OPENING PANDORA’S BLACK BOX: A COASIAN 1937 VIEW OF PERFORMANCE RIGHTS ORGANIZATIONS IN 2014

Bruce H. Kobayashi

INTRODUCTION

In his seminal 1937 article, The Nature of the Firm, Ronald Coase analyzed how the costs of using market transactions determined the nature and scope of the firm.¹ In particular, Coase mentioned the costs of negotiating a contract for each exchange, and the cost of discovering market prices, as costs associated with using the market.² Coase’s explicit recognition of these costs, now generally referred to as “transaction costs,” enabled Coase to look inside the “black box” of the firm to explain the existence of firms³ and other organizations.⁴ This analysis enabled Coase to explain why administrative allocation within a firm would be used instead of market transactions.⁵ Coase’s article, along with F.A. Hayek’s contemporaneous articles on the use of knowledge in society,⁶ are identified as the founding documents of the New Institutional Economics (“NIE”) movement⁷ and of the

² Id.
modern economic analyses of the theory of the firm based on transaction cost economics.  

This Article applies Coase’s analysis to the large music publishers’ recent decisions on whether to use performing rights organizations (“PROs”) to license performance rights for musical compositions. In the United States, there are three main PROs for musical compositions (“PRO’s”), the American Society of Composers, Authors and Publishers (“ASCAP”), Broadcast Music Incorporated (“BMI”), and SESAC (originally the Society of European Stage Authors and Composers). The PRO’s grant non-exclusive licenses to publicly perform compositions of affiliated songwriters. These PRO’s collect royalties from numerous licensees and pay royalties to their affiliated songwriters. From the standpoint of the transaction costs of using market transactions, these PRO’s are arguably the quintessential example of a Coasian organization (i.e., an organization whose existence is based on the mitigation of transaction costs that would be generated by the use of market transactions to license, price, collect and distribute performance right royalties).

However, an important part of Coase’s framework is that any economic analysis claiming to explain the existence and nature of real world organizations should be a “comparative institutional analysis.” Thus, a complete analysis of PRO’s cannot end with an accounting of the costs of carrying out market transactions. Rather, this analysis must take into account the relative benefits and costs of using a PRO to set prices in lieu of reliance on market pricing. As Coase noted in his article,

At the margin, the costs of organising within the firm will be equal either to the costs of organising in another firm or to the costs involved in leaving the transaction to be “organised” by the price mechanism. Business men will be constantly experimenting, controlling more or less, and in this way, equilibrium will be maintained. This gives the position of equilibrium for static analysis. But it is clear that the dynamic factors are also of considerable importance, and an investigation of the effect changes have on the cost of organising within the

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8 See, e.g., Alchian & Woodward, supra note 3, at 110; Oliver E. Williamson, Transaction Cost Economics: The Natural Progression, 100 AM. ECON. REV. 673, 675 (2010).
10 Besen et al., supra note 9, at 385.
11 Id.
12 Coase, supra note 1, at 390-92.
firm and on marketing costs generally will enable one to explain why firms get larger and smaller. We thus have a theory of moving equilibrium.\textsuperscript{14}

In the context of the PRO’s, both changes in technology and costs of the mechanism used in lieu of market pricing have arguably lowered or eliminated the net benefits of using these organizations. This in turn has resulted in significant pressures by music publishers to change or bypass the traditional PRO\textsuperscript{2} model. From a Coasian perspective, the recent attempts by large music publishers to withdraw their “new media” rights\textsuperscript{15} from the PRO’s can be explained by the lower costs of market transactions brought on by digital technology and by the high costs of the pricing mechanism that must be used under the 1941 antitrust consent decrees that govern ASCAP and BMI.\textsuperscript{16} The attempt by the large music publishers to withdraw their new media rights from the PRO’s can thus be viewed as a Coasian decision to choose market transactions over the administrative allocation for new media rights through the PRO’s, while keeping the status quo for traditional media rights.

Moreover, the effect of the rate court’s recent determinations in the Pandora litigation,\textsuperscript{17} that partial withdrawals are not allowed under 1941 antitrust consent decrees, yields a Hobson’s choice for the publishers: completely withdraw from the PRO’s,\textsuperscript{18} allowing the preferred market solution in the new media market but requiring the same—but not preferred—solution in the traditional media market; or maintain their affiliation with the PRO’s, allowing the preferred status quo in the traditional media market, but preventing the preferred move to a market solution in the new me-

\textsuperscript{14} Coase, supra note 1, at 404-05.


dia market. Under these circumstances, the effect of the consent decrees is to perpetuate a static equilibrium from an ancien regime and prevent the implementation of the efficient dynamic Coasian solution in the market for performance rights.

The remainder of this Article is organized as follows. Part I describes the public performance right under U.S. copyright law. Part II discusses the PRO’s role as transaction-cost-reducing Coasian organizations. Finally, Part III examines the effect of the antitrust consent decrees and technological change on the music publishers’ Coasian decision to withdraw from the PRO’s.

I. PERFORMANCE RIGHTS UNDER U.S. COPYRIGHT LAW

Under U.S. copyright law, there are two separate copyrightable works that may be protected when a sound recording is performed publicly.²⁹ The first is the musical composition, which is the song’s arrangement of notes and lyrics.³⁰ The second is the sound recording, which is the recording of the song by a musician/artist.³¹ The owner of the copyright to the sound recording can be different than the owner of the musical composition. For example, consider the case of John Coltrane’s (the musician) jazz recording of the classic standard “My Favorite Things.”³² The Williamson Music Company holds the performance right to the musical composition, which was composed by Richard Rodgers and Oscar Hammerstein II.³³ The rights to the sound recording would be owned by the artist’s estate or by the record company (originally Impulse Records, now part of the Universal Music Group).³⁴

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²⁹ To “perform” a work “means to recite, render, play, dance, or act it, either directly or by means of any device or process or, in the case of a motion picture or other audiovisual work, to show its images in any sequence or to make the sounds accompanying it audible.” 17 U.S.C. § 101 (2012). To perform or display a work “publicly” means

(1) to perform or display it at a place open to the public or at any place where a substantial number of persons outside of a normal circle of a family and its social acquaintances is gathered; or
(2) to transmit or otherwise communicate a performance or display of the work to a place specified by clause (1) or to the public, by means of any device or process, whether the members of the public capable of receiving the performance or display receive it in the same place or in separate places and at the same time or at different times.

_id.

³¹ See id. § 102(a)(7).
³⁴ COLTRANE, supra note 22 (© 1991 MCA Records, Inc.).
The right of public performance to the musical composition is one of the enumerated rights given to songwriters and publishers. A license to perform the musical composition “My Favorite Things” can be acquired directly from the Williamson Music Company. Rights to publicly perform the musical composition can also be acquired by obtaining a blanket license from ASCAP to perform all of the musical compositions in its repertoire, which includes the rights to perform the musical composition “My Favorite Things.”

Prior to 1996, the right of public performance in the United States applied only to musical compositions and did not apply to sound recordings, so no payment for the public performance would be owed to the owner of the sound recording (the record company or artist). The Digital Performance Right in Sound Recordings Act of 1995 (“DPRA”) added an exclusive right to public performance for sound recordings by means of a digital audio transmission. Under DPRA’s three-tier system, holders of the copyright to the sound recording are still not owed any payments for performances of sound recordings by business establishments or in terrestrial radio broadcasts. However, “new media” services are required to acquire licenses to perform sound recordings. Interactive transmission services such as YouTube, where users can play specific sound recordings, must now negotiate a license agreement with the artist/record company that owns the copyright to the sound recording. Non-interactive transmission services, where users can tailor by genre the songs that are streamed to them, but cannot choose a specific sound recording, are required to pay a statutory license fee. These services include Satellite Radio services such as Siri-

25 17 U.S.C. § 106(4) (giving the owner of copyright the exclusive right, in the case of literary, musical, dramatic, and choreographic works, pantomimes, and motion pictures and other audiovisual works, to perform the copyrighted work publicly).
27 COLTRANE, supra note 22 (ASCAP Work ID 430114253, IPI #126573278).
28 Other countries have recognized a public performance right for sound recordings. See Shourin Sen, The Denial of a General Performance Right in Sound Recordings: A Policy that Facilitates Our Democratic Civil Society?, 21 HARV. J.L. & TECH. 233, 234 (2007) (statistical analysis showing an increase in the relative prevalence of recording artists who also wrote their own songs during the period where performance rights for sound recordings did not exist under U.S. copyright law).
30 17 U.S.C. § 106(6) (giving the owner of a sound recording copyright the right to perform the copyrighted work publicly by means of a digital audio transmission).
32 Id.
usXM and Internet Radio services such as Pandora Radio, Slacker Radio and iTunes radio.\textsuperscript{35} The statutory fee is determined by a schedule set by the Copyright Royalty Board (“CRB”).\textsuperscript{36} These payments are in addition to payments made to the composer/publisher for the public performance of the musical composition.\textsuperscript{37} The statutory license fees are administered, collected, and distributed by SoundExchange, a sound recording performance rights organization (“PRO”).\textsuperscript{38}

\section*{II. PROS AND THE REDUCTION OF TRANSACTIONS COSTS}

This section examines the pre-DPRA landscape, and the basic operation of the PRO’s in the United States. As Landes & Posner point out, the PRO’s can be “efficient market responses to copyright problems caused by high transaction costs. The number of users (radio and television stations, restaurants, hotels, night clubs, movie producers, and so on) of copyrighted music is so great that individual negotiations with copyright holders to acquire performance rights are infeasible.”\textsuperscript{39}

The PRO’s serve to reduce the transaction costs of licensing performance rights to musical compositions in several ways. These organizations serve as a central clearinghouse for the licensing of performance rights to musical compositions that reduce broadcasters’ and commercial establishments’ costs of licensing these rights. The PRO’s allow publishers and songwriters to avoid the costs of having to negotiate numerous individual market transactions. Songwriters and publishers need only to affiliate and register their songs with a PRO\textsuperscript{3}, and do not have to engage in individual negotiations with the numerous potential users of their works.\textsuperscript{40} The PRO’s

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\textsuperscript{35} Lane, supra note 33, at 465.
\textsuperscript{37} Lane, supra note 33, at 462.
\textsuperscript{38} In addition to collecting and distributing the statutory fees under 17 U.S.C. § 114, SoundExchange also collects and distributes the statutory fees under 17 U.S.C. § 112. In the vast majority of cases, the mechanical license fees under 17 U.S.C. § 115 are collected on behalf of copyright owners outside of the statutory scheme by the Harry Fox Agency. See Fakler, supra note 36, at 3. In other countries, some of these functions are consolidated into a single PRO. For example, PRS/MCPS in the United Kingdom collects both performance and mechanical rights. However, this is not possible under the antitrust consent decrees governing ASCAP and BMI, as they do not allow composers and publisher to grant these PRO’s rights other than the rights of public performance. See Antitrust Consent Decree Review, supra note 16.
\textsuperscript{39} WILLIAM M. LANDES & RICHARD A. POSNER, THE ECONOMIC STRUCTURE OF INTELLECTUAL PROPERTY LAW 116 (2003) (footnote omitted). See also Besen et al., supra note 9, at 386-87.
\textsuperscript{40} Besen et al., supra note 9, at 385.
also reduce transaction costs by providing centralized monitoring, collection, and distribution functions for the songwriters and publishers. The PRO’s also lower the costs of transacting for the users of the works. Instead of having to negotiate a contract for each exchange transaction, the PRO’s negotiate and grant non-exclusive blanket licenses that allow the licensees to perform all songs in the PRO’s repertoire.\textsuperscript{41}

Figure 1 illustrates the costs of market transactions, and the way in which the traditional PRO’s lower these costs. On the top of each panel are representations of, from left to right, songwriters, artist/songwriters, and music publishers who hold the rights to perform musical compositions. On the bottom of each panel are representations of, from left to right, business establishments (bars and restaurants) and terrestrial radio stations that publicly perform musical compositions.

Figure 1 – PROs and Reductions in the Costs of Market Transactions

The left-hand panel shows the “web” of transactions that would take place in the absence of the PRO’s. The right-hand panel shows the lower number of transactions when PRO’s replace individual market transactions. For songwriters and publishers, affiliating and registering their songs with a PRO replaces numerous individual transactions with potential users of their copyrighted works. Use of the blanket license also reduces the number of transactions for potential users, as a single license with each of the PRO’s replace individual negotiations with numerous songwriters and pub-

lishers. In addition to economizing on the number of transactions, the PRO’s can also lower costs by taking advantage of economies of scale in negotiating licenses, in monitoring which works have been performed, and in distributing royalty payments to songwriters and publishers.\textsuperscript{42}

III. THE ANTITRUST CONSENT DECREES, TECHNOLOGICAL CHANGE, AND THE DECISION TO WITHDRAW FROM THE PRO’S.

The reduction in transaction costs, illustrated in Figure 1, represents the primary benefit of using the PRO’s over individual market transactions between songwriters and music publishers and those that publicly perform copyrighted works. This part discusses two issues that can impact publishers’ voluntary decision to use one of the PRO’s: the mechanism used by the PRO to replace the price system; and the effect of technology on the costs of using the market system. This Article then examines the music publishers’ Coasian choice to withdraw from the PRO’s in light of these two issues.

A. The Mechanism Used to Set Prices

The first issue examined is the relative cost of the mechanism used by the PRO’s to discover price information. In a market, such information is transmitted through market prices. Market prices aggregate and condense dispersed bits of information outside of the knowledge of any individual in a way that allows these individual market participants to act and adjust their actions with an economy of knowledge. Indeed, Hayek viewed the transmission of aggregated information through prices as the central feature of markets.\textsuperscript{43}

In Coase’s analysis, the deliberate choice to use administrative allocation and forgo the informational efficiency of markets reveals a calculation that administrative control lowers overall costs and allocates resources more effectively than can the market through comparative prices.\textsuperscript{44} The extent to which these conditions hold depends upon the relative cost and efficiency of the mechanism used to replace the market’s production and transmission of information through prices. As noted above, Coase contemplated that those directing firms and other organizations would constantly make adjustments on the margin in response to new information about

\textsuperscript{42} Besen et al., supra note 9, at 404.

\textsuperscript{43} Hayek, Use of Knowledge, supra note 6, at 526 (“We must look at the price system as . . . a mechanism for communicating information if we want to understand its real function . . . .”).

\textsuperscript{44} See generally Priest, supra note 6.
changing conditions. These adjustments could include altering the size and scope of the firm by replacing formerly internal transactions with market transactions.

In the case of the PROs, the mechanism used to determine prices are the procedures set out in the 1941 antitrust consent decrees between the U.S. Department of Justice, and ASCAP and BMI. In particular, the consent decrees required that licenses be made available on non-discriminatory terms. The decrees also provide that if the parties fail to reach a voluntary agreement on a “reasonable” royalty rate, the rate will be set in a rate court proceeding by a federal district court judge from the Southern District of New York. In these proceedings, the rate court judge seeks to set a reasonable royalty rate that reflects the outcome of a hypothetical negotiation, taking into account the fact that the rate court hearings exist as a result of the PROs position as “monopolists exercising disproportionate power over the market for music rights.” The effect of the rate court provisions of the antitrust consent decrees is illustrated in Figure 2. In particular, the choice to use one of the two PROs subject to the antitrust consent decrees results in lowered transaction costs bundled with rate determination carried out in the shadow of the rate court provisions contained in the consent decrees.

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45 Id. (discussing the primary role of information implicit in Coase’s theory of the firm).
46 See supra note 16. SESAC, the smallest of the three U.S. PROs does not operate under an antitrust consent decree.
47 See supra note 16.
48 See supra note 16.
While a detailed discussion of the details of the operation of the consent decrees in general, and the rate court procedures in particular,\textsuperscript{50} are beyond the scope of this Article,\textsuperscript{51} it is more than plausible that the rate court proceedings, based on seventy-plus-year-old consent decrees last modified in 2001, differ from the flexible and incremental approach of the entrepreneur contemplated by Coase.\textsuperscript{52} Even if the costs of the rate court procedure were, at some point in time, small relative to the savings of transaction costs produced through use of the PRO’s, over time an inflexible rate court procedure may fail to approximate, at a reasonable cost,\textsuperscript{53} the process that would be voluntarily adopted by the parties.\textsuperscript{54} This in turn could trigger a Coasian adjustment by the publishers to end their affiliation

\textsuperscript{50} See In re Petition of Pandora Media, Inc., 6 F. Supp. 3d 317, 320 (S.D.N.Y. 2014) (rate court determination of reasonable fees equal to 1.85 percent of revenue for a through-to-the-audience blanket license to perform musical compositions in ASCAP repertoire).


\textsuperscript{52} See Einhorn, supra note 51, at 3-5 (discussing the flexibility benefits of voluntary contracting that are constrained under by the consent decree). Court-determined royalty rates in the absence of a voluntary agreement are also used to determine FRAND rates for standard essential patents. See, e.g., Microsoft Corp. v. Motorola, Inc., No. C10-1823JLR, 2013 WL 2111217 (W.D. Wash. Apr. 25, 2013). These proceedings generate similar issues to the use of the rate court to determine rates for PRO’s licenses under the consent decree. See Richard A. Epstein & David J. Kappos, Legal Remedies for Patent Infringement: From General Principles to FRAND Obligations for Standard Essential Patents, 9 COMPETITION POL’Y INT’L 69, 69-71 (2013). Similar issues also arise in cases determining reasonable royalties damages for patent infringement under 35 U.S.C. § 284. See Uniloc USA, Inc. v. Microsoft Corp., 632 F.3d 1292, 1318 (Fed. Cir. 2011) (holding expert testimony using a 25 percent rule of thumb to calculate a reasonable royalty rate was inadmissible under F.R.E. 702 and 703); ResQNet.com, Inc. v. Lansa, Inc., 594 F.3d 860, 868 (Fed. Cir. 2010) (rejecting reasonable royalty rate calculation based on improper and inappropriate past license evidence).

\textsuperscript{53} Critics have noted the high costs of the rate court proceedings, and have suggested use of less costly forms of adjudication, such as an arbitral forum. See, e.g., Einhorn, supra note 51; Antitrust Consent Decree Review, supra note 16 (requesting public comment on whether the rate-making function currently performed by the rate court be changed to a system of mandatory arbitration). Even if the high costs of using the rate court procedure results in the parties entering into voluntary agreements, asymmetric costs or systematic deviations from market-based outcomes at trial can result in settlement outcomes that create distortions. See generally Bruce H. Kobayashi, The Law and Economics of Litigation, in THE OXFORD HANDBOOK OF LAW & ECONOMICS (forthcoming 2015).

\textsuperscript{54} See generally Epstein & Kappos, supra note 52 (discussing this issue in the context of the determination of rates for FRAND licenses).
with the PRO’s and rationally substitute direct market transactions despite the tangible transaction cost savings associated with using the PRO’s.\textsuperscript{55}

B. \textit{The Effect of Technology}

As noted above, an important implication of Coase’s analysis is that exogenous changes in the nature of the market and transactions costs can alter the nature of the firm over time.\textsuperscript{56} An important source of exogenous change in transaction costs is technology. Technology has profoundly changed the way music is performed by the public, and has altered the transaction and information costs associated with the determination, collection, and distribution of performance right royalties. For example, in the twentieth century, recording artists and record companies made money from sales of traditional media such as records and tapes, and then CDs. In earlier times, composers’ and music publishers’ incomes were greatly influenced by sheet music sales.\textsuperscript{57} Public performances of songs by bands and the performance of sound recordings by radio stations served as complements that increased the demand for sound recordings and sheet music. This in turn led to the use of payola as a common practice, where music publishers paid artists, and record companies paid radio stations, to induce each of them to publicly perform their works.\textsuperscript{58}

The widespread diffusion of high-speed internet access and new digital media distribution models altered the way in which consumers acquired music, which has led to changes in the way music is distributed.\textsuperscript{59} In particular, the public performances of sound recordings and musical compositions occurring through interactive and non-interactive digital transmissions have grown rapidly. In contrast to the economics of traditional media distribution that created incentives for payola, these new media performances are

\textsuperscript{55} The analysis does not specifically address the issue of the efficiency of government versus market-based price determination. As Priest, supra note 6, at 10, points out, Coase suggested that the role of the decision maker could be the filled by a government officer. However, his later work emphasized “the primacy—indeed the dominance—of market decisions versus governmental decisions concerning the allocation of resources.” \textit{Id.} at 2. See also generally Victor P. Goldberg, \textit{Regulation and Administered Contracts}, 7 BELL J. ECON. 426 (1976) (describing complexity of the comparative institutional analysis between market and administered pricing).

\textsuperscript{56} See supra text accompanying notes 14-15.

\textsuperscript{57} ALCOHON & BOB KOHN, KOHN ON MUSIC LICENSING 45 (4th ed., 2010) (noting the decline in physical sound recording sales post-1999 paralleled earlier the decline in sheet music sales from 1920 to 1935).


\textsuperscript{59} For a recent discussion of these issues, see KOHN & KOHN, supra note 57, at 45; Stan J. Liebowitz & Richard Watt, \textit{How to Best Insure Remuneration for Creators in the Market for Music? Copyright and Its Alternatives}, 20 J. ECON. SURVS. 513, 520-22 (2006); Alex Solo, \textit{The Role of Copyright in an Age of Online Music Distribution}, 19 MEDIA & ARTS L. REV. 169, 175-77 (2014).
substitutes, and not complements, for the purchase of sound recordings. Thus, these new media digital distribution models have a negative effect on the sales of sound recordings.

Technological change and the economics of the new media digital distribution models induced changes to U.S. copyright laws. As noted above, these changes included the creation of digital performance rights for sound recordings, which facilitated the ability of artists and record companies to appropriate the returns to their copyrighted sound recordings using these new media digital distributional models. Also included were provisions for statutory licenses for non-interactive transmission services such as Pandora Radio under 17 U.S.C. § 114, as well as provisions for the determination of rates for these statutory licenses through the CRB. In addition, this change also induced the creation of SoundExchange, a PRO that administers, monitors, and collects the sound recording performance royalties.

The effect of technological change, the changes to copyright law contained in DPRA, and the creation of a PRO (SoundExchange) are illustrated in Figure 3. On the copyright holder side, Figure 3 adds the owners of sound recordings, which include recording artists (who are not songwriters) and record companies. On the user side, the figure adds non-interactive internet radio companies such as Pandora Radio and iTunes radio.

60 See KOHN & KOHN, supra note 57, at 45; Leibowitz & Watt, supra note 59, at 521-22. Indeed, the first set of digital distribution models included file-sharing programs such as Napster and Grokster, and later-generation file sharing models such as BitTorrent. For a discussion of these developments, see Solo, supra note 59, at 175-77.


62 See supra text accompanying notes 29-30.

63 See supra text accompanying note 36. The determination of the appropriate Section 114 statutory fee schedule through the CRB shares some similarities with the fee determination provisions of the rate court under the PRO antitrust consent decrees. However, there are procedural difference in the rate court and CRB proceedings. For example, in contrast to the standard used by the rate courts under the antitrust consent decrees, the CRB is supposed to set Section 114 rates based on a fair market value standard “that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller.” 17 U.S.C. § 114(f)(2)(B) (2012). See also Fakler, supra note 36, at 5.

64 See supra text accompanying note 38.

65 For purposes of clarity and to simplify the figure, transactions involving firms that provide interactive digital transmissions are not illustrated.
The legal landscape for pure songwriters on the copyright holder side, and business establishments and terrestrial radio stations (and other broadcasters exempt from the provisions of the DPRA) on the user side is unchanged. However, singer/songwriters, as well as the large publishing groups that hold copyrights to musical compositions and to sound recordings now receive distributions from the PRO’s and from the PRO’s SoundExchange. In addition, on the user side, interactive and non-interactive internet radio services are required to acquire a license to publicly perform the sound recording and the musical composition. Thus, non-interactive internet radio services such as Pandora Radio request licenses from the PRO’s (SoundExchange) and from the PRO’s. Note that for this set of users, some of the services provided by the PRO’s and PRO’s, such as negotiations and monitoring, will overlap.66

Consider, for example, the integrated artist/songwriter or publishers that own both the performance right to the musical composition. The digital transmission of a sound recording will generate a copyright-protected public performance of both the sound recording and musical composition. The monitoring and distribution functions performed by SoundExchange and the PRO’s for both interactive and non-interactive internet radio licenses could be, in theory, efficiently consolidated into a single transaction. That is, the integrated copyright holder could license a bundle of performance rights that included both the musical composition and digital sound recording rights. This integration in pricing of the digital sound recording performance right and the musical composition performance right can reduce transaction costs and avoid the problem of successive monopolies. See AUGUSTIN COURNOT, RESEARCH INTO THE MATHEMATICAL PRINCIPLES OF THE THEORY OF WEALTH (Nathaniel T. Bacon trans., Macmillian Co. 1897) (1838); Kobayashi, supra note 41, at 714. See also, e.g., David Oxenford, ANOTHER ROYALTY PAYMENT FOR WEBCASTERS? EMI Withdraws from ASCAP for New Media Licensing, BROADCAST L. BLOG (May 8, 2011), http://www.broadcastlawblog.com/2011/05/articles/another-royalty-payment-for-webcasters-emi-withdraws-from-ascap-for-new-media-licensing/ (discussing “efficiencies that will be created by its licensing the musical compositions directly—in conjunction with
From the standpoint of the transaction costs savings associated with a music publisher using a PRO\textsuperscript{6}, the savings that result from dealing with non-interactive digital music services and other new media distribution models are likely to be smaller. In particular, the costs of monitoring which sound recordings and musical compositions are performed will be lower for two reasons. The first is that advanced technology associated with new media distribution will make the costs of monitoring which sound recordings and musical compositions have been performed easier to track and compile.\textsuperscript{67} The second is that, in contrast to the large number of geographically based terrestrial radio stations and local business establishments, web-based internet and satellite radio companies will be national in scope and limited in number by technology-generated economies of scale. While non-interactive internet radio services such as Pandora do not allow users to induce the public performance of specific sound recordings, they do allow users to personalize channels to songs by and related to an artist or genre. The choice of programming that occurs in terrestrial radio, based on the demographics of the local geographic population, is replaced by algorithms that tailor the listening experience based on information provided by the individual user. Under these conditions, individual market transactions for the handful of internet radio companies will not generate the high costs associated with identification, negotiation, licensing, and monitoring a large number of diverse and geographically dispersed business and terrestrial radio stations. Thus, the Coasian analysis suggests that these changes shift the margin in favor of direct market transactions between publishers and non-interactive internet radio services.\textsuperscript{68}

\textsuperscript{67} This results from the advanced technology used in such internet radio business, which allows production of machine-readable and searchable data available at a low marginal cost. Moreover, advanced search use of advanced technologies can reduce the cost of using market transactions even for low-tech public performances. \textit{See, e.g.,} Steve Rosenbush, \textit{How Big Data Will Disrupt the $9 Billion Music Publishing Rights Business}, \textit{WALL ST. J.} (May 16, 2012), http://blogs.wsj.com/cio/2012/05/15/how-big-data-will-disrupt-the-9-billion-music-publishing-rights-business/ (noting the use of automated recognition and monitoring software being used by Tune Sat to detect public performances that are currently not being detected by the existing PROs). \textit{See also generally} Bruce H. Kobayashi & Larry E. Ribstein, \textit{Law’s Information Revolution}, 53 \textit{ARIZ. L. REV.} 1169 (2011) (discussing the use of technology and its effect on law and legal practice generally).

\textsuperscript{68} \textit{See generally} Besen et al., \textit{supra} note 9 (analyzing the properties of a competitive direct licensing model, and noting the social costs of using blanket licenses and collective pricing when direct licensing is feasible).
C. The Coasian Decision of Music Publishers to Opt-Out of the PRO’s

The analyses in Section A and B of this part demonstrate how the pricing mechanism used by the PRO’s and the technological changes in the market both serve to reduce the comparative benefit of using the PRO’s over direct market transactions. In May 2011, consistent with the predictions of the Coasian analysis, music publisher and record company EMI, now part of the Universal Music Group, withdrew from ASCAP for new media licensing after the ASCAP Compendium was modified in April 2011 to allow publishers to selectively withdraw from ASCAP the right to license works to new media entities such as Pandora.\(^69\) EMI’s withdrawal of new media rights was followed by similar withdrawals by Sony and UMPG,\(^70\) and similar withdrawals of new media rights from BMI.\(^71\)

Figure 4 modifies Figure 3 to illustrate the effect of the withdrawals of new media rights from the two PRO’s under the antitrust consent decrees by large music publishers. The number of transactions rises, and now includes the additional “publisher direct” transactions. The number of transactions for the withdrawing broadcasters and the new media licensees increase. In addition, the transactions involving internet radio companies and the PRO’s under the antitrust consent decrees now involve licenses to perform only the non-withdrawn compositions of the PRO’s’ repertoire, requiring adjustments to the license contracts struck prior to the withdrawals.

However, as noted above, the magnitude of the increase in transaction costs are limited by technological advance. In addition, the music publishers also gain by avoiding use of the costly price-setting mechanism that would be conducted in the shadow of potential rate court proceedings. The use of partial withdrawals also leaves in place the status quo and the efficiencies of using the PRO’s for individual songwriters, terrestrial radio, and business establishments.

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\(^70\) Id.

As noted above, both rate court judges ruled that withdrawals of new media rights were not allowed under the terms of the antitrust consent decrees covering ASCAP and BMI. As noted in the Introduction, the decrees, if not modified, create a Hobson’s choice for the publishers: completely withdraw from the traditional PRO’s, allowing use of the preferred market solution in the digital market but requiring the same but not preferred solution in the non-digital market. Figure 5 shows the transaction-costs-increasing effect of complete withdrawal from ASCAP and BMI. Alternatively, the publishers could choose to maintain their affiliation with the traditional PRO’s, allowing the preferred status quo in the non-digital market, but preventing the preferred move to a market solution in the digital market.

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72 See cases cited supra note 71.
73 Faughnder, supra note 18.
CONCLUSION

The large music publishers’ recent decisions to withdraw new media rights to publicly perform musical compositions from the performing rights organizations ASCAP and BMI are consistent with a Coasian marginal decision regarding the types of activities conducted within a firm versus through the market. For new media licensing, the publishers’ net benefits of using ASCAP and BMI over direct market transactions have diminished over time due to changes in technology and the constraining effects of the 1941 antitrust decrees that govern ASCAP and BMI.

The music publishers’ decision to use direct market transactions for new media rights, despite substantial transaction costs savings associated with use of the performing rights organizations, is consistent with the broader comparative and dynamic analysis of the marginal costs and benefits of using these organizations contemplated by Coase in his 1937 paper. The partial withdrawal allows the imposition of the preferred Coasian solution in the market for new media rights while simultaneously allowing the status quo involving business establishments and terrestrial radio. The rate courts’ decisions that the antitrust consent decrees do not allow the publishers to withdraw only their new music rights creates a Hobson’s choice that forces the publishers to make an inferior Coasian choice in one of these two settings.

In closing, it should be noted that the evaluation of the effect of the rate courts’ interpretation of the consent decrees might be too pessimistic in the long run. The costly short-term consequences of continuing to apply outdated antitrust consent decrees in a rigid manner can encourage the production of legal or technological solutions that will serve to mitigate these
Indeed, the decisions may place greater pressure on the Department of Justice to consider significant changes to, or even abandonment of, the consent decrees. It may also spur or accelerate innovation, including the creation of private Coasian firms such as Songtrust,\textsuperscript{75} TuneCore,\textsuperscript{76} CD Baby Pro,\textsuperscript{77} and TuneSat\textsuperscript{78} that provide innovative technological solutions to lower transaction costs associated with the licensing of performance rights.

\textsuperscript{74} See LANDES & POSNER, supra note 39, at 116 (noting how the widespread application of fair use because of the presence of high transactions costs can “sap the incentive to develop innovative market mechanisms that reduce transaction costs and make economic exchanges between copyright holders and users feasible”).

\textsuperscript{75} One Stop Song Registration and Royalty Reporting, SONGTRUST, www.songtrust.com (last visited Mar. 18, 2015) (“One-stop song registration and royalty reporting.”).

