those who only espouse a transaction costs-addressing approach to liability rules, the mechanical license, as it was historically applied, was "suboptimal" because it provided a price ceiling that undervalues the price of copyrighted works compared to those that would likely prevail in a free market.[101] As the property-rules liability rules scholarship emphasizes, a market-derived compulsory license rate indeed makes sense if the regime's primary concern is transaction costs. But a policy-sensitive rate (even if it is below market) may make more sense if the regime's goals are more aligned with fair use's emphasis on rebalancing between incentives and access. This is not to say that the two goals are not sometimes aligned; the overcoming of transaction costs will often further access by increasing the overall dissemination of copyrighted works. The distinction matters more as a question of degree; how much should the balance shift in favor of access. As the fair use scholarship clarifies, a policy-sensitive approach may sometime warrant providing the copyright owner with no compensation in order to facilitate maximum access; so too the policy-sensitive rate-setting criteria used for some of the Copyright Act's compulsory licensing schemes have often yielded lower rates, in order to allow innovative technologies of dissemination to foster access to copyright works.[102]

The distinction is especially important in terms of understanding the narratives that have informed compulsory licensing throughout its history. As Part II explains, the first compulsory music license and its rate regime were born from a concern over access that sound in copyright policy goals. But as Part III, explores Congress and rate-setting regulators have become more interested in the transaction costs-mitigating function of compulsory licensing, in recent years, leading them to privilege free-market mimicking rate-setting approaches over copyright policy-sensitive criteria.

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[101] Robert P. Merges, *Of Property Rules, Coase, and Intellectual Property*, 94 COLUM. L. REV. 2655, 2671 (1994) (calling the mechanical license a "suboptimal liability rule").

[102] *See infra* ______ (further discussing the relationship between fair use and compulsory licensing).

II. THE MECHANICAL LICENSE AND THE INCENTIVES-ACCESS TRADE-OFF

Section 115 of the Copyright Act establishes what is commonly called the "mechanical" compulsory license, named after its original purpose of regulating the reproduction of sheet music into "mechanically" playable forms like player piano rolls and records. According to Section 115 of the Copyright Act, once the owner of a musical composition agrees once to allow her composition to be recorded into a sound recording (which, when fixed into a physical object, like a CD or record, is known in the parlance of copyright law as a "phonorecord"), then she must agree to license her composition to all additional licensees at a predetermined price.[103] Licensees may simply use the copyright work and provide notice and payment to copyright owner through the Copyright Office, a regulatory body that administers copyright registrations and other parts of the copyright system. But licensees and licensors can also bypass this process by reaching direct licensing deals,[104] which they often do via an intermediary known as the Harry Fox Agency.[105] In this respect, the mechanical license often functions as a default rule, setting a de facto cap on licensing rates for parties bargaining in its shadow.[106] 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." But the regulatory scope of the license is far more expansive: the determined rates, which are set periodically by a regulatory body known as the Copyright Royalty Board, via trial-like regulatory proceedings, generally create a de facto ceiling on negotiated licensing rates for any recording of a musical composition, including the first recording.[107]

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[103] 17 U.S.C. § 115(a).

[104] 17 U.S.C. § 115(b)-(c).

[105] 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

[106] Lemley, *supra* note 5, at 479; *Register's Music Licensing Report, supra* note 1, Chap. 2, 2015 WL 1227760, at *9.

[107] FISHER, *supra* note 22, at 48 (When a publisher licenses first licenses a song to a record label "they would be free as a matter of law to pick any price they wanted. In practice, however, the amount they select would will be heavily influenced by [the mechanical compulsory license]"). Although the mechanical license was originally designed to regulate the licensing of musical compositions by composers/publishers to the creators of sound recordings (recording artists/record labels), legislative changes in the 1990s—described further in the Part III—established that distributors of sound recording files ("digital phonorecords"), like iTunes, must obtain licenses from both the holder of the sound recording copyright and the musical composition copyright; the latter implicates the government-set mechanical license rate. *See infra* ___.

This Part argues that the early history of the mechanical license clarifies its role as a tool for negotiation the incentives/access trade-off. The first Section argues that the license was created as 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 works. While the mechanical license originally sought 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 with the goal of ensuring that compensation to copyright owners and distributors could be readjusted periodically to ensure the proper balance of incentives and access.

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.[108] In its early years, this copyright interest was limited to the distribution of sheet music and the public performance of musical works, both of which required the payment of a royalty to the copyright owner.[109] In the late 1800s, two new technologies began disrupting this status quo. The first was the record player (originally known as the "talking machine" and phonograph)[110] 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.[111] Both player piano and record technologies dramatically and quickly increasing 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.[112]

Records and piano rolls allowed for the fixation of a copyrighted musical composition into an object capable of playing (and replaying) a recording of 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,[113] but the law was unsettled as to whether the unlicensed

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

[109] Loren, *supra* note 13, at 683.

[110] Wu, *supra* note 24, at 297.

[111] Loren, *supra* note 23, at 545.

[112] Wu, *supra* note 24, at 298.

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

creation of a record or piano roll infringed the copyright owner's exclusive rights.

The owners of musical composition copyrights, including composers and sheet music publishers, began pursuing targeted litigation to extend copyright protection to mechanical reproductions. The Supreme Court findally addressed the question in *White-Smith Music Pub. Co. v. Apollo Co*,[114] and concluded that piano rolls did not implicate copyright because they are not "copies within the meaning of the copyright act."[115]

The Court, however, invited Congress to extend copyright to mechanical reproductions, if it so chose.[116] 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."[117] The 1909 Act, however, applied a "condition" to this extension of a copyright protection: the compulsory licensing scheme that is now known as the mechanical license or Section 115 license. The Act explained that once a copyright owner has chosen to distribute a copyrighted work to the public in the form of a mechanical reproduction, any other person may "make similar use" of the copyrighted composition as long as they pay the copyright owner a 2 cent royalty per copy and abide by various statutory notice requirements.[118]

Many 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.[119] 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 become the exclusive licensee of musical composition copyright owners. The monopolization explanation makes sense to a point. The Aeolian Company had indeed entered into exclusive licensing arrangement with a group of music publishers even before Congress or the Supreme Court had established that a musical composition copyright extended to mechanical reproductions.[120] 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

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[114] 209 U.S. 1 (1908).

[115] 209 U.S. at 17.

[116] *Id*. at 18.

[117] 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].

[118] *Id*.

[119] *See, e.g.*, Merges, *supra* note 11, at 1309 ("The 1909 Act, [] reflected Congressional concern with [] potential market power. . ."); Abrams, *supra* note 13, at 220; Loren, *supra* note 23, at 548; Loren, *supra* note 13, at 681; Samuelson, *supra* note 11, at 24; *see also Register's Music Licensing Report, supra* note 1, Chap. 2, 2015 WL 1227760, at *7.

[120] Abrams, *supra* note 13, at 219–20; Ralph Oman, *The Compulsory License Redux: Will It Survive in A Changing Marketplace?*, 5 CARDOZO ARTS & ENT. L.J. 37 (1986).

"monopolize the business of manufacturing [and] selling music-producing machines, otherwise free to the world."[121]

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 frame their arguments against expanding copyright to mechanical reproduction in monopoly terms because of contemporary fears over trusts.[122] The Aeolian Company, the chosen scapegoat, was painted as beneficiary of a large global conspiracy designed to further its own wealth, at the expense of the nascent recording industry, songwriters, and the public.[123] 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.[124] 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.[125]

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, [126] and this approach was uncommon until the 1940s (and, even after

[121] H.R. Rep. No. 60-2222, at 7 (1909), reprinted in 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").

[122] Wu, *supra* note 24, at 300.

[123] Wu describes 1908 editorials in the publication that "Musical Age" described an international "syndicate" responsible for lobbying Congress to expand copyright to cover mechanical reproduction. One editorial asked: "who raises this hue and cry and creates this clamorous demand for new and drastic [copyright] legislation? Is it the author? [No] . . . It is the speculator and gambler. . . . In this country, it is the Æolian company which assumes the role of 'chief speculator." *Id.*

[124] Abrams, *supra* note 13, at 219–20; *see also* III RUSSELL SANJEK, AMERICAN POPULAR MUSIC AND ITS BUSINESS: THE FIRST FOUR HUNDRED YEARS: 1900-1984, 22-23 (1988).

[125] Burkan, 1907 Memorial to Congress, *supra* note ___, at 2-5 https://archive.org/details/TheChargeThatThePassageOfTheCopyrightBillSenateBill6330WillCreateAMonopolyInTheM; *see also* Zvi S. Rosen, COMMON-LAW COPYRIGHT, 85 U. Cin. L. Rev. 1055, 1133 n.143 (2018) (outlining Aeolian and the music publishers' other evidence used to refute the monopoly allegations).

[126] Hartford-Empire Co. v. United States, 323 U.S. 386, 417, *supplemented*, 324 U.S. 570 (1945) ("Congress was asked as early as 1877, and frequently since, to adopt a system of compulsory licensing of patents. It has failed to enact these proposals into law. It has also

that, quite rare).[127] In contemporaneous antitrust cases, a more common approach was the simple voiding of contracts that were being used to further monopolization efforts.[128]

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 the reproduction right to mechanical reproduction with a compulsory licensing scheme, Congress "compensated copyright holders but permitted the development of a recording industry."[129] Wu similarly views the creation of the license as a compromise between the incumbent music distribution industry, publishers of musical sheet music, and a new-technology challenger, the piano roll industry—the first of many similar copyright-related compromises between incumbents and challengers over the course of the early twentieth century.[130]

In this respect, the birth of the mechanical royalty appears to be an example of Congress reconfiguring the incentives/access trade-off through coupling a property entitlement with a market-restricting liability rule regime. 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 recording—but then immediately tempered that entitlement using a compulsory licensing scheme requiring licensing to all comers. Under this compromise, the new access-fomenting industry would be allowed to flourish, but the copyright owners would still receive some compensation via licensing.

Though not pointed to by Ginsburg and Wu, Congress's choice to set the mechanical rate at a fixed 2 cents is important to understanding what kind of balance this regime achieved. A compulsory licensing approach to mechanical reproductions was not a new idea; German law already recognized a compulsory mechanical license[131] and the revised Berne

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rejected the proposal that a patentee found guilty of violation of the antitrust laws should be compelled, as a penalty, to license all his future inventions at reasonable royalties.").

[127] *See* IP AND ANTITRUST, *supra* note 60, at 6-61 – 6-69.

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

[129] Ginsburg, *supra* note 24, at 1627; *see also* Peter Dicola, Matthew Sag, *An Information-Gathering Approach to Copyright Policy*, 34 CARDOZO L. REV. 173, 202 (2012) ("Congress [] sought to reach a compromise between two competing interests that it saw as legitimate: the publishers' and composers' interest in compensation and the piano roll manufacturers' interest in growing and profiting from the nascent recording industry.").

[130] Wu, *supra* note 24, at 302-05.

[131] WORLD INTELLECTUAL PROPERTY ORGANIZATION, THE BERNE CONVENTION FOR THE PROTECTION OF LITERARY AND ARTISTIC WORKS FROM 1886 TO 1986, 156 (1986).

Convention of 1908 implicitly recognized the possibility by granting musical composition authors the exclusive right to control mechanical reproductions but allowing member states to create "reservations and conditions" to this right.[132] But the German approach differed significantly from the 1909 Act's regime. Under the German approach, once a copyright owner licensed their work to a recording company, other recording companies would be permitted to ask for "a similar concession in return for an equitable compensation."[133] It was only if an agreement could not be reached that a state authority would step in and impose a government-determined rate, determined through reference to existing free-market deals.[134]

In contrast, Congress created a simple 2 cent rate, applicable ex ante to all licensing agreements between copyright owners and disseminators. In prior versions of the legislation, Congress had in fact considered setting the rate using mechanisms that would more closely track market forces, such as a percentage of the record or piano roll retail price,[135] a percentage of the manufacturer's revenue,[136] or based on extant free-market licensing deals,[137] but ultimately chose the flat 2 cent rate.[138] Congress offered no clear

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[132] Berne Convention Art. 13 (1908). German law already recognized a compulsory license for mechanical reproductions and Germany sought to explicitly include a compulsory license option in the text of the Convention. According to a report by the drafters of the 1908 revision, Germany believed such a compulsory licensing provision was necessary to "safeguard the interests of small manufacturers by protecting them both against the too heavy costs they could face as a result of excessive estimates on the part of authors and publishers and against the danger of the establishment of monopolies in favour of some manufacturers with large amounts of capital at their disposal." WORLD INTELLECTUAL PROPERTY ORGANIZATION, THE BERNE CONVENTION FOR THE PROTECTION OF LITERARY AND ARTISTIC WORKS FROM 1886 TO 1986, 156 (1986). Opposition from member states whose legislation did not contain compulsory regimes led the committee to reject German proposal, instead including the more open-ended language of "reservations and conditions." *Id.*; *see also* Brennan, *supra* note J. LEGAL HIST., at 29-31.

[133] WORLD INTELLECTUAL PROPERTY ORGANIZATION, THE BERNE CONVENTION FOR THE PROTECTION OF LITERARY AND ARTISTIC WORKS FROM 1886 TO 1986, 156 (1986).

[134] *Id.*

[135] *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).

[136] *See, e.g.*, H.R. 27310, 60th Cong., 2d Sess. (1909) ("five per centum of the sum derived bona fide by the manufacturer thereof, from the manufacture, use, sale, or lease of such parts").

[137] *See, e.g.*, H.R. 21592, 60th Cong., 1st Sess. (1908) ("a royalty equal to the royalty agreed to be paid by the licensee paying the lowest rates of royalty for instruments of the same class"); H.R. 24782, 60th Cong, 2d Sess. (1908) (setting rate either based on existent licensing deals or 10% of the retail price with a two cent minimum); *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).

[138] 1909 Copyright Act, *supra* note _______, § 1(e). Compulsory licensing became more prevalent in other countries' laws in the years following the 1909 Act. For example, despite fierce resistance, the United Kingdom implement a compulsory license for mechanical reproductions in its 1911 copyright reform. Brennan, *supra* note J. LEGAL

justification for choosing the fixed rate.[139] But seen through the lens of copyright policy, this approach makes a little more sense. Unlike the German approach, Congress's ultimate choice of a fixed, non-market-driven royalty rate bolstered the nascent recording industry, if not by design than at least in practice. The copyright owners were certainly better off than they were after *White-Smith*, when they had no copyright entitlement over mechanical reproductions at all, but the mechanical license provided them with less compensation than they would have received in an open market,[140] to the benefit of the burgeoning new dissemination industries.

Throughout most of its history, the power of the mechanical license has primarily been the shadow it rate casts across all negotiations between music publishers and record companies. The Harry Fox Agency ("HFA) was created by the National Music Public Association in 1927 as a middleman between publishers and recording companies. HFA served, and still serves, in an agent capacity for publishers, issuing mechanical licenses and collecting fees.[141] Royalties were and are frequently agreed to and paid through HFA, rather than through Copyright Act's formal process for invoking the mechanical license. But the 2 cent statutory became a de facto ceiling on these negotiated rates since secondary users could always leave the bargaining and table and exercise the compulsory license.[142] The royalty

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HIST., at 33-35. But 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).

[139] 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). The actual choice of 2 cents, as opposed to some other number, was also not justified; only in the final House debate did one representative speculate that "it amounts to about 5 per cent probably on the selling price [of a piano roll]." 43 Cong. Reg.. 3766 (1909), *reprinted in* 5 LEGISLATIVE HISTORY OF THE 1909 COPYRIGHT ACT, *supra* note ___, pt. M, at M110; *see also* Greenman & Deutsch, *supra*, at 11.

[140] A fixed two-cent rate was likely lower that what many publishers could have charged in 1909. Merges, *supra* note 11, at 1393 n.38 (speculating that "[w]ithout the compulsory license provision, an exclusive license could be negotiated at substantially higher royalty rates, or even non-exclusive licenses might be negotiated at higher royalty rates in the absence of a statutory ceiling."). Even if this was not true in 1909, it quickly became true. In a report commissioned by the copyright office, one economist speculated that in the absence of compulsory licensing, the royalty rates paid to composers would have at least doubled. 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) ("I offer the estimate that the components of the music publishing industry collectively are able to obtain only from one-third to one-half of the income available in an 'open' market.").

[141] Harry Fox Agency, *What Does HFA Do?* https://www.harryfox.com/publishers/what_does_hfa_do.html; *see also Blaisdell Study, supra* note 140, at 94.

[142] *Blaisdell Study, supra* note 140, 101-102; *see also* Recording Indus. Ass'n of Am. v. Copyright Royalty Tribunal, 662 F.2d 1, 4 (D.C. Cir. 1981) ("Today, the vast majority of

rates agreed to by publishers and record labels were sometimes lower than the 2 cent statutory ceiling,[143] even for the first recording of the song.[144] In the 1930s and 1940s, for example, the actual rates that prevailed in the market place ranged from around 1.25 to 2 cents.[145] At the same time, the recording industry grew exponentially. For example, one of the predominant record makers, the Victor Talking Machine Company, increased its assets from $2.7 million to $33.2 million between 1902 and 1917.[146] While it would speculative to attribute this growth directly to the below-market licensing rates, it is certainly plausible that the mechanical royalty played some role.[147]

B. Policy-Driven Rate Setting

The 1909 Act's 2 cent rate was a relatively blunt instrument; while it certainly restructured music licensing market to allow access-fomenting technologies to thrive, its status as a fixed rate, unable to even account for inflation, grew increasingly controversial.[148] 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."[149]

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

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contracts for use of copyrighted musical works involve voluntary payment at precisely the statutory rate."); sources *supra* note 5.

[143] *Blaisdell Study, supra* note 140, at 95.

[144] Publishers could have, in theory, sought higher rates for the first recording, because first-recording are not subject to the mechanical license. *See supra* _____. But the 2 cent rate became a de facto ceiling even on negotiations for first recordings. *Blaisdell Study, supra* note 140, at 95, 102.

[145] *Henn Study, supra* note 137, at 34; *see also* Greenman & Deutsch, *supra* note 139, at 12-13.

[146] I. Trotter Hardy, *Copyright and "New-Use" Technologies*, 23 NOVA L. REV. 659, 705 n.72 (1999).

[147] This became a frequent argument used by the mechanical royalty's defenders as Congress considered revisions to the license. For example, in the 1950s, one commenter speculated to Congress that the license was directly responsible for the growth of the record industry in the 1940s and 1950s, including the many new entrants to the business and the industry's overall high levels revenue. *Henn Study, supra* note 137, at 77-78 (comments of Ernest S. Meyers). *See also Blaisdell Study, supra* note 140, at 125 (Comments of Ernest S. Meyers).

[148] *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").

[149] *Blaisdell Study, supra* note 140, at 119 (Comments of Ralph Peer).

designed to force special interest groups to negotiate with one another."[150] 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 likely no exception.[151] 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 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, as well as for newly created compulsory licenses governing several other copyright industries, including cable retransmissions of broadcast television.[152] The 1976 Act set the statutory rate at the greater of 2.75 cents or 0.5 cents per minute of the sound recording,[153] but provided that the CRT would adjust the rate in 1980, again in 1987, and then every 10 years after that.[154] 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;

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

[151] *See* Greenman & Deutsch, *supra* note 139, at 15 (describing lobbying by the RIAA to prevent repeal of the mechanical license).

[152] The CRT consisted of five "commissioners" appointed by the President with advice and consent by the Senate. Its decisions were appealable to D.C. Circuit. *See* Recording Indus. Ass'n of Am. v. Copyright Royalty Tribunal, 662 F.2d 1, 5 (D.C. Cir. 1981).(outlining legislative history surrounding the CRT).

[153] 17 U.S.C. § 115(c)(2) (1976).

[154] 17 U.S.C. § 804(a)(2)(B) (1976).

(D) To minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices.[155]

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.[156] Under U.S. law, firms that provide public goods such as electricity and gas are frequently permitted to function as natural monopolies but are in turn subject to regulation, including price-setting, to prevent various inefficiencies, including the monopoly exploiting its market power to charge consumers high prices.[157] The rates that these firms may charge to consumers are generally regulated by rate-making agencies that fix reasonable rates based on a "balancing of the investor and the consumer interests."[158] 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.[159]

In invoking public utility regulation, the record industry sought to frame the mechanical license as a tool for preventing publishers from being "in a position to discriminate against one [record] manufacturer and another, charging one higher prices and the other lower prices, excluding a third entirely from the field, and determining what compositions should be recorded, how they should be recorded, which artist should perform and, in fact, dominate the whole record industry."[160] As in 1909 Act, the invocation of the publishers' market power appeared to have been a strategic decision designed to convince Congress to forego a rate based on market criteria in favor of a rate designed to make it easier and cheaper for the recording industry to produce music. For example, Thurman Arnold, counsel for the Recording Industry Association of America, explained that the mechanical license rate should be adopted using "accepted standards of statutory ratemaking," including ensuring uniformity in rates and 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."[161]

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[155] 17 U.S.C. § 801(b)(1) (1976).

[156] *See, e.g.*, 1967 Senate Hearings at 383, 479.

[157] CHRISTOPHER DECKER, MODERN ECONOMIC REGULATION: AN INTRODUCTION TO THEORY AND PRACTICE 14-28 (2015).

[158] Fed. Power Comm'n v. Hope Nat. Gas Co., 320 U.S. 591, 603 (1944).

[159] DECKER, supra note 157, at 104-108.

[160] 1967 Hearings, *supra* note 156, at 925 (Testimony of Thurman Arnold).

[161] *Id*. at 469 (Testimony of Thurman Arnold); *see also* 1967 Hearing at 926-27 (Statement of Thurman Arnold).

The music publishers and their experts bristled at this proposed standards, and the analogy to public utilities more generally. One economist explained that the music industry "is a personal service industry[, in which t]here is no large physical plant and large-scale fixed investment as characterizes most public utilities."[162] But these arguments fell on deaf ears. By the time Congress returned to the issue in 1976, it appeared to have been convinced that the mechanical license rate-setting should be based on policy criteria similar to those introduced by Thurman Arnold. A 1976 House Judiciary Committee laid out a version of the standards similar to what ultimately became the 801(b) factors.[163] Though the legislative history is not clear about how Congress landed on the specific language of the 801(b) factors, it appears to have been derived from elements of Arnold's proposal.[164] In particular the "fair return" and "relative roles" objective, which explains that a rate should be based on the "contributions" of the copyright owner and user, seem to clearly have drawn from Arnold's notion that the rate should allow the publishers only a "reasonable return" on their investment, while explicitly ensuring the recording industry could continue to disseminate music.

This "public utility" rate-setting approach to mechanical licenses differed dramatically from the other rate-setting schemes in the 1976 Act, which appear to have been designed to remedy more conventional transaction cost issues and, accordingly, used rates tied to market proxies. In particular, the 1976 Act's compulsory license for public broadcasting provides the best contrast to 801(b). Under this license, non-commercial broadcasters (such as NPR and PBS), pay rates for copyrighted works according to a rate schedule determined by the CRT.[165] It would be reasonable to think that this license was borne out of a desire to encourage non-commercial broadcasting, for the public's benefit, and that Congress would have used a similar policy-sensitive approach as the 801(b) factors. But Congress in fact made clear that its primary concern was transaction costs, in particular "administratively cumbersome and costly 'clearance' problems" encountered by small public broadcasters when seeking to use musical or literary works.[166] Consistent with a transaction cost-addressing approach, the rate-setting standard was market-mimicking, instructing the CRT to set rates based on "rates for

[162] *Id.* at 1090-94 (Testimony of Robert R. Nathan); *see also id*. at 383 (Testimony of Robert R. Nathan) (arguing that the songwriting and publishing industry is "a creative and non-standardized area," and "public utility aspects are just not prevalent in this industry."); *id*. at 1094 (Testimony of Robert R. Nathan) ("As far as the third 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.").

[163] 1976 House Report at 174.

[164] Greenman & Deutsch, *supra* note 139, at 53.

[165] 17 U.S.C. § 118(b)(3) (1976).

[166] 1976 House Report, *supra* note 163, at 117; *see also* Samuelson, *supra* note 11, at 25.

comparable circumstances under voluntary license agreements negotiated" between copyright owners and commercial broadcasters.[167]

In contrast, the policy-sensitive 801(b) factors correspond in many respects to an approach to compulsory licensing that emphasizes the incentives/access trade-off, rather than transaction costs. In particular, the first factor emphasizes that the goal of rate-setting regulators should be to maximize the availability creative works, "*to the public*." As Part I explained, the primary way that copyright maximizes works is by providing exclusive rights that allow creators to receive financial incentives to create, while simultaneously limiting those exclusive rights in order to prevent the public's access from being unduly frustrated. The first factor appears to at least tacitly invite this kind of balancing inquiry. The third 801(b) factor makes this balancing approach even more explicit by asking the rate-setting body to weigh the contribution and costs of the copyright owner against the contribution and costs of disseminator in making the copyrighted works "available to public."

The third factor's origins in public utility-rate setting principles also bolsters this reading. The analogy between music copyright owners and natural monopolies is imprecise[168] (and, as explained above, was likely chosen by the recording industry for rhetorical effect). Indeed, as the D.C. Circuit noted in an appeal of an early rate-setting decision (described further below), the 801(b) factors are quite different from the "cost of service rate-making" utilized for most public utilities.[169] Nonetheless, public utility regulation's historic emphasis on using costs as a primary driver of an appropriate rate has parallels in what many 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."[170] 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 to authors so as to encourage the creation of creative works.[171]

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

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[167] 17 U.S.C. § 118(b)(3) (1976).

[168] *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).

[169] Recording Indus. Ass'n of Am. v. Copyright Royalty Tribunal, 662 F.2d 1, 11 (D.C. Cir. 1981).

[170] Lunney, *supra* note 77, 1015.

[171] FISHER, *supra* note 22, at 178-82 (drawing this link).

publishers and songwriters (represented primarily by the NMPA) against a group of record labels (represented primarily by the RIAA).[172] 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. Publishers argued that the rate need to significantly raised.[173] After a 46 day hearing, the CRT chose to raise the statutory rate from the 2.75 cents chosen in the 1976 Act to 4 cents per reproduction.[174] Though this decision was certainly favorable for publishers, it was lower than the rates they sought: 8% of song list prices, or alternatively, 5 cents per reproduction.[175]

In grounding the four-cent rate in the 801(b) objectives, the CRT noted that the first factor, to "maximize the availability of creative works to the public," related to copyright's policy goals of "encourag[ing] the creation and dissemination of musical compositions." For copyright owners this policy goal takes the "form of an economic incentive and the prospect of pecuniary reward—royalties payable at a reasonable rate of return."[176] Finding that evidence that record label profits has increased at a level that far surpassed mechanical royalties, songwriters/publishers were not receiving adequate economic incentives under the current rate. Because "the fortunes of the record companies, the copyright users, have been enhanced in the last decade. . . . [and] the fortunes of songwriters and music publishers, the copyright owners—subject to a price-fixed mechanical royalty in a period of great inflation—have dwindled," an increase was in order.[177]

A more nuanced analysis took place under the third "relative roles" factor. In analyzing this factor, the CRT noted that while upward adjustment of the statutory rate was necessary to ensure 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 is far greater when it comes 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." This "opening of new markets" also occurred "through record clubs, mail order sales and

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

[173] *Id.* at 10467.

[174] *Id.* at 10480.

[175] *Id.* at 10467.

[176] *Id.*at 10479.

[177] *Id.* at 10483. The CRT also noted that the fact that record industry had "flourished during the past decade" showed that it would not be unfair to raise the rate under factor 2. *Id.* at 10480.

television advertising campaigns" arranged by the labels.[178] The CRT explicitly weighed the copyright owners' role in providing the work against the record labels' market-opening contributions, and still concluded that this balance would still be served by a rate increase.[179]

This discussion of the third factor is notable because it provides an example of the CRT appearing to weigh authors' incentives against the prospect of increased music dissemination through technological innovation and/or the opening of new markets for consumers. The CRT ultimately treated this balance as asking whether copyright owners (publishers and composers) would need a higher royalty rate to maintain an adequate incentive to provide the work of authorship, as weighed against whether the copyright users (in this case, record labels) could continue to engage in their innovative dissemination-related activities while paying a higher rate. Even though, in this case, CRT ultimately chose to raise the royalty rates, its analysis of the third factor has provided something of a blueprint to future rate-setting decision, in which the third factor has often caused rate-setting bodies to pause before raising royalty rates when evidence existed that the these higher rates, coupled with existing dissemination-related costs to distributors, would affect distributors' ability to reach large numbers of consumers.[180]

III. THE EROSION OF POLICY-SENSITIVE COMPULSORY 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 copyright system. This Part examines the trends that have placed pressure on this original role, both in the legislative context and in the 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. At the same time, Congress has expanded compulsory licensing to cover the use of sound recordings by digital radio stations. Congress originally implied that this new licensing regime—the Section 114 license—was also designed to encourage technologies of dissemination; it even applied the 801(b) factors to rate setting for this new license. However, soon after, Congress seemingly pushed the regime away from this approach by establishing a new "willing buyer and willing seller" rate-setting standard to be applied to internet radio. Most

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[178] *Id*. at 10480-10481. The CRT also noted the work of the record labels "in finding and signing the right talent; deciding on the material; directing the recording sessions; and in the development of artists' careers." *Id*. at 10480.

[179] *Id*. at 10480-10481

[180] *See infra* _________.

recently, the Music Modernization Act has pushed the narrative that compulsory licensing should only be used to address transaction costs-related market failures by replacing all music-related rate-setting with this willing buyer and willing standard.

Similar moves have taken place in the rate-setting context. The CRB originally recognized that the policy-oriented approach of the 801(b) objectives should be used to encourage new forms of music dissemination. However, the CRB began moving away from this approach and became increasingly focused on attempting to mimic the free market in rate-setting decisions. The recent CRB rate-setting decision for streaming mechanical royalties illustrates this trend, as well as pointing to some of the reasons why the shift is problematic.

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The legislative and regulatory changes discussed in this Part deal with complex and confusing areas of copyright law and some additional background information is in order. First, recall that sound recordings and musical compositions are distinct copyright interests; Celine Dion's recording of "It's All Coming Back to Me" was made using the copyrighted musical composition—the notes, orchestration, lyrics—but her recording itself carries a distinct copyright. The sound recording copyright is a relatively new creation (and remains somewhat limited in scope, as explained further below).

A copyright interest carries with it a number of separately enumerated exclusive rights: most importantly, the right to reproduce a copyrighted work and distribute copies of the work (for example, selling copies of a book)[181], the right to publicly perform a copyrighted work (for example, performing a play or broadcasting a song on the radio)[182], 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).[183]

The creation of a sound recording implicates the exclusive rights of the musical composition copyright owner and, more specifically, the right to reproduce and distribute copies of the copyrighted work.[184] As explained in the last Part, this relationship has, to a large extent been regulated by the mechanical license.

The dissemination of a sound recording implicates *both* the musical composition copyright and (with some exceptions) the sound recording

[181] 17 U.S.C. § 106(1), (3).

[182] 17 U.S.C. § 106(4).

[183] 17 U.S.C. § 106(2); *see also* 17 U.S.C. § 101.

[184] 17 U.S.C. § 106(1), (3) (discussing right to reproduce and distribute "phonorecords"); 17 U.S.C. § 101 (defining phonorecords).

copyright. Where things get particularly confusing, however, is that different forms of dissemination implicate different exclusive rights. For example, the distribution of an MP3 sound recording by iTunes implicates the reproduction/distribution rights for both the musical composition and sound recording copyrights, but streaming of a song on a digital radio station, like Pandora, primarily implicates the *public performance* rights for both the musical composition and the sound recording.

As the next Section explains, Congress and regulators have often struggled to come up with coherent ways of applying these exclusive rights to new forms of dissemination, particularly in the digital age. In particular, the mechanical license, as well a new compulsory license regime, the Section 114 license, have been applied to some forms of dissemination and not others. What has resulted is a highly complex web of rules, in which different forms of dissemination—including uses that seem analogous—are treated differently.

A. Legislative Context

1. Background: The Sound Recording Copyright

As the last Part explored, the mechanical license, historically, regulated copyrighted works used by technologies of music dissemination: the player piano, phonograph, and, later, the record player. By creating a compulsory license coupled with a dissemination-favoring royalty rate, these new technologies were able to cheaply and easily disseminate music to the public.

The mechanical license's role in facilitating *dissemination* becomes somewhat counterintuitive in the current copyright landscape, where it continues to be useable by recording artists in making sound recordings of musical composition. The ways in which recording artists use their talents to create their own take on a preexisting musical composition seems closer to the creation of a distinct creative work than a way of disseminating a preexisting work. However, copyright law has been slow to recognize the independent copyrightability of sound recordings, and the current regime for sound recordings has a complicated approach to treating sound recordings as independently copyrightable new works.[185]

Congress provided for limited copyright protection for sound recordings in 1971,[186] with the specific goal of preventing "piracy" by companies that were copying recorded music on records and tapes and selling them to public.[187] The 1971 Act forbade the copying of a sound recording

[185] Ginsburg, *supra* note 24, at 1647 n.73.

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

[187] For that reason, as explained further below, terrestrial radio stations do no need to pay royalties to sound recording copyright owners. *See infra* ___.

without permission of the copyright owner (though, as explained further below, did not extend exclusive rights to sound recording public performance). Congress, however, made clear that despite the fact that sound recordings now had limited copyright protection, the creation of a sound recording under the mechanical license was still a form of mechanical *reproduction*, rather than the creation of a derivative work, as long as the recording artist did "not change the basic melody or fundamental character of the work."[188] An important practical implication of this regime is that while sound recording artists can stop infringers from directly duplicating pieces of their recording,[189] they have no rights in the underlying musical work, which are the purview of the musical composition copyright owners (albeit with the limitations imposed by the mechanical license). Thus, cover songs—even songs that directly mimic the style of an earlier recording—do not implicate the sound recording copyright.[190]

Even so, as this Section explores, 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.

Concerns that the sound recording copyright might stymie music dissemination have been present since the copyright inters was first created. In the lead up to the 1971 Act, tape manufacturers argued that the mechanical license should be extended to sound recordings in order to further goals of dissemination. In making this argument, they echoed many of the original arguments for 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."[191] 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."[192] A compulsory license for sound recordings would provide "compensation sufficient to encourage" the creation of additional sound recordings, while still allowing the tape

[188] 17 U.S.C. § 115(a)(2).

[189] 17 U.S.C. § 114(b). ("The exclusive right of the owner of copyright in a sound recording. . . is limited to the right to duplicate the sound recording in the form of phonorecords or copies that directly or indirectly recapture the actual sounds fixed in the recording.").

[190] *See* FISHER, *supra* note 22, at 53.

[191] 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

[192] *Id*. at 73-74; *see also id*. at 84 ("The reasons which caused Congress to enact the original compulsory licensing fee provisions are still valid today.")

reproduction market to flourish.[193] In so doing, consumers would benefit from lower fees, as well as from access to a greater variety of musical works.[194] Though Congress was sympathetic to these arguments,[195] the record industry effectively painted the tape industry as "pirates" and "parasites" who could not be trusted to abide by the requirements of compulsory licensing regime, leading Congress to ultimately reject the compulsory license proposal.[196]

At the same time, in the 1971 Act, Congress declined to provide a public performance right for sound recordings. (Recall that the right to publicly perform a musical work, including by broadcasting a song over the radio, is distinct from the right to reproduce a song in a sound recording embodied in a record, CD, or digital file or to copy an existing sound recording.). Congress revisited this issue again the in 1976 Act and, likely thanks to lobbying from radio stations and publishers, again declined to extend public performance rights to sound recordings.[197] This meant that radio stations were 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 had minimal implications in restricting 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 consent of the copyright owners, or even compensating them, at all. On the distribution side, record companies continued to be the primary distributors of recorded music, and technologies involving the duplication of the sound recordings embodied in

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

[194] *Id*. at 118 ("For example, if copyists were allowed to purchase via a compulsory license the right to copy sound recordings they could assemble sound recordings taking from existing sound recordings the more successful pieces. This would furnish the consumer with the opportunity to purchase in one recording a series of desired pieces. There would appear products which would contain renditions by performers not all of whom were employees of the same recording company, which products would be a valuable addition to the market place.")

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

[196] *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).

[197] García, *supra* note 12, at 1134.

those records had yet to become pervasive.[198] Congress's refusal to extend the mechanical license to sound recording 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 first sale doctrine allowed the resale of lawfully made records, tapes and CDs without consent of copyright owners.[199]

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* without a compulsory license scheme meant that digital retailers of MP3 files—such as iTunes—were required to clear licenses from record labels before selling music through free market transactions, as discussed further below. But the complete 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.

The recording industry grew increasingly concerned about the threat that digital radio posed to its traditional revenue streams[200] and, in 1995, convinced Congress to pass the Digital Performance Rights in Sound Recordings Act (DPRA).[201] The DPRA and follow-on legislation fundamentally altered the copyright public performance right by creating a public performance rights in sound recordings performed "by means of a digital audio transmission," such as those provided by satellite and internet radio.[202] The DPRA, however, coupled this grant with a new compulsory licensing regime requiring licensing of sound recordings to any digital radio service.[203]

In many ways, this process paralleled the original creation of the mechanical license. Congress granted copyright interests where none had existed before in order to ensure authors would be incentivized to continue to

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[198] When home analog duplication technologies became more common in the 1980s, record companies took the position that these activities violated their copyrights but primarily declined to take legal action against consumers. FISHER, *supra* note 22, at 83-84.

[199] 17 U.S.C. § 109(a).

[200] 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").

[201] 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.)

[202] 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)).

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

create—in fact, the need for financial incentives was a key argument used by the record labels leading up to the DPRA[204]—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 license would be to encourage technologies that increase music dissemination, like internet radio: "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. . . . Such systems could increase the selection of recordings available to consumers, and make it more convenient for consumers to acquire authorized phonorecords."[205] Congress sought to balance this priority against the need of "appropriate copyright protection in the digital environment [to incentivize] the creation of new sound recordings and musical works."[206]

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 sub-section explores, early rate-setting decisions under the 801(b) factors explicitly accounted for internet and satellite radio's access-fomenting effects, as weighed against the importance of providing economic incentives to sound recording copyright owners.

In 1998, however, Congress altered the Section 114 license through 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.[207] 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 and terms "that most clearly represent the rates and terms that would have been

[204] 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.").

[205] 1995 DPRA, S. Rep. 128 (Aug. 4, 1995).

[206] *Id.*; *see also* FISHER, *supra* note 22, at 104.

[207] Dicola & Sag, *supra* note 129, at 224.

negotiated in the marketplace between a willing buyer and a willing seller."[208] However (at least until very recently, as explained below) satellite radio services and internet radio services that "preexist[ed]" passage of the DMCA (namely, the services Music Choice and Muzak) would have their rates set using the 801(b) policy objectives.[209]

The DMCA's switch to a "willing buyer and seller" standard for any new digital radio services was never explained in the Congressional record. It may have been a product of lobbying by the record labels; indeed, it was added shortly before the bill was passed. But it also could very well have reflected a belief that the Section 114 compulsory license should primarily regulate transaction cost-based market failures and would best do so using a market-mimicking rate-setting approach.[210] As Part I explained, a market-based rate standard is more common for liability rules designed to address transaction costs that characterize conventional markets.

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 that implicate the public performance of musical compositions have 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.[211] In the early twentieth century, copyright owners began addressing this problem by forming performance rights organizations ("PROs"). The PROs aggregate

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[208] 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 12, at 1164–69.

[209] 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

[210] 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 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." This approach runs in contrast to alternative rate-setting standards that "force copyright owners to subsidize billion dollar corporations who use the compulsory license to exploit copyrighted programming." *Id*. at 174-75.

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

copyright interests to make it logistically easier for public performance licensees, such as radio stations, bars and restaurants, and TV stations, to license large quantities of musical works for public performance.[212] 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.[213] 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.[214] Most notably, the PROs must only grant nonexclusive licenses and must license to all comers.[215] Additionally, licensees unsatisfied with a proposed licensing rate may petition courts in the Southern District of New York for a court-determined rate.[216]

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.[217] SoundExchange essentially functions like a PRO: it facilitates blanket licensing of Section 114 licenses and also facilitates royalty payments to disparate rightsholders.[218] In 2002, Congress explicitly incorporated SoundExchange into the architecture of the Section 114 licensing scheme,[219] and it is now the sole entity entitled to collect and distribute Section 114 royalties to copyright owners and artists.[220]

As explained in Part I, an approach to compulsory licensing solely focused on transaction costs should attempt to approximate a free market

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[212] Merges, *supra* note 11, at 1329.

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

[214] Wu, *supra* note 24, at 310–11 (noting the de facto compulsory license established via the consent decrees).

[215] *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).

[216] LUNNEY, *supra* note 215, at 65.

[217] Dicola & Sag, *supra* note 129, at 230.

[218] García, *supra* note 12, at 1183, n.1.

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

[220] Dicola & Sag, *supra* note 129, at 230.

rates.[221] For this reason, some of the Copyright Act's other compulsory licensing regimes, such as the regime for cable television and the public broadcasting, have historically utilized market proxies during rate-setting.[222] 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."[223] 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 willingness to replace the 801(b) factors with a willing buyer and willing seller standard in the DMCA.

3. The Mechanical License's Slow Shift Towards a Transaction Costs-Focused Approach

While the DPRA and the DMCA made significant changes to the sound recording performance 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 includes 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 primarily 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 previously recorded music to consumers in the form of downloadable files. Unlike a radio public performance, the selling of an MP3 file clearly implicated 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. While the authority of a record label to license a sound recording copyright was obvious, it remained somewhat uncertain how a digital sale of a sound recording by a third-party distributor would implicate the musical composition copyright 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

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[221] *See supra* _____.

[222] *See supra* _____.

[223] 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.

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.[224] In passing the DPRA, 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 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 have received permission to distribute sound recording to bypass direct negotiations with the owners of musical composition copyrights (*i.e.* publishers).[225]

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; this arguably impeded the ability of digital distributors to engage in efficient bulk licensing of content.[226] 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.

Another of the DPRA's choices had important implications for the music streaming industry. As the last Sub-Section explained, the DPRA established that satellite radio and internet radio services (also known as webcasters or non-interactive streaming services) could take advantage of a compulsory license to license the sound recording performance rights held by records labels. These service also can (and do) utilize the PROs to receive blanket licenses for musical composition public performance rights.[227]

But the DPRA provided an important exception to this regime for one class of digital distributors: "interactive" streaming services. The distinction between non-interactive and interactive streaming services is complex but, in essence, a non-interactive service provides a service akin to radio—

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[224] 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.

[225] 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 burden on transmission services by placing record companies in a position to license not only their own rights, but also, if they choose to do so, the rights of writers and music publishers to authorize digital phonorecord deliveries.").

[226] *See infra* _____.

[227] *See* In re Pandora Media, Inc., 6 F. Supp. 3d 317 (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).

consumers can listen to music stations but cannot directly choose a specific song. In contrast, interactive services provide on-demand music, allowing consumers to choose specific songs to stream (and, frequently, to save temporary downloads of these songs on their devices).[228] The original version of Pandora is an example of a non-interactive service,[229] whereas Spotify is an interactive service.

Unlike internet radio services, interactive streaming services cannot take advantage of the Section 114 sound recording compulsory license. This means that services like Spotify must negotiate licenses with record labels in order to stream music to the public.[230] Congress, when it passed the DPRA and DMCA, believed that interactive services would become substitutes for direct sales of music (CDs, MP3s, etc.) by record labels, concluding that it would thus be unfair to record labels to allow interactive services to take advantage of a compulsory license for sound recording copyrights.[231] (As Part IV argues, Congress was likely correct about this substitution effect, but that does not necessarily mean a sound recording compulsory license for streaming services was inappropriate.)

While streaming services must enter into freely negotiated licensing deals with record labels to cover the sound recording copyright, the musical composition copyright is murkier. The Copyright Office, in 2008, determined that because interactive streaming services must make server copies of sound recordings in order to operate, they must pay mechanical royalties to musical composition copyright owners whenever music is streamed.[232] Though some streaming services have attempted to dispute that streaming implicates mechanical reproduction,[233] a CRB-approved 2009 settlement established mechanical royalty rates to be paid by streaming

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[228] LUNNEY, *supra* note 215, at 67; FISHER, *supra* note 22, at 104; *Register's Music Licensing Report, supra* note 1, Chap. 2, 2015 WL 1227760, at *20

[229] Pandora now also operates an interactive service.

[230] Thus, record labels and recording artists can and have chosen to pull all of their music from streaming services. *See, e.g.*, 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-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.

[231] LUNNEY, *supra* note 215, at 67; FISHER, *supra* note 22, at 105.

[232] 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.

[233] *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).

services to the owner of musical composition copyrights.[234] 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.[235] 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 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.[236]

The ways in which streaming services now use the mechanical license has reinforced a narrative that the regime should be understood as transaction costs-addressing: 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.[237] At the same time, the mechanical license's cumbersome individual licensing notice process has proven highly inefficient for services,[238] and 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.[239] As explained further below, recent changes to the mechanical license seem designed to remedy these inefficiencies and thus push the mechanical license even further into the transaction costs narrative.

4. 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 sound recordings, primarily record labels. But thanks to the 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. Distributors of digital

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[234] *See infra* ____; see also *Register's Music Licensing Report, supra* note 1, Chap. 2, 2015 WL 1227760, at *8

[235] *Register's Music Licensing Report, supra* note 1, Chap. 4, 2015 WL 1227762, at *19

[236] *Phonorecords III*, Initial Determination, *supra* note 28, at 5-6.

[237] Jeong, *supra* note 105.

[238] 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).

[239] *See* Jeong, *supra* note 105. As failure to abide by the mechanical license regime render 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 id.*

sound recording files, like iTunes, were required to pay free-market licenses to sound recording copyright owners, while still paying fees to musical composition copyright owners capped by the mechanical license rate. Digital and satellite radio stations continued to pay licensing fees to musical composition copyright owners via the PROs, as terrestrial radio had been doing for years, but now also were required to pay sound recording copyright royalties to record labels (while terrestrial radio remained exempt) via the new Section 114 compulsory licensing regime. Even more strangely, interactive streaming was placed in its own regulatory category, required to pay sound recording copyright owners free market rates, while utilizing the mechanical licensing regime to pay musical composition copyright owners.

Furthermore, as explained in more detail below, the different compulsory licensing regimes were governed by different rate setting criteria: payments to musical composition owners by digital retailers and streaming services via the mechanical license remained subject to the 801(b) objectives, payments to sound recording copyright holders by satellite and "preexisting" digital radio stations were also subject to the 801(b) objectives, and payments to sound recording copyright owners by newer digital radio platforms, like Pandora, were subject to a new "willing buyer and willing seller" standard.

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, and transparency.[240] Tellingly, however, this Report struggled to articulate any compelling reasons for the continued regulation of the music industry.[241] To the extent it arrived at any guiding principles, the report advocated primarily for "treating analogous uses alike in the digital environment.[242] The report also articulated a preference for free market negotiated rates and/or government imposed rates "designed to achieve to the greatest extent possible the rates that would be negotiated in an unconstrained market."[243]

In advocating for a free-market-mimicking approach to rate setting, the report tacitly rejected the original guiding principles of the mechanical license and Section 114 license as tools for promoting innovative technologies of dissemination.[244] Instead, the Report concluded that "compulsory licensing should exist only when clearly needed to address a market failure."[245] While the Report questioned whether music compulsory

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[240] *Register's Music Licensing Report, supra* note 1, Chap. 4, at *2.
[241] *Id*. at *3.
[242] *Id*. at *4
[243] *Id*. at *8
[244] *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.").
[245] *Id.* at *21.

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.[246] But it proposed several changes seemingly designed to further the license's transformation into a tool to be used exclusively to address transaction costs concerns. Most notably, the Report advocated that the 801(b) factors be replaced across the board with a "willing buyer and willing seller standard."[247] Using the model of the PROs and SoundExchange,[248] the Report also suggested that a collective be created to handle blanket licensing of musical composition mechanical rights to streaming services.[249]

Congress implemented many of these suggestion in the recently passed Music Modernization Act ("MMA"). One of the goals of the MMA was to address several of the "inconsistent" rules that govern compulsory music licensing.[250] Among other things, the Act does this by replacing the 801(b) factors with the "willing buyer and willing seller" standard, previously only used for internet radio stations created after the DMCA. 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.[251]

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. Instead, the mechanical license will now utilize a dual approach. 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. But digital distributors—including those that sell individuals music files or operate an

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[246] *Id.* at *20-21 ("[T]here are millions of musical works in the marketplace. . . . Understandably. . . digital music providers are intensely opposed to a system that would require individual licensing negotiations with thousands of musical work owners. Even publisher proponents of the proposal to sunset section 115 do not deny that it would be extraordinarily difficult for services to negotiate with myriad small copyright owners for all of the mechanical licenses they seek.").

[247] *Id*. at *8.

[248] *Id.* at *24 ("Throughout this study, the Office has heard consistent praise for the efficiencies of blanket licensing by SoundExchange and the PROs"); *see also id.* at *27 ("One of the few things that seems to be working reasonably well in our licensing system is the statutory license regime under sections 112 and 114, which permits qualifying digital services to engage in noninteractive streaming activities at a CRB-determined (or otherwise agreed) rate.") .

[249] *Id*. at *22-24.

[250] 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.

[251] Music Modernization Act, *supra* note 30, § 102 (codified at 17 U.S.C. § 115(c)), § 103 (codified at 17 U.S.C. § 114(f)).

interactive streaming platform–may (as of around two years from the date of the Act's passage) receive a special blanket compulsory license to utilize the musical compositions embodied in any sound recording that the service has authorization to distribute. This process, and payment to copyright owners, will be managed by a new "mechanical licensing collective," very similar to SoundExchange.[252] This new system will decrease the need for "[s]ong-by-song licensing negotiations [and their associated] transaction costs."[253]

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 remedy transaction costs. An implication of this narrative—one made explicit in the MMA—is that rate-setting regulators should be charged with mimicking market-based prices when setting rates. This Section explores the prevalence of this shift in narrative within the CRB's rate-setting decisions even before passage of the MMA. In particular, recent rate-setting decisions in regimes governed by the 801(b) objectives have seen the CRB move away from the 801(b) objectives as a source of rate-making guidance in favor of relying almost exclusively on free market proxies. In more concrete terms, the CRB and its predecessor, in their earlier post-DPRA decisions, often cited the 801(b) factors as a reason to depart downward from ostensible market-based rates in order to encourage the flourishing of technologies that facilitate dissemination of music. In the recent rate-setting decision for streaming, however, the CRB concluded that free market benchmarks were the only appropriate source of rate-setting guidance even in the face of plausible evidence that these benchmark-driven rates will make it harder for streaming services to reach the largest number of consumers.

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

Rate setting proceedings related to the music industry were infrequent in the 1980s and 1990s due to a series of 10-year industrywide settlements for the mechanical license royalty rates.[254] However, following passage of the DPRA and DMCA, the CRB and its predecessor, the Copyright Arbitration Review Panel or "CARP" (which had replaced the CRT system

[252] *Id*. at § 102 (codified at 17 U.S.C. §§ 115(b), 115(d)).

[253] Report and Section by Section Analysis of H.R. 1551 by the Chairmen and Ranking Members of Senate and House Judiciary Committees at 3 (Oct. 19, 2018), https://www.copyright.gov/legislation/mma_conference_report.pdf.

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

described in Part II),[255] were confronted with a range of new compulsory licensing regimes related to digital distributors of music. As explained above, these include 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 implicated by the existing mechanical license, which continued to be set under the 801(b) factors.

During this period, the CARP/CRB primarily used a two-part process for rate setting under the 801(b) factors. First, the judges identified a range of rates derived from marketplace benchmarks or "analogies," which were based on evidence from similar free-market licensing contexts.[256] Then, the judges adjusted these benchmark rates based on explicit consideration of the 801(b) objectives.[257] 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 by the CRB and D.C. Circuit.[258] Indeed, the CARP noted that 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."[259] Nonetheless, the CARP/CRB has consistently started its inquiries by looking at market benchmarks.[260]

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[255] 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.

[256] Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings, 63 FR 25394-01 (May 8, 1998) [hereinafter *1998 CARP Proceeding*]. The first stage can often involve choosing both a rate structure (such as a per-unit price vs. a percentage of revenue) as well as an actual rate.

[257] *1998 CARP Proceeding*, *supra* note 256, 63 FR 25394-01.

[258] 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 (*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 256, 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.").

[259] *1998 CARP Proceeding*, *supra* note 256, 63 FR 25394-01 at 25409.

[260] 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

That said, the CARP/CRB has often maintained that the 801(b) factors required a downward departure from the benchmark rates, in order to further the policy objectives. An important example of this trend is the first rate-setting proceedings applying the 801(b) objectives to the new Section 114 digital performance compulsory license for internet radio. In that proceeding, the CARP explicitly adopted a "low rate favoring the [digital radio] Services" in light of the 801(b) objectives.[261] The CARP relied in particular on the third factor (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."[262] While the record labels argued that "only [] the creation of the sound recordings" is relevant to making music available to the public, the Register of Copyrights, in reviewing the CARP decision, rejected this argument. The Register 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 benefit the services.

This interpretation of the relative roles factor is consistent with what the last Parts identified as the primary purpose of the compulsory music licensing 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, the Register of Copyright noted that the record labels had themselves taken advantage of this interpretation in order to receive mechanical license rates lower than those that would prevail in an open market.[263]

In the years following the 1998 CARP decision, the CRB, on several occasions, recognized that innovative technologies of dissemination should pay lower royalty rates under the 801(b) factors. 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

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Royalty Rate for Coin-Operated Phonorecord Players, 46 FR 884-01 (adopting the "concept of basing the rate on marketplace analogies").

[261] *Id.*

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

[263] Specifically, the Register 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*.

indicated by marketplace data" because of satellite radio services' technology-related expenses.[264] When revisiting these rates in 2012, the CRB again found that the third factor counseled in favor of a downward departure from marketplace benchmarks because of the costs to satellite radio services in maintaining their "proprietary music distribution system."[265] The CRB has also occasionally cited the relative roles 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 requests from publishers that these rates be raised, concluding that the prior rates reflected the "balance of the contributions made by the parties."[266]

2. Phonorecords III

In earlier rate setting decisions, the CRB and its predecessors appeared to understand the 801(b) factors as policy oriented, distinct from the question of what rates would prevail in an open market. The factors, in particularly the third factor, pointed towards below-market rates for music distributors in situations where an innovative technology had facilitated music access for the public. 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,[267] but the music industry nonetheless entered into two settlements governing mechanical

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

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

[266] 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 265, 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).

[267] *See supra* ___.

royalty rates for streaming: *Phonorecords I* in 2009[268] and *Phonorecords II* in 2013.[269] In the 2017 *Phonorecords III* proceeding, the CRB was tasked with setting mechanical rates for January 2018 through December 2022.[270] No settlement was reached,[271] meaning that the CRB was, for the first time, tasked with identifying an appropriate musical composition royalty rate for the entire 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.[272]

The *Phonorecords I* and *II* settlements had set the interactive streaming mechanical royalty amounts using a complicated formula primarily focused on percentage of the services' revenue, with different calculation used depending on the streaming service's business model. For example, different formulas were used for subscription services vs. services that provided free platforms with revenue derived only from advertising.[273] The theory behind this system appears to be that it would allow for greater price discrimination—services operating free, ad-supported streaming plans were generally required to pay less than services operating subscription plans—and, accordingly, for more consumers to be reached.

The judges, nonetheless, decided to abandon the "Rube-Goldberg-esque complexity and impenetrability of the existing, settlement-based" system[274] instead adopting a rate structure applicable across the board. In other words, the new rate structure set by the CRB applies to all forms of streaming and has no variation based on business model. The new rate structured is calculated by looking both at service's revenue along with service's "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.[275] In including a TCC calculation, the judges sought to "import" the free-market rates from the sound recording licensing markets and thus "influence [] directly" the ratio

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[268] *Phonorecords I, supra* note 266, 74 Fed. Reg. 4510 at 4514.

[269] *Phonorecords II, supra* note 266, 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).

[270] 81 Fed. Reg. 255 (Jan. 5, 2016).

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

[272] *Phonorecords III*, Initial Determination, Majority Opinion *supra* note 28, at 5.

Phonorecords III, Initial Determination, Majority Opinion *supra* note 28, at 10, 27; *Phonorecords III*, Initial Determination, Dissent, *supra* note 28, at 26-30; see also HARRY FOX AGENCY, RATE CHARTS, https://www.harryfox.com/find_out/rate_charts.html.

[274] *Phonorecords III*, Initial Determination, Majority Opinion *supra* note 28, at 11.

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

of sound recording royalties to music composition royalties, which the judges believed were not in line with the ratio that would prevail in an unregulated market.[276]

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 with explicit reference to the goal of using the sound recording licensing market to mimic the rates that would otherwise prevail in an unregulated musical composition licensing market. Utilizing a complicated game theory approach coupled with record label, publisher, and streaming service financial data,[277] 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 (the label, publishers, and services), and their bargaining positions.[278] 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 panels 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,[279] the judges, in an unusual step, declined to weigh the factors' policy objectives in an inquiry separate from the their benchmarking inquiry, instead declaring that the 801(b) objectives simply "provide[] further support for the[] findings" of their game theory analysis.[280] 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

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[276] *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*.

[277] 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.

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

[279] *1998 CARP Decision*, *supra* note 256, 63 FR 25394-01.

[280] *Phonorecords III*, Initial Determination, Majority Opinion *supra* note 28, at 80.

unadjusted."[281] After drawing this tautological conclusion, the judges ultimately chose rates at the higher end of the range they had identified, while failing to explain why these rates were chosen over the other options.[282]

CRB judge David Strickler, in a lengthy dissenting opinion, identified the problems with majority's approach, both from the perspective of the economics of the music market and through the lens of the 801(b) factors. 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."[283] The dissent noted that the record companies' high level of market power makes this particularly perilous for the services. Because the music catalogues are complementary rather than substitutional, a service needs access to the catalogs of each of Universal Music Group, Sony, and Warner Music Group (which together account for nearly 75% of all songs in existence) in order to operate. The record labels thus operate as a complementary oligopoly, which they can and do leverage in licensing deals with services. Under the majority's rate structure, the dissent explained, the musical composition licensing rate would also increase with any rise in sound recording licensing rates brought about by the labels exercising their market power.[284]

The dissent also criticized the majority for failing to abide by the statutory mandate to make a "determination" setting rates, as required by the Copyright Act.[285] By simply "pegging the regulated mechanical royalty rate to the unregulated sound recording royalty rate" the judges had failed to perform their rate-setting responsibilities.[286] Instead, the 801(b) factors require the judges to actively "consider not only the reasonableness of the rates, but also how the four itemized factors. . . bear on the reasonableness of

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[281] *Phonorecords III*, Initial Determination, Majority Opinion *supra* note 28, 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

[282] *Id*. at 89.

[283] *Phonorecords III*, Initial Determination, Dissent, *supra* note 28, at 3 & n.5.

[284] *Id*. at 4. The dissent additionally noted that an assumption of majority's rate structure—that an in increase in mechanical royalty rates would be accompanied by a voluntary decrease in sound recording rates by the record labels—is unlikely to occur. *See id*. at 7-9.

[285] 17 U.S.C. § 801(b)(1) (2012).

[286] *Phonorecords III*, Initial Determination, Dissent, *supra* note 28, at 10.

the rates."[287] Judge Strickler noted that "[t]hese are not factors necessarily implicated or fully addressed by a market-based analysis."[288]

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.[289] As explained further in the next Part, Judge Strickler's alternative analysis takes a remarkably different approach than 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 engaged in a thoughtful consideration of the unique realities of the music marketplace through the lens of the goals of the copyright system.

In particular, Judge Strickler recognized that, as discussed in Part I,[290] 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.[291] Having recognized that copyright law aims to find the right "balance between access and incentives,"[292] Judge Strickler 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,' which, in the broadest sense, means simply a departure from a single, per-unit price.[293]

While acknowledging that perfect price discrimination is not possible, Judge Strickler gravitated towards the existing settlement rate structure because it allows forms of price discrimination. In particular, the settlement's business-model-dependent royalty price structure "enhances variable pricing that allows streaming services to work their way down the demand curve, i.e. to engage in price discrimination that expands the market."[294] This decreases copyright's deadweight loss by allowing a greater number of consumers to

[287] *Id*. at 26.

[288] *Id*.

[289] *Id*. at 12.

[290] *See supra* __.

[291] *Phonorecords III*, Initial Determination, Dissent, *supra* note 28, at 33-35; *see also infra* ______ (discussing this issue further).

[292] *Phonorecords III*, Initial Determination, Dissent, *supra* note 28, at 33.

[293] *Id*. at 38.

[294] *Id*. at 50-51.

be reached. For example, the ad-supported "freemium" tiers offered by many streaming services is both "an efficient means of marketing – segregating listeners according to [willing to pay] – still allowing them to 'experience' interactive streaming, while, second, still providing royalties to Copyright Owners."[295]

Like the majority, Judge Strickler also treated the 801(b) factors as "provid[ing] further support for [his] findings identifying the reasonable rate structure and rates," rather than using the factors to actively adjust his benchmarking analysis.[296] In this respect, he framed his belief in the preferability of the settlement rate structure as endogenous to the process of emulating the free market through benchmarking,[297] rather than emerging from the 801(b) policy goals.[298] As explained further in the next Part, Judge Strickler's ability to ground his analysis in a market-emulating benchmarking inquiry (rather than the 801(b) factors) has important implications for understanding what considerations are properly encompassed in the new "willing buyer and willing seller" standard established in the MMA.

* * *

Though not framed as such by the majority or dissent, the *Phonorecords III* dispute can be understood as reflecting the tension between the two approaches to rate-setting described in the last two 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, despite the market power imbalances in that market. In contrast, Judge Strickler's more nuanced understanding of

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[295] *Id*. at 56. Copyright scholars have noted that price discrimination, where feasible, can often be an effective tool in facilitating maximum access to copyright works without compromising copyright owners' ability to monetize those works. *See* FISHER, *supra* note 22, at 167.

[296] *Phonorecords III*, Initial Determination, Dissent, *supra* note 28, at 121-22 ("[T]o the extent that market factors may implicitly address any (or all) of the four itemized factors, the reasonable, market-based rates may remain unadjusted"); *see also infra* ____.

[297] *Phonorecords III*, Initial Determination, Dissent, *supra* note 28, at 85-87, 118-119 (analyzing both the 2012 settlement rate structure and actual rates from the perspective of the "characteristics of an appropriate benchmark").

[298] However, Judge Strickler also explained why the 801(b) factors *also* favored the use of the settlement rate structure. From this analysis, we can further see how his analysis reflects a more normative understanding of how licensing markets *should* operate in order to further copyright policy goals. In particular, Judge Strickler noted that a rate structure that enables price discrimination furthers the first factor's goal of maximizing musical works for the public. This is because a "rate structure that contains multiple royalties [rates] reflective of and derived by [consumers'] variable [willingness to pay] will facilitate beneficial price discrimination. In turn, such price discrimination allows for access to be afforded 'down the demand curve,' making musical works available to more members of the public." *Id*. at 124-131.

the unique aspects 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 practical 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.[299] The overall higher rates may make it unfeasible for services to operate free, ad-supported plans, and may require them to charge more for subscription plans generally.[300]

The next part explores in more detail why this change is problematic, arguing that the history of the mechanical license, as well as copyright policy goals more generally, counsel in favor of regulating the relationship between streaming services and copyright owners using policy-sensitive rate-setting. This form of rate-setting would recognize that streaming has much in common with the forms of the dissemination that the mechanical royalty was designed to regulate originally and therefore treat compulsory licensing as a tool for ensuring this access-fomenting technology can flourish.

IV. Justifying Policy-Driven Compulsory Licensing in the Streaming Era

The last Part examined the conflicting narratives regarding the role of compulsory licensing in the copyright system. The last decades have seen the increased prevalence of an approach that sees compulsory licensing as exclusively a tool for remedying transaction costs-based market failures and, accordingly, sees free market proxies as the most appropriate guidelines for rate setting. This is a very different approach from the original mechanical license, which, as Part II argued, operated as a tool for facilitating innovative technologies of music dissemination, such as the phonograph and record player.

This Part argues that this shift is problematic and seeks to make a normative case for why the mechanical license's original approach should persist within the music compulsory licensing schemes, especially with respect to interactive and non-interactive streaming.

This is not to say that transaction costs minimization should not also be a primary consideration in the architecture of the Copyright Act's compulsory licensing regimes. Digital services and copyright owners both

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[299] *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/.

[300] 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.

benefit from the ability to blanket license entire catalogues of music. This reduction in transaction costs certainly allows for more works to reach the public.[301]

But the choice is not an either/or, but rather more of a spectrum; Part I explained that price-setting is the locus of the distinction between a purely transaction costs-focused approach to compulsory licensing and a copyright-policy-sensitive approach. On one side of the spectrum, an approach solely committed to transaction costs reduction will try to mimic the likely prevailing market rates. On the other side, an approach to compulsory licensing solely committed to facilitating access might provide for a zero-price license, as fair use does. The historical approach to the mechanical license has existed in the middle: strategically pricing compulsory rates to further access-related goals, while still ensuring the copyright owners are compensated. Thus, a compulsory licensing regime sensitive to the incentives/access balance should account for these goals in the context of rate-setting. The overall architecture of the regime, including the ability for copyright users to engage in blanket licensing, would not be affected.

This Part first makes a normative case for why streaming should be governed by a compulsory licensing rate-setting approach that accounts for copyright policy goals. Recognizing that legislative change is unlikely anytime soon, the second Section highlights some ways that the CRB can potentially facilitate these goals even under the current "willing buyer and willing seller" rate-setting standard.

A. A Defense of Policy-Driven Compulsory Licensing in the Music Marketplace

As Part III explored, compulsory licensing rate-setting 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 goal of this Section is to make the normative argument that certain aspects of music streaming and its relationship to sound recording and musical composition copyright interests suggest that free market licensing rates are unlikely to provide an appropriate balance of incentives and access. I focus on three aspects in particular: the innovative nature of interactive and non-interactive streaming in facilitating unprecedented access to music for the public; the evidence that music copyright's scope exceeds the level necessary to incentivize new creative works; and the music copyright owners' high levels of market power, which exacerbate the imbalance between incentives and access in the music marketplace.

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[301] *See supra* ___.

The analysis below considers both the relationship between services and record labels and the relationship between services and publishers. As of now there is little uniformity in the compulsory music licensing system: while the relationship between non-interactive streaming services and sound recording owners are regulated by the Section 114 license only the relationship between interactive streaming services and publishers is governed by a compulsory licensing regime, namely, the mechanical license. To make things even more confusing, both interactive and non-interactive streaming services must obtain musical composition performance licenses. This process remains partially regulated through the PRO consent decrees, but the recent withdrawal of several publishers from the PROs[302] and the growing possibility that the Department of Justice will sunset the consent decrees[303] means that free market licensing deals may become increasingly common in the musical composition performance licensing market as well.

A uniform system that regulates both sides of the music licensing market—sound recordings and musical composition—for all forms of streaming would better allow the music compulsory licensing regime to fulfill its original access-fomenting function.[304] I recognize that for such a proposal to be implemented, significant changes to the Copyright Act would be required. Considering the difficulty in passing new copyright legislation, such changes are unlikely. That said, outlining the normative case for a copyright policy goal-sensitive approach to compulsory licensing for digital dissemination also has implications for the Copyright Act's existing compulsory licensing schemes, as next Section explores further.

1. 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 provide access to every single recorded song ever commercially released. As William Fisher presciently argued in 2004, streaming has the unique potential to "satisfy consumers' desires more fully, rapidly, and precisely" than other forms of music dissemination and thus "as wireless Internet access becomes more common and reliable. . . consumers will likely come to rely increasingly upon interactive streaming for musical entertainment, instead of replaying tracks permanently stored on CDs or in their computers. The potential terminus of this trend would indeed be divine:

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[302] García, *supra* note 213, at 186 (discussing this trend).

[303] *See* Glenn Manishin, *Don't Revoke the Music Licensing Antitrust Decrees*, LAW 360 (June 12, 2018), https://www.law360.com/articles/1052629/don-t-revoke-the-music-licensing-antitrust-decrees.

[304] *See supra* (discussing interactive and non-interactive streaming distinction).

from your home, from your car, through your portable stereo, you would be able to gain access at any time to any musical recording ever made."[305]

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 allows users to curate detailed compilations and share them across social media communities.[306] Similarly, non-interactive services provide innovative music discovery tools, which make these services far more customizable than traditional radio.[307] Together, these technologies have dramatically changed the ways consumers utilize music in their day to day lives, with more changes likely to come.[308]

But technological innovation is not alone sufficient to warrant imposition of a compulsory licensing regime; rather, these benefits need to be assessed from the perspective of copyright's policy goals. Here, the original creation of mechanical license provides an important parallel to streaming's role in today's music marketplace. As Part II explained, the mechanical license was originally created to prevent copyright owners who had previous relied on a specific form of dissemination—sheet music publishing—from frustrating the development of a new innovative form of dissemination: the player piano and record player.[309] Congress created the mechanical license to ensure that these new markets could develop without concern that copyright owners would frustrate their development by refusing to license or by licensing to only one piano roll manufacturer. In setting a low fixed rate, later replaced by the 801(b) factors' policy goal-sensitive adjustable rate, Congress facilitated access to musical works by bolstering

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[305] FISHER, *supra* note 22, at 25; *see also Phonorecords III*, *supra* note 28, 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).

[306] *see also Phonorecords III*, *supra* note 28, 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); *see also Phonorecords III*, *supra* note 28, Witness Statement of Paul Joyce at 5, https://www.crb.gov/rate/16-CRB-0003-PR/statements/google/statement.pdf (discussing Google Play services); *see also see also Phonorecords III*, *supra* note 28, 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).

[307] 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).

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

[309] *See supra* ___.

these developing industries. But by using a compulsory licensing scheme—rather than by simply declaring that music composition copyright owner 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 some monetary incentive to create new works.[310] The streaming industry's conflict with publishers and record labels has much in common with this early story, except now two separate copyright-owner-controlled industries—the publishing industry and the recording industry—feel threatened. Indeed, the concerns expressed by publishers and record labels that streaming is "cannibalizing" CD sales are similar to the protestations of the early publishing industry when faced with the player piano and phonograph.[311]

While the mechanical license was explicitly created to address a new technology of dissemination, much of this paper has argued that the mechanical license also gave rise to a specific approach to rate-setting—governed by the 801(b) factors—designed to refine the proper relationship between incentives and access through periodic rate-setting proceedings. Though these proceedings ended up being infrequent, several of them arrived at lower royalty rates by pointing explicitly to the importance of rewarding music disseminators for their role in innovating new forms of music dissemination, even if this required a reduction in royalties to copyright owners. The third 801(b) factor was particularly important to these determinations; the first mechanical license rate-setting proceeding noted that records labels were "opening [] new markets" through technological innovation,[312] and a later CARP proceeding explicitly lowered royalty rates because innovations by internet radio providers had expanded "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."[313] Despite the CRB's unwillingness to apply this reading of the third objective in *Phonorecords III*, music streaming seems like precisely the type of technology that the 801(b) factors have encouraged in the past.

The important role of streaming services in enhancing access to music also implicates more basic aspect of copyright law and policy. As Part I argued, it is important to understand industrywide compulsory licensing regimes, like the mechanical license, as being part of the same family as the fair use doctrine, which is considered one of the most importance 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.

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[310] *See supra* ___.

[311] *Phonorecords III*, Initial Determination, Dissent, *supra* note 28, at 70-71 (discussing and rejecting cannibalization argument).

[312] *See supra* __ .

[313] *See supra* ___.

While much fair use case law deals with the use of existing copyright works in follow-on expressive works, 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."[314] This trend arguably began with the *Sony* case, which found that recording existing television content for later viewing could be fair use.[315] The increased prevalence of mass digitization of copyrighted content has extended this line of reasoning significantly. The Ninth Circuit, for example, has repeatedly held that the creation of thumbnail images of copyrighted content for search engine purposes is fair use.[316] Most importantly, 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.[317] Recently, a Second Circuit opinion by Judge Leval reflected on these lines 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]."[318]

Consistent with the limitations of the fair use doctrine—in particular, the market harm factor—all of these decisions took care to note that the secondary user had not "merely retransmitted [the works] in a different medium,"[319] 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[320] can implicate basic question 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.[321] Streaming's ability to enhance users' basic relationship to music consumption is akin to these kinds of innovative uses.

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

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[314] 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 307, at 19 (discussing the line of "functionally transformative" cases).

[315] Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417, 447 (1984).

[316] 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).

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

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

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

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

[321] *See also supra* ___ (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).

be too great to sustain such a finding.[322] However, as future work will explore more fully in the fair use context,[323] we might understand compulsory licensing as operating in the space outside the limits of fair uses, where the market harm to copyright owners is great enough that a zero price license is inappropriate, but where the innovative nature of the use still supports a compulsory license at a royalty rate calculated to provide an optimal balance between incentives and access.

Even many who agree that streaming services provide important tools for increasing consumer access to music will sometimes dispute whether services "need" lower royalty rates in order to continue providing their services. For example, during *Phonorecords III*, copyright owners frequently argued that the 2012 settlement rates were calculated when streaming was "experimental" and now that they are "highly profitable" these rates no longer make sense.[324] Whether the music streaming market is "profitable" is disputed to begin with,[325] 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 recognize, 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.[326] 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 transformative simply because they are able to profit off it when their use is successful.[327]

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[322] In a recent fair use case, the Second Circuit considered an innovative new aggregation service that provided a searchable database along with clips of copyrighted news shows. The court found that even a use, like the defendant's that is "at least somewhat transformative in that it renders convenient and efficient access to a subset of content" could not be fair use because the defendant had "usurped a function for which [the copyright owner] is entitled to demand compensation under a licensing agreement." Fox News Network, LLC v. Tveyes, Inc., 883 F.3d 169, 180–81 (2d Cir. 2018); *see also* Capitol Records, LLC v. ReDigi Inc., 910 F.3d 649, 660-64 (2d Cir. 2018) (denying fair use under similar reasoning).

[323] *See* Jacob Victor, *Fared Use Revisited* (draft on file with the author).

[324] *Phonorecords III*, *supra* note 28, Witness Statement of David Israelite 36-37, https://www.crb.gov/rate/16-CRB-0003-PR/statements/copyright-owners/volume1.pdf.

[325] *Phonorecords III*, Initial Determination, Majority Opinion, *supra* note ___, at 8l; *Phonorecords III*, Initial Determination, Dissent, *supra* note 28, 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").

[326] *1998 CARP Decision*, *supra* note 256, 63 FR 25394-01; *see also* 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).

[327] Authors Guild v. Google, Inc., 804 F.3d 202, 219 (2d Cir. 2015) ("Many of the most universally accepted forms of fair use, such as news reporting and commentary, quotation in

Furthermore, one of the goals of the compulsory licensing regime should also be to ensure that multiple services can operate, and can compete with one another.[328] Even if established services can survive under higher fees, this goal would be frustrated if new services are priced out of entering the market.[329]

2. Authors' Financial Incentives

From the perspective of copyright's policy goals, streaming's role in facilitating access to music cannot be assessed independent of the importance of ensuring that authors maintain a sufficient financial incentive to continue producing content. But considering streaming through the lens of authors' financial incentives provides further support for subjecting streaming to a policy-sensitive form of compulsory licensing.

The dual nature of music copyright—that a single stream, music file, CD or record embodies independent copyrights in both the underlying musical composition (owned by composers/publishers) and the sound recording (owner by recording artists/record labels)—means that music is arguably unique among other forms of copyrighted content.[330] One important effect of this double copyright is that it potentially allows the free market to provide financial benefits to music copyright owners that exceed the level necessary to effectuate copyright's incentive function.

The market-based nature of copyright means that a copyright owner will likely try to receive the highest licensing fee that it can negotiate. The multilayering of two copyrights on the same good complicates this process because two sets of copyright owners will each independently try to extract the largest amount of money possible from distributors, like streaming services. This is problematic because, as Judge Strickler noted in his dissent, 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." Therefore, the music market is potentially vulnerable to hold up problems. Hold up problems, frequently discussed in the patent context, occur when, for example, a "patentholder[] demand[s] royalties from a defendant when it is most vulnerable--after it has implemented a technology. The patentholder 'holds up' the seller, prompting a settlement driven by the timing of the

historical or analytic books, reviews of books, and performances, as well as parody, are all normally done commercially for profit.").

[328] *See* FISHER, *supra* note 22, at 161 (arguing that a "large, independent, variegated Webcasting industry has many social benefits").

[329] *See* García, *supra* note 12, 1183 n.105 (discussing barrier to entry in the streaming market).

[330] García, *supra* note 213, at 192.

demand, rather than its merits."[331] While some have claimed that hold up problems are not common in copyright marketplaces,[332] the double copyright in music goods provides a clear example of a copyright market where this particular problem is likely. In the absence of compulsory licensing, composition copyright owners could extract outsized licensing fees by threatening to refuse to grant services permission to play particularly popular sound recordings.

Music's double copyright is not the only reason that market-driven royalty payments may exceed copyright's policy goals. As recent work by Glynn Lunney had shown, copyright appears to play little role in incentivizing songwriters and recording artists to create new works to begin with. Lunney analyzed decades of recording industry financial data, showing that this revenue rose from $4 billion in 1962 to $20 billion in 1999 (both adjusted to 2013 inflation levels), and then declined to $7 billion by 2014, due to the advent of online file sharing. Lunney used this data as a natural experiment for testing copyright's incentive role: in theory, the rise and fall in revenue should have been accompanied by a rise and fall in new, high-quality albums. Instead, the opposite appears to be true: more high-quality works appear to be created during periods of low revenue.[333] Lunney attributes this state of affairs to the fact revenue in the music industry flows to only a handful of superstar artists.[334] When revenue is high, these artists become complacent and less productive, and when revenue is low, they produce more. The vast majority of artists, who operate at the margin, are generally unaffected by these rises and falls in overall industry revenue.

Separate from these copyright-specific problems, other aspects of the music industry also call into question whether free market-driven royalty rates make sense for incentivizing authors to create new musical works. Indeed, it appears quite clear that the current system of copyright protection provides little compensation to the vast majority of recording artists and composers. Many blame compulsory licensing for this problem,[335] but there is little empirical support for this aregument. Indeed, the sound recording

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

[332] Jiarui Liu, *Copyright Reform and Copyright Market: A Cross-Pacific Perspective*, 31 BERKELEY TECH. L.J. 1461, 1512–13 (2016) ("A single party can hardly have any veto power to block the entire project, which renders the holdup problem remote.").

[333] LUNNEY, *supra* note 215, at 122-56.

[334] *See also* FISHER, *supra* note 22, at 77. Lunney also attributes this fact to a more basic principles of copyright law, in particular, the fact that copyright's protections apply uniformly across all works. Thus, a highly successful work will be able to earn significantly more than a less successful work—the degree of success or popularity does not lead to any reduction in protection (and reduction in a copyright owners' ability to monetize their works). LUNNEY, *supra* note 215, at 122-56.

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

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.[336]

A large part of the problem appears to lie in the basic structure of the music industry and the ways in which royalties are allocated. 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.[337] At a time when the barriers to entry for new artists were high, this made some sense; record labels could front the large costs associated with music distribution, which meant they were invaluable to recording artists. But digitization has eliminated the need for the "brick-and-mortar world of paper, plastic, trucks, and warehouses."[338] As the creation of another digital copy is essentially costless, now the main costs are only those associated with creation of the work itself, which, for music, are relatively low (unlike films and television).[339] At the same time, however, the record labels have maintained their dominant position, and most recording artists sign over a large share of their royalty entitlements to the labels in order to have any chance of gaining access to digital distribution platforms.[340] Thus many believe that the financial troubles of artists have little to do with underpayment by digital distributors, and far more to do with the music industry's unequal and middleman-favoring royalty distribution practices.[341]

Thus, compulsory licensing with a policy-drive rate-setting regime, is unlikely to frustrate artists' incentive to create, as copyright appears to be providing little compensation to actual creators to begin with, even in unregulated markets. In fact, a well-structured compulsory licensing regime could actually increase payments to artists. For example, the Section 114 compulsory license for digital distributors allocates a percentage of revenue to the recording artists regardless of whether they or a record label own the

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[336] FISHER, *supra* note 22, at 77-78.

[337] FISHER, *supra* note 22, at 19-20, 55-56, 76-77; *Register's Music Licensing Report, supra* note 1, Chap. 3, 2015 WL 1227761, at *5-*6 (summarizing this argument).

[338] 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).

[339] *Id.*

[340] *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 338, at 305-306.

[341] Josh Constine, *The Truth About Streaming: It Pays Labels A Lot, They Don't Pay Musician*, TECHCRUNH, 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).

sound recording copyright.[342] The PROs often arrange for similar direct-to-songwriter payments in their licensing deals.[343] Providing a similar arrangement in a music industry-wide compulsory licensing regime could ensure that songwriters and recording artists could receive more royalty payments irrespective of the ownership of the copyrights in their creations. 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.[344]

3. Market power

The CRB has repeatedly noted that the music marketplace—both on the musical composition side and the sound recording side—is characterized by market power imbalances. Only four publishers control almost all of the most important music composition copyrights,[345] and only three record labels control almost of the most important sound recording copyrights.[346] As consumers expect a streaming service to provide access to most commercially available recorded music, a streaming service essentially requires licenses to use all of the major publishers' catalogues and all major record labels' catalogues in order to remain competitive. Thus, both the musical composition licensing market and the sound recording 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.'"[347] This complementary oligopoly power allows publishers and labels to extract "supranormal" licensing rates;[348] indeed, there is

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[342] 17 U.S.C. § 114(g)(2); *see also Register's Music Licensing Report, supra* note 1, Chap. 2, 2015 WL 1227760, at *19.

[343] *Register's Music Licensing Report, supra* note 1, Chap. 4, 2015 WL 1227762, at *13 (discussing these arrangements).

[344] *See* García, *supra* note 12, at 1151–52 (proposing this type of amendment to the sound recording performance compulsory license).

[345] *Phonorecords III*, Initial Determination, Majority Opinion, *supra* note 28, 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.

[346] *Phonorecords III*, Initial Determination, Dissent, *supra* note 28, at 36, n. 67; *Register's Music Licensing Report, supra* note 1, Chap. 2, 2015 WL 1227760, at *5.

[347] *Phonorecords III*, Initial Determination, Dissent, *supra* note ___, at 36 n. 69; *see also Phonorecords III*, Initial Determination, Majority Opinion, *supra* note 28, at 48; *Web IV*, *supra* note 258, at 26348.

[348] *Phonorecords III*, Initial Determination, Dissent, *supra* note 28, at 36 n. 69.

evidence that this occurs in the unregulated sound recording licensing market for interactive streaming.[349]

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. Assessing market power in the context of intellectual property regimes raises difficult questions about the intersection of antitrust and intellectual property, which are generally outside the scope of this article. 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.[350] Rather, antitrust law is primarily concerned with "anticompetitive *conduct* designed to achieve market power."[351] Ownership of an intellectual property interest (or, more 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.[352] 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 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,[353] 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 the Sherman Act, merger review, and consent decrees.[354]

Even if the market power imbalances in the music market may be of unclear consequence from the perspective of antitrust law, they may still be significant from the perspective of copyright law and policy.[355] As Neil Netanel has explained, copyright policy must account for "copyright industries' market structure;" in particular, industries in which "a small number of firms holding vast inventories of copyrighted works enjoy oligopolist and oligopsonistic dominance of their sectors" can lead to

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349 *Phonorecords III*, Initial Determination, Majority Opinion, *supra* note 28, at 75; *Phonorecords III*, Initial Determination, Dissent, *supra* note 28, at 3.

350 IP AND ANTITRUST, *supra* note 60, at 1-12; 4-9 – 4-13; Richard A. Posner, *Transaction Costs and Antitrust Concerns in the Licensing of Intellectual Property*, 4 J. MARSHALL REV. INTELL. PROP. L. 325, 329–30 (2005).

351 IP AND ANTITRUST, *supra* note 60, at 1-13 (emphasis added).

352 *Id.* at 4-13 (discussing these considerations).

353 García, *supra* note 213, 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.").

354 *Id.* at 230-42.

355 Indeed, as one treatise notes, market power is often assessed through the lens of copyright policy goals, rather than antitrust, in several other context, including copyright misuse. IP AND ANTITRUST, *supra* note 60, at 3-67 – 3-73.

practices that "exacerbate" the ways that copyright limits dissemination.[356] 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 that the potential for monopoly in the burgeoning player piano role industry was used to rationalize why copyrighted musical compositions should be made available to all comers through the mechanical license. More recently, Judge Strickler, in his copyright policy-sensitive alternative rate-setting decision, described above, also noted that publishers' complementary oligopoly power provided an "additional complexity" in assessing what rate structure and rate makes the most sense for streaming.[357] Judge Strickler also noted that, hypothetically, adjusting market benchmarks to correct for market power imbalances would be consistent with the 801(b) factors because such an adjustment would ensure that copyright owners did not earn royalties that far exceed their costs in producing new works.[358]

Seen through this lens, the publishers' and labels' market power is problematic because it further intensifies the imbalance between incentives and access discussed above by allowing copyright owners to extract licensing fees that far exceed the level necessary to incentivize authorship, simultaneously preventing services from facilitating access to works. Thus, compulsory licensing's ability to prevent the labels and publishers from exploiting their complementary oligopoly power remains important.[359] Moreover, as described further below, a rate-setting process that is sensitive to market power is essential to allowing regulators to arrive at rate-setting decisions that are untainted by benchmarks taken from industries with market power imbalances.

B. Realizing Copyright Policy Goals Under the "Willing Buyer and Willing Seller" Standard

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[356] Netanel, *supra* note 42, at 24–27; *see also* FISHER, *supra* note 22, at 181-82 (discussing how entertainment copyright owners' market power relates to the copyright policy in warranting regulation).

[357] *Phonorecords III*, Initial Determination, Dissent, *supra* note 28, at 35.

[358] *Id*. at 138-39. As explained further below, however, Judge Strickler did not believe that such an adjustment was necessary to his own benchmarking determination because he concluded that the rates suggested by the benchmark adequately reflected the factors. *See infra* _______.

[359] In a similar vein, Kristelia García has made an important argument that "regulation," including certain forms of compulsory licensing, is the best option "for checking anticompetitive behavior, maintaining competition, encouraging innovation, preventing technological lock-in, and ensuring payment to artists" in the music industry. García, *supra* note 213, at 242-56. García's work, however, does not explicitly focus on the interplay between these regulatory tools and copyright policy goals, which is the primary concern of this Article.

The previous Section argued in favor of applying policy-oriented rate-setting, rather than purely market proxy-driven rate-setting, to all forms of music streaming within both the sound recording and musical composition licensing markets. Such a regime would provide both the transaction costs-addressing benefits that scholars have understood as the primary rational behind compulsory licensing, but would also allow compulsory licensing to achieve some of the copyright-specific goals that it has historically accomplished; namely, recalibrating the balance between incentives to create and public access to creative works.

Legislative change facilitating such a system of compulsory licensing, however, is unlikely anytime soon. New copyright legislation now almost always emerges as a result of industrywide compromises, and record labels have shown that they are effective in advocating against creating a compulsory license regime for the use of sound recordings in interactive streaming,[360] and in other forms of innovative distribution technologies.[361] Furthermore, the pendulum appears to be swinging even further away from policy-oriented rate-setting generally: one of the MMA's most important changes is the abolition of the 801(b) objectives in favor of a willing buyer and willing seller standard. In future rate-setting proceedings for all compulsory music licensing regimes, the CRB will be expected to apply this standard.

This Section argues that despite these changes, rate-setting in the existing music compulsory licensing regimes, including both the mechanical license and the Section 114 sound recording performance regime, may still be able to allow for a more nuanced approach to rate-setting—one that accounts for incentives/access balancing—even under an ostensible market-driven willing buyer and willing seller standard.

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 text is as follows:

> The Copyright Royalty Judges shall 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. In determining such rates and terms for digital phonorecord deliveries, the Copyright Royalty Judges shall base their decision on economic, competitive, and programming information presented by the parties, including—(i) whether use of the compulsory licensee's service may substitute for or may promote the

[360] *See supra* ___ .

[361] *See supra* ___ (discussing labels' opposition to extending the mechanical license to sound recordings in 1971).

> sales of phonorecords or otherwise may interfere with or may enhance the musical work copyright owner's other streams of revenue from its musical works; and (ii) 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.[362]

The second clause's reference to the "relative roles" of the copyright owners and licensees uses language very similar to the third 801(b) factor, suggesting that prior decisions applying that factor could potentially inform rate setting even under the willing buyer and willing seller standard.

Nonetheless, prior CRB decisions interpreting the willing buyer and willing seller standard have not taken this approach (or even mentioned the "relative roles" prong 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.[363] This was certainly true in some of the earlier proceedings setting rates for sound recording public performance licenses for internet radio (a.k.a. webcasting). In fact, the CRB set rates that were so high that Congress chose to intervene, vacating the established rates and allowing SoundExchange, the sound recording rights management entity, to negotiate new rates.[364]

But the high rates may have been more of a result of gamesmanship by copyright owners than anything inherent in the statutory text. Indeed, several scholars have noted that attempting to find "free market" rates in a market that has always been regulated, like mechanical royalties or sound recording performance royalties, is something of a contradiction in terms.[365] As explained above, rate-setting entities like the CRB instead search for market benchmarks in order to arrive at rates that might prevail in an ostensibly free market. But this benchmarking approach can be vulnerable to manipulation, especially in proceedings, like internet radio sound recording performance royalty rate-setting, where policy objectives like the 801(b) factors are not present to serve as guidelines for interpreting the results of the benchmarking analysis. Indeed, the controversially high webcasting rates were partly driven by the fact that the CRB used as benchmarks

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

[363] García, *supra* note 12, at 1140–45.

[364] *Register's Music Licensing Report, supra* note 1, Chap. 2, 2015 WL 1227760, at *22 (discussing Webcaster settlement legislation); Dicola & Sag, *supra* note 129, at 223 (same); *Register's Music Licensing Report, supra* note 1, Chap. 4, 2015 WL 1227762, at *8 (discussing rates for satellite radio).

[365] Dicola & Sag, *supra* note 129, 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 12, at 1140–45; Lemley & Weiser, *supra* note 17, at 833–34.

licensing agreement that did not accurately reflect industrywide realities.[366] The subjectivity of this standard also makes it vulnerable to manipulation; for example, in the first webcaster rate-setting proceeding, there was indication that record labels entered into inflated licensing deals in other sectors of the music market in order to influence the benchmarking inquiry.[367]

But the standard's subjectivity also means that it is potentially capacious enough to accommodate a more nuanced understanding of how copyright licensing markets should operate. In fact, there is already some evidence that courts and regulators have taken copyright policy goals into account when setting rates under an ostensible willing buyer and willing seller rate setting standard.

An important example is the recent rate-setting proceedings in the Southern District of New York under the consent decrees that govern the performance rights organization ASCAP. The rate court is charged with setting a "reasonable" rate, which is interpreted as "the fair market value—'the price that a willing buyer and a willing seller would agree to in an arm's length transaction.'"[368] 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 question 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 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, and that does not create distorting incentives in the marketplace that will improperly affect the choices made by composers, inventors, investors, consumers and other economic players.[369]

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[366] *See* Dicola & Sag, *supra* note 129, at 228; Lemley & Weiser, *supra* note 17, at 833–34.

[367] *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 before the CARP, generally with businesses driven by factors other than the value of the sound performance rights."). 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 12, at 215–16.

[368] United States v. Broad. Music, Inc., 316 F.3d 189, 194 (2d Cir. 2003).

[369] 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.

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 is highly favorable to Pandora. Among other things, Judge Cote 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."[370] Judge Cote also rejected ASCAP's argument that Pandora's alleged success entitles it to a higher royalty fee, concluding that "Pandora has shown that its considerable success in bringing radio to the internet is attributable not just to the music it plays (which is available as well to all of its competitors), 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. These investments by Pandora. . . do not entitle ASCAP to any increase in the rate it charges for the public performance of music."[371] As with the fair use case law discussed above, a subtext of this conclusion is that when copyright users make innovative enhancement to the public's experience of accessing existing copyright works and profit off of them, an increase in royalty fees for the copyright owners is not warranted even under an ostensible free market inquiry.

In the recent *Web IV* proceeding, which set sound recording performance royalties for internet radio services, the CRB indicated a willingness to interpret the willing buyer and willing seller standard more broadly than in the past.[372] In particular, the CRB determined that the use of free-market licensing agreements was not alone sufficient when setting rates under the standard; rather, the judges "can and should determine whether the proffered rates reflect a sufficiently competitive market, *i.e.*, an 'effectively competitive' market."[373] The judges determined that a freely negotiated licensing agreement from the interactive streaming market was suspect because of market power imbalances in that market, namely, the

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).

[370] 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 307, at 40-44.

[371] 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).

[372] Recall that even before passage of the MMA, the willing buyer and willing seller standard applies to most forms of internet radio's use of sound recording copyrights.

[373] *Web IV*, *supra* note 258, at 26,332.

complementary oligopoly problem described above.[374] Thus the rate derived from that benchmark required adjustment "to render it. . . usable as an 'effectively competitive' rate in. . . the noninteractive subscription market."[375]

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."[376] The D.C. Circuit disagreed, and affirmed the CRB's determination. The court applied the *Chevron* approach, concluding 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" and thus only applicable in rate-setting involving the 801(b) factors. The court held that policy objectives can be considered in conjunction with the willing buyer and willing seller standard, as long those policy objectives are not "external to that provision's mandate" to establish rates that should prevail between a willing buyer and seller, which, the D.C. Circuit further acknowledged, is a mandate capacious enough to account for a large range of economic considerations.[377]

The best example of a copyright-policy-sensitive approach to a free market benchmark inquiry can 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 is typical even in rate-setting proceedings governed by the 801(b) objectives.[378] These benchmark inquiries were essentially no different than the kind of inquiry that occurs under the willing buyer and willing seller standard.[379] Judge Strickler arrived at the conclusion that the previous rates

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[374] *Id.* at 26,343–44, 26,353.

[375] *Id*. at 26,344, 26,404–05. As explained above, effective competition (or lack thereof) can have direct consequences on copyright policy goals, including incentives/access. 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).

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

[377] *Id.*

[378] *Id.*

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

for streaming should be maintained solely through this benchmark inquiry, without relying on the 801(b) factors. 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.[380] 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 analytic disagreements about the nature of copyright markets that appear to 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."[381] He also noted that, in the streaming market, the deadweight loss generated by copyright's exclusive rights generally is magnified by the "additional complexity" of the publishers' market power.[382] A free market benchmark inquiry sensitive to these consideration counseled in favor of adopting a rate-structure that would allow streaming services to operate tiers of service at different price points (including a free ad-supported tier), [383] as well as rates significantly lower than those adopted by the majority. Thus, by treating questions of incentives/access and copyright owners' market power as endogenous to the CRB's market-mimicking inquiry, Judge Strickler's dissent potentially points to a way that these considerations could play a role in future proceedings, even under a willing buyer and willing seller rate-setting standard.

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[380] *Phonorecords III*, Initial Determination, Dissent, *supra* note 28, at 121-22.

[381] *Id*. at 33-35; *see supra* _____; *see also* Strickler, *supra* note 375, at 4 (bemoaning that "economists who testify [at the CRB and] do not necessarily emphasize the economic nuances of copyright issues").

[382] *Phonorecords III*, Initial Determination, Dissent, *supra* note 28, at 35-37

[383] *See supra* ____ (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 258, 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 a services' business model is compatible with the willing buyer and willing seller standard.

All of these examples support the conclusion that switch to a willing buyer and willing seller standard will not itself prevent regulators from furthering the original goals of the compulsory music licensing regimes in future rate setting proceedings. The 801(b) objectives certainly provided a helpful push in this direction but, as the *Phonorecords III* proceeding made clear, these factors were never alone sufficient to ensure rates consistent with copyright policy objectives. Rather, a conception of copyright markets that is sensitive to the incentives/access tradeoff, as well as the role of market power concentration in distorting that balance, can likely lead to appropriate outcomes even under the new 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, to be used until evidence emerges that private ordering can provide as effective a solution. 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 provide a sound recording compulsory license to 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 conclusion of these trends is the complete dismantling of the compulsory music licensing regime, especially if private ordering-based solutions could be found to any remaining transaction costs concerns.

As this Article has argued, these arguments miss a main justification of compulsory music 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 policy goals and recognized as tool for ensuring that copyright's otherwise market-oriented approach towards ensuring authors have adequate financial incentives does not entirely overwhelm the public's interest in access to creative 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 providing balance in the copyright system.

In this respect, the approach historically taken by the music compulsory licensing regime could serve as a model for addressing new technologies for enhancing access to existing copyrighted works these new forms of dissemination come into tension with copyright owners. Indeed, a

question looming in the background of this Article is what makes music different; why has music been subject to such an intricate regime of a compulsory licensing while no other copyright industries have been similarly regulated. A potential 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, whereas 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, the explosion of fair use cases involving a new "utility" enhancing technology making use of existing copyrighted content—from television news aggregators to massive book digitization projects, like Google Books—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-fomenting technologies to flourish. 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 flourish. Copyright law's complex 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.