ISSN 1936-5349 (print)
ISSN 1936-5357 (online)

HARVARD

JOHN M. OLIN CENTER FOR LAW, ECONOMICS, AND BUSINESS
FELLOWS' DISCUSSION PAPER SERIES

THE PRICE OF FAME: THE ANTITRUST LAW AND ECONOMICS OF BROADCASTING, MUSIC, AND ADVERTISING

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Discussion Paper No. 35

7/2010

Harvard Law School
Cambridge, MA 02138

THE PRICE OF FAME: THE ANTITRUST LAW AND ECONOMICS OF BROADCASTING, MUSIC AND ADVERTISING

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ABSTRACT

Why do we watch and listen to so many ads on radio and television when we would rather not? Why are most songwriters in the U.S. and elsewhere unable to make a living out of their creative efforts, but the few that can are often rewarded more than all others combined? Are these the features of efficient or otherwise desirable markets? Three separate strands of economic literature spanning over more than two decades on the economics of superstars, the structure and performance of broadcasting markets and the economics of music licensing suggest that these features are staples of rather well functioning markets, and that in fact there isn't much to regret about this state of affairs. Superstardom is a direct consequence of talent, or perhaps consumer choice or bandwagon effects. Advertising likely provides valuable information, but even uninformative advertising is essential to fund the commercial radio or television programs that people do want to consume: "reduce it, and broadcasters won't be able to afford high quality content" the argument goes. Courts, Congress, government agencies and legal scholars have long relied on many of these economic theories to decide antitrust cases, guide government oversight efforts, and engineer laws and regulations in broadcasting and music licensing markets. In this article I challenge the dominant economic analysis of these markets and show that more than six decades of antitrust oversight and enforcement efforts in these markets by U.S. courts, Congress and government agencies have been utterly misguided. It is in large part because of such misguided efforts, this article argues, that we presently experience inefficiently high levels of advertising, skewed income distributions for songwriters and reduced audience welfare. After examining one of the most far reaching and enduring regulatory efforts in U.S. history, I expand the economic understanding of these markets and leverage a novel analytical framework to show how legal scholarship, building on faulty economics, has evolved its own series of misguided policies. On this understanding I suggest that courts are indeed compelled by antitrust law to begin transforming these markets by declaring current licensing practices in broadcasting and music markets illegal and that the Antitrust Division of the Department of Justice is equally compelled to either abandon or radically modify its oversight over Performing Rights Organizations. I conclude with a proposal for market design that eludes most of the pitfalls of current market structure and likely results in vast welfare improvements all while substantially reducing unnecessary oversight expenditures.

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*S.J.D., Harvard Law School. For helpful comments and support, I am grateful to Einer Elhauge, William Fisher III, Stavros Gadinis, Jane Hopwood, Louis Kaplow, Katerina Linos, Vlad Perju, Yuval Procaccia, Holger Spamann, Steve Shavell, Elina Treyger and workshop participants at Harvard Law School, Yale Law School, the University of Michigan School of Law and Boston University School of Law. I also wish to thank the John M. Olin Center for Law, Economics and Business at Harvard Law School for its generous research support.

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1 INTRODUCTION

Of the many peculiar things we human beings are known to enjoy, watching television and listening to radio rank high. The average American, for example, spends the lion's share of his or her leisure time watching about 28 hours of TV and listening to 19 hours of radio each week.[1] Paradoxically however, much of this time is spent consuming ads, which most of us enjoy less than songs or other broadcasted content.[2]

Besides reducing the quality of perhaps the most important pastime in the life of millions of Americans (and billions of viewers and listeners elsewhere) ads take up a large portion of two very limited resources, airtime and available leisure time, which as a consequence cannot be devoted to (and therefore depresses demand for) content that audiences value more. The livelihoods of countless artists supplying such content are in turn profoundly affected by the ratio of advertising to content in commercial broadcasting, from which they derive a substantial part of their income. For hundreds of thousands of songwriters in the U.S. for instance, royalties collected from commercial broadcasting licenses are often the same as those they receive from all other income sources including record sales and song downloads.

In this article I argue that this peculiar state of affairs is the result of poorly performing broadcasting and music licensing markets, and in the case of the U.S., of many decades of unwise regulation and misguided oversight by courts and government agencies—namely the Antitrust Division of the Department of Justice (DOJ) and the Federal Communications Commission (FCC)—whose actions are presently reducing the welfare of audiences, jeopardizing the livelihoods of most U.S. songwriters and squandering limited resources on costly and counterproductive policies.

The primary source of such substantial market shortcomings and unwise policies however, runs deeper than the actions of courts and government agencies, and can be traced back to decades of misguided recommendations by influential works both in legal and economic scholarship.

Focusing first on this long line of legal and economic inquiries, the analysis below begins the task of exposing their analytical shortcomings by eliciting novel answers from three rather traditional questions these literatures have repeatedly pursued: Why do we watch and listen to so many ads on radio and television when we would rather not? Why are most songwriters unable to make a living out of their

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[1] *See* Arbitron, *Radio Today: How America Listens to Radio Today* (2007 Edition), http://www.arbitron.com/downloads/radiotoday07.pdf.

[2] Modeling ads as imposing nuisance costs on audiences is a common assumption in the literature and it provides an intuitive framework to explain the phenomena analyzed here. The proposal that this article puts forward, however, circumvents the issue of whether ads increase or reduce utility by advancing an alternative market design that allows markets to simply price annoyance costs more efficiently in *all* inputs used by broadcasters, be they ads or songs. For a survey on the literature on advertising and annoyance costs, *see e.g.,* Anthony Dukes & Esther Gal-Or, *Negotiations and Exclusivity Contracts*, 22(2) MARKETING SCI. 222–45 (2003); *see also,* Gary S. Becker & Kevin M. Murphy, *A Simple Theory of Advertising as a Good or Bad,* 108-4 Q. J. ECON. 941, 961 (1993)*;* GARY S. BECKER, ACCOUNTING FOR TASTES 223 (1996).

creative efforts, but the few that can are often rewarded more than all others combined? Are these superstars the end result of an efficient market?

While these questions have been answered many times by analytically isolated lines of inquiry, presenting them under a common analytical framework quickly reveals that the answers presently offered within the economic and legal literatures are incapable of providing a unified view of broadcasting, advertising and music licensing markets which is both encompassing and coherent.

How so? The economic analysis of TV and radio as two-sided markets has offered uneasy, slightly disheartening, learn-to-live-with-your-share-of-ads comfort in predicting advertising levels as a result of interdependent demands of audiences and advertisers mediated by broadcasting platforms. But the analysis has so far failed to consider the interdependent supply and demand of (cartelized) songwriters, squaring a three-sided market in two-sided shoes and therefore missing readily available policy tools capable of reducing advertising levels.

Superstardom economists have focused on the talent and popularity of superstars, but have neglected to examine the prices of songs, which nearly every outlet that plays songs—from supermarkets to broadcasters, in every corner of the world—observes through the distorted goggles of blanket licenses, which price fame no differently than obscurity.

Economists and lawyers dissecting the law and economics of copyright collectives have long suggested that the use of blanket licenses—just like pricing songs at marginal cost—results in an optimal output of songs, but they have misunderstood how high blanket license prices, by making advertising more attractive to broadcasters (i.e. suboptimally cheap) reduce the available airtime to songwriters (i.e. the output of songs) in ways that neither competition between songwriters or between collectives, nor rate courts have been able to correct. Indeed, they also missed that, regardless of the advertising market, marginal cost pricing is not necessarily output enhancing when negative prices can increase the profits of songwriters who sell not only songs, but bundles of products, such as concerts, song downloads, and t-shirts.

What do these analytical oversights have in common? All of them, in some way or another, have overlooked "the price of fame," that is, how song prices must vary from one songwriter to another, and why, when they don't (and currently they don't), we get higher advertising levels than desired, revenues more skewed than what is desirable or efficient, and why-oh-why most of us get to know that "15 minutes can save us 15% or more on car insurance."

Without better guidance from these strands of legal and economic analysis or the aid of a general theory of these markets, agencies have been unable to assess the full and unfortunate consequences of their actions. The DOJ has on the one hand enabled Performing Rights Organizations (PROs) to suppress price competition between songwriters (through their offerings of all-you-can-eat blanket licenses) and on the other prosecuted associations of broadcasters trying to limit the amount of advertising which high song prices invite. The FCC has been concerned about the amount of advertising on commercial broadcasting, and also about the livelihoods of independent songwriters trying to break into new media markets, but it has undermined its own goals by enforcing anti-payola regulations which put most

songwriters—implicitly overpricing their songs as a consequence of blanket licenses—at a disadvantage vis-à-vis advertisers and vis-à-vis few competing and implicitly better-priced songwriters—superstars. Additionally, courts which, with aid of better theories, should have constrained the actions of both the agencies and the firms these agencies seek to regulate, are instead helping to perpetuate the status quo.

Correcting the analytical shortcomings which inform these actions results in the following novel legal and economic insights:

(a) blanket licenses should presently be considered illegal under U.S. antitrust law and declared as such by courts and enforcement agencies;

(b) doing away with them will likely lower advertising levels and de-skew—at least partially—revenues for hundreds of thousands of songwriters;

(c) the large judicial and government expenditures that for more than six decades have been devoted to monitoring PROs through antitrust consent decrees, funding rate courts, and funding anti-payola enforcement should be understood as an unnecessary and entirely avoidable waste of resources, not only because songwriters can already price songs on their own without "collective" participation, but because declaring blanket licenses illegal can solve a chicken-and-egg problem that has likely prevented better transactional platforms (e.g. eBay like platforms) from supplanting PROs;

(d) online transactional platforms, can allow markets to vastly outperform blanket licenses—quantitatively and qualitatively—by allowing different songwriters to employ several pricing strategies simultaneously (e.g. auctions or any arbitrarily set price). Payola, when properly examined in this context, is merely the tip of a much larger market that remains almost entirely submersed because it lacks the necessary transactional platforms that would make it viable. Because modern online platforms can accommodate simultaneously both negative and positive auction values (think of negative reservation values), for the first time in history, songwriters could also have access to a competitive advertising market for songs (i.e. a truly competitive payola market). Under such a system, the price of particular songs could be determined through auctions as either negative or positive, solely on the basis of competition between radio stations offering airtime (advertising spots) and songwriters offering songs—which are simultaneously an input for broadcasters and a promotional tool for songwriters wishing to stimulate the sale of CDs, song downloads, concerts, and the like. In other words, this is a problem of market design for which we now possess suitable technological solutions.

The analysis below proceeds as follows:

Section 2 examines the economic structure of broadcasting, advertising and music licensing markets and makes four principal contributions to economic analysis. First, it extends a recent strand of research examining commercial broadcasting as a two-sided market and corrects a fundamental shortcoming in the economic modeling of the market—the misunderstood significance of a cartelized side (songwriters) which is not presently modeled. This correction shows for the first time how music licensing practices increase the quantity of advertising in equilibrium in commercial broadcasting in a welfare decreasing way. Second, this section challenges the premature and misguided application of mainstream economic theories of superstardom to the music industry by advancing two novel alternative theories that

explain skewed revenue distributions in songwriter markets as partly attributable to decreased competition between songwriters and advertisers and decreased competition among songwriters, both caused by a blanket license pricing system that coalesces with uniform pricing systems also prevalent in record sales and downloaded music. Third, the section extends the economic analysis of payola by examining the practice in the framework of a multi-sided market and by exposing previously ignored positive externalities (information spillovers) associated with the practice that tend to raise the utility of audiences. Fourth, it extends the economic analysis of copyright collectives by assessing the performance of these institutions in conjunction with commercial broadcasting—by far their largest customers—and introducing a novel theory of competitive harms, which includes increased advertising levels, artificially skewed income distributions and reduced creative incentives. This analysis of the licensing behavior of collectives further examines why price and output effects related to songs, remain misunderstood by the economic literature, and why quality effects on songs have been missed entirely. The analysis of collectives is discussed in both Sections 2 and 3.

Section 3 examines the legal determinants of the pricing anomalies uncovered in Section 2, and challenges mainstream analysis (both legal and economic) of the harms and pro-competitive benefits of blanket licenses and anti-payola regulations. The analysis of blanket licenses is structured as a rule of reason inquiry under U.S. antitrust law in order to show not only that mainstream legal analysis has failed to properly assess the welfare consequences of the use of blanket licenses, but indeed to suggest that proper judicial scrutiny presently compels a declaration of blanket licenses as illegal restraints of trade, and consequently that enforcement practices by the DOJ are in urgent need of reform. Section 3 further describes available remedies and examines alternative market design choices. The section then advocates for ELEGANCE in the market, that is, a novel market design where transactions take place within a network of Electronic Licensing Engines Giving Authors a Non-Collusive Environment. ELEGANCE, by pricing songs through auctions—although most individual pricing mechanisms are feasible—is able to eliminate pricing (and licensing) intermediaries such as PROs and the harms that they inflict through the collective pricing of songs. The system of competition between licensing engines or platforms—unconcerned with pricing songs—is shown to outperform current licensing practices by, among other things, allowing negative price auctions—making the payola/pay-for-play market truly competitive—and by enabling, for the first time in nearly a century of song licensing, the efficient trading of exclusive rights in public performance licenses, curving overuse and underuse of songs by commercial broadcasters.

Section 4 offers concluding remarks.

2 A THREE SIDED MARKET IN TWO SIDED SHOES: BROADCAST RADIO AND THE TAYLOR SWIFT PARADOX

2.1 The Taylor Swift Paradox

Fame and fortune are no strangers to songwriter and singer Taylor Swift. In the first week of August of 2009, her song "You belong to me" claimed the top spot in radio airplay and commanded, according to Mediaguide, 19,361 *spins*[3] or plays on the more than 2500 radio stations they monitor in 150 U.S. markets.[4] In fact, by August 9, 2009, "You Belong to Me" had spent four weeks at the number one spot of radio airplay, thousands of spins above the closest song.[5]

By industry standards, twenty year-old Swift is a phenomenon. Celebrated as "[o]ne of pop's finest songwriters" by The New York Times,[6] Swift was the biggest record selling artist of 2008 in the U.S., her album "Fearless" selling more copies than any other album since Santana's "Supernatural" in 2000.[7] When Swift goes on tour, things are not much different. According to Forbes, tickets for her May 22, 2009 concert at the Los Angeles Staples Center, for example, were sold out in the first two minutes.[8]

As much as audiences like Swift however, when counting the number of plays of all performances on those same radios, Swift hardly even makes the top ten list of those with the most "spins" or plays. During the first week of August 2009, it was insurance company "Geico" that took the number one spot, with 42,544 spins or more than twice the number of plays Swift received.[9] Home Depot came in second with 41,371 and Mac Donald's third with 34,593.[10] In that week, in fact, Swift only scratched the number ten spot slightly behind AT&T which obtained 19,574.[11]

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[3] *See* Mediaguide, National Mainstream, http://charts.mediaguide.com/format/National_Mainstream_single.html (last visited Aug. 10, 2009).
[4] *See* Mediaguide, http://www.mediaguide.com/about (last visited Dec. 26, 2009).
[5] *See* Mediaguide, *supra* note 3.
[6] *See* Jon Caramanica, *Sounds of Swagger and Sob Stories*, December 21, 2008, N.Y. TIMES, AR33, available at http://www.nytimes.com/2008/12/21/arts/music/21cara.html?_r=1.
[7] *See* Katie Hasty, *Taylor Swift Remains Atop Billboard 200*, Feb. 25, 2009, http://www.billboard.com/news/taylor-swift-remains-atop-billboard-200-1003944728.story#/news/taylor-swift-remains-atop-billboard-200-1003944728.story (last visited Dec. 26, 2009).
[8] *See CMA and AMA Award Winner Taylor Swift Expands Doll Line With Playsets*, New Fashions, Dec. 1, 2009, http://www.forbes.com/feeds/businesswire/2009/12/01/businesswire132227701.html (last visited Dec. 26, 2009).
[9] *See* Mediaguide, Top Brands & Advertisers on Radio, http://charts.mediaguide.com/ads/National_Advertiser.html (last visited Aug. 10, 2009).
[10] *Id.*
[11] *Id.*

This is an odd state of affairs, not only because people enjoy songs and overwhelmingly dislike listening to ads on the radio,[12] or even because in this particular week the top song by one of this decade's superstars barely even made it in the top most often played things on the radio, but because the first week of August 2009, was in fact an ordinary week for radio broadcasting in the U.S. and elsewhere.

Indeed, that global leisure time is impoverished by ads also means that valuable talent that would have otherwise replaced those annoying commercials is instead squandered by societies' inability to reward it. If ads could be replaced by the content audiences enjoy the most—songs for instance—the incomes lost and impoverished livelihoods of countless songwriters—the vast majority of which currently can't make a living out of the public performance of their songs alone[13]—would be able to receive a substantial boost from all the freed airtime.

In the U.S. alone for instance the average person listens to 19 hours of radio each week. Radio reaches 93% of U.S. consumers each week,[14] and 72% every day.[15] By 1999 Anderson and Coate report that non-programme minutes exceeded "20 min per hour on some network television programs and 30 min per hour on certain radio programmes."[16] Multiply those ad spins by the number of listeners times the number of hours they spent on such unpleasant an activity, and this *massive* waste of time by audiences provides not only dramatic measure of diminished audience welfare but a proxy for the large toll imposed by ads on songwriters in the case of radio, and an even bigger pool of artists in the case of television.

The prevalence of ads, however, is not the only paradox afflicting songwriters, for regardless how big the pie is, it is only a few that get most of it. In many sectors of the economy, differences in the marginal productivity of capital or labor generally command proportional differences in interest or wages. But Taylor Swift has substantially higher number of spins than anyone else in the industry. Is that a reflection also of substantially higher talent? This question is not restricted to Taylor Swift: looking at the number of spins for all hits with the most radio air-time, the number "one" artists, and the few that follow them, generally command dramatically more spins than anyone else on radio. This metric tracks quite accurately the differences in income that artists derive from radio or TV airplay (as revenue is based

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[12] That advertising of products other than music generally annoys listeners is a common assumption in the economic literature in the field. *See* Sheila M. Campbell, Two-Sided Markets with a Negative Network Effect: Radio, Advertisers, and Audiences 6 (2006) (unpublished Ph.D. dissertation, Boston College)(on file with Boston College University Libaries).

[13] *See generally*, Pew Internet & American Life Project, *Artists, Musicians and the Internet*, 46-47, http://www.pewinternet.org/Reports/2004/Artists-Musicians-and-the-Internet/The-musicians-survey.aspx?r=1; Martin Kretschmer & Philip Hardwick, *Authors' Earnings from Copyright and Non-copyright Sources: A Survey of 25,000 British and German Writers* (2007), http://www.cippm.org.uk/downloads/ACLS%20Full%20report.pdf.

[14] Age 12 and older.

[15] *See* Arbitron, *supra* note 1.

[16] *See* Simon P. Anderson & Stephen Coate, *Market Provision of Broadcasting: A Welfare Analysis*, 72 REV. ECON. STUD. 947, 947-48 (2005).

on song air-time weighted by some measure of importance of the particular time-slot and medium), and indeed from other venues such as record sales.[17]

Furthermore, the few studies that evaluate the distribution of songwriters' income suggest that skewed revenue distributions are indeed likely a global phenomenon. Although data is privately held and hard to obtain,[18] a recent article by Kretschmer and Hardwick surveying empirical evidence on income distribution for songwriters in several countries, found for example, that only 2.4% of German songwriters "can live from their creative output."[19] The authors also noted "that in the UK, about 1500 (5%) composers/songwriters reach the average (mean) national wage from copyright earnings alone."[20]

So why are audiences forced to spend so much time on less rewarding activities than listening to Taylor Swift? Why is the part not taken by ads dominated by so few artists getting most of the available airplay? And why are these few artists earning disproportionately more than most other songwriters? In short, what explains the Taylor Swift paradox?

2.2 The Present State of Economic Analysis

Within economic theory, two strands of research have sought to explain two important aspects of what we call here the Taylor Swift paradox. Explaining how advertising levels are set in the media has been a long pursued endeavor of economic inquiry[21] but in the last decade, the most promising and influential developments have probably been made in the recent literature dealing with the economics of multi-sided markets.[22] On the other hand, answering why some artists and not others make it to

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[17] *See e.g,* REBUTTAL REPORT OF WILLIAM M. LANDES ON BEHALF OF NATIONAL MUSIC PUBLISHERS' ASSOCIATION, INC., THE SONGWRITERS GUILD OF AMERICA AND THE NASHVILLE SONGWRITERS ASSOCIATION INTERNATIONAL, 10 fn 13, , http://www.loc.gov/crb/proceedings/2006-3/copyright-owners/landes-rebuttal-statement-related-exhibits.pdf. Although the main text of the document containing royalty payments has been redacted, it can be reasonably inferred from the accompanying footnote that "the vast majority of Universal Publishing's songwriters" earned $10,000 or less in total royalties annually over the period from 2000 to 2006. With regard to the distribution of revenues from public performances in the U.S. there aren't any recent, publicly available statistics, and PROs keep this data private. However, the District Court in Buffalo Broadcasting Co. v. American Society of Composers, Authors and Publishers, 546 F. Supp. 274, 284 (S.D.N.Y. 1982), *rev'd*, 744 F.2d 917 (2d Cir. 1984), *cert. denied*, 469 U.S. 1211 (1985), stated "[T]he evidence clearly establishes that only a handful of leading composers secures the bulk of the benefits of the blanket licensing system. In 1979, only 13% of all ASCAP and BMI publishers received any television distributions and less than .8% received more than 75% of all ASCAP and BMI television performance royalties."

[18] *See* Martin Kretschmer & Philip Hardwick, *supra* note 13 at 61.

[19] *See id.* at 63 reviewing highly skewed revenues from Performing Rights society in the U.K.

[20] *Id*. at 61-62.

[21] *See generally*, Steven T. Berry & Joel Waldfogel, *Free Entry and Social Inefficiency in Radio Broadcasting*, 30-3 RAND J. ECON. 397 (1999).

[22] *See generally,* Jean-Charles Rochet & Jean Tirole, *Defining Two-Sided Markets* (2004), http://www.brousseau.info/semnum/pdf/2004-03-01_tirole.pdf; Simon P. Anderson & Jean J. Gabszewicz, *The Media and Advertising: A Tale of Two-Sided Markets*, CORE DISCUSSION PAPERS 2005088, Université Catholique de Louvain, Center for Operations Res. & Econometrics (2005). *See also*, Gregory S. Crawford, *Media Ownership Television Station Ownership Structure and the Quantity and Quality of TV Programming Author,* FCC: MEDIA OWNERSHIP STUDY NO. 3 (2007),

the top and why the earnings of some artists (i.e. superstars) appear to be far higher than those of most other artists has been the task of a different and analytically isolated strand of economic literature which may be grouped under the label of "economics of superstars." Although this latter strand has gained little in theoretical insights in the last decade, it remains a fertile field of empirical research in the music industry and elsewhere.[23]

There are, however, two other strands of economic inquiry, the economic analysis of payola and the economic analysis of copyright collectives, which while almost entirely oblivious to the inquiries of the previous two groups, are nevertheless key to understanding the Taylor Swift paradox. In fact, these four strands of economic research, when pieced together, provide the framework not only to solve problems that each in isolation has failed to address, but crucially, it allows us to *perceive*, for the first time, what many of those problems are.

In this section, I combine these four strands of economic research to portray the workings and malfunctions of a market larger than any of these strands of inquiry separately has managed to envision and examine. The Taylor Swift paradox, as we shall see, is not only avoidable, but is as much a cultural and market anomaly, as it is a curable deficiency of economic and legal analysis.

2.2.1 Copyright Collectives and the Price of Fame

Since 1897 U.S. copyright laws confer upon proprietors of copyrighted musical compositions the exclusive right to perform such works publicly and for profit.[24] Similar laws secure these rights for copyright owners in most countries.[25]

In the U.S. authors rely upon any of three PROs to license these rights, monitor their use, collect the royalties derived from such use, and distribute these royalties among the authors. ASCAP is the largest of the three PROs, BMI the second largest and close in size to ASCAP, and SESAC is by far the smallest of the three.[26]

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http://hraunfoss.fcc.gov/edocs_public/attachmatch/DA-07-3470A4.pdf; Lisa George, *Peer Review: Media Ownership Television Station Ownership Structure and the Quantity and Quality of TV Programming Author: Gregory S. Crawford*, http://www.fcc.gov/mb/peer_review/prstudy3.pdf, citing two-sided markets suggesting that many ads are not proxy for bad quality.

[23] *See* Mary Beckman, *No Recipe for Superstardom*, SCIENCE NOW, Feb. 9, 2006, available at http://news.sciencemag.org/sciencenow/2006/02/09-03.html. *See also,* Egon Franck & Stephan Nüesch, *Talent, Past Consumption and/or Popularity- Are German Soccer Celebrities Rosen or Adler Stars?,* (University of Zurich, Institute for Strategy and Business Economics Working Paper 2005).

[24] Act of Jan. 6, 1897, 54th Cong., 29 Stat. 481.

[25] The Trade-Related Aspects of Intellectual Property Rights Agreement requires in its Article 9.1 that members comply with articles 1-21 of the Bern Convention. Article 11 of the Berne Convention for the Protection of Literary and Artistic Works (Paris Text 1971) establishes: "(1) Authors of dramatic, dramatico-musical and musical works shall enjoy the exclusive right of authorizing:
(i) the public performance of their works, including such public performance by any means or process;
(ii) any communication to the public of the performance of their works."

[26] ASCAP has more than 370,000 members including U.S. composers, songwriters, lyricists, and music publishers *see* ASCAP, About ASCAP, http://www.ascap.com/about/ (last visited Feb. 6, 2010). ASCAP claims to represent "the world's largest repertory totaling over 8.5 million copyrighted musical works." *See* ASCAP, About ASCAP, http://www.ascap.com/press/2009/0817_women_behind_the_music.aspx (last visited Feb. 26, 2010).

Most songs publicly performed in commercial venues by music users such as commercial broadcasters, restaurants, and internet radio[27] in the U.S. are licensed by these PROs.[28] Almost all U.S. music authors (including composers, lyricists and music publishers) have granted either to ASCAP, BMI or SESAC the non-exclusive right[29] to license users to perform their compositions.

Put differently, the licensing practices examined in this article currently affect the livelihood of more than 700,000 lyricists, composers and publishers in the U.S. (hereinafter authors), and hundreds of thousands of authors[30] worldwide, influencing the distribution of income among creators, limiting their ability to break into new markets and compromising their participation in the fabric of our culture.

In most countries, when copyrighted songs are performed publicly—whether on radio, television, or in restaurants or supermarkets—it is safe to say that the venues offering such performances have probably obtained a public performance license from a PRO, and that said PRO has granted the license in terms nearly identical to any other PRO anywhere in the world.

Rather than granting licenses for individual songs, PROs generally license all of the songs contained in their repertories as a bundle, offering music users what is known as a *blanket license.* Under a blanket license, music users such as radio stations are allowed to play any and all songs contained in the *repertoire* of the PRO for a single fee which remains fixed regardless of whether they play popular or obscure songs, for either short or extended periods of time, or even play no songs at all—imagine an "all-you-can-eat music buffet." The price of fame is therefore obscured for users of the blanket license, which neither perceive relative prices of different compositions, nor economize on the use of songs based on the cost of each additional song. The cost of music licensing, is therefore for most music users a sunk, fixed and indivisible cost.

PROs are by and large responsible for this oddity in the pricing of music and have relentlessly ensured that licensing regimes, with these and other peculiar characteristics, remain in place. Regulators, law makers and courts across the globe have, in spite of fierce and persistent opposition from music users, for the most part, sided with PROs.

BMI claims it represents 400,000 songwriters, composers and music publishers with more than 6.5 million works, *see* BMI, About BMI, http://www.bmi.com/about/?link=navbar (last visited Feb. 6, 2010). SESAC states in its website that it is the smallest of the three PROs but does not state the amount of members, *see* SESAC, About US, http://www.sesac.com/aboutsesac/about.aspx (last visited Feb. 6, 2010).

[27] In addition to securing licenses from PROs webcasters need to secure mechanical rights from the Harry Fox agency.

[28] U.S. PROs also have reciprocal agreements with foreign PROs to distribute the revenues perceived by foreign authors in the U.S. and U.S. composers abroad.

[29] Non-exclusive means, in this context, that authors retain the ability to license music users directly through what are known as *source licenses* or *direct licenses*.

[30] In Europe and the U.S. alone there are more than a million authors who are members of PROs. GESAC that groups 34 societies in the European Union, Norway and Switzerland has nearly 500,000 members, *see* GESAC, Introduction, http://www.gesac.org/ (last visited Feb. 6, 2010) and ASCAP, BMI and SESAC amount to more than 700,000.

Because blanket licenses allow PROs to operate as a cartel of authors subjecting the entire national supply of songs to a single all-you-can-eat price (and the world supply of songs is in turn controlled by about 60 such organizations), PROs have often been tempted to leverage their monopoly power into abusive conditions for music users and authors and occasionally also to quash nascent competitors in the market. By harnessing market power through collective pricing, we shall examine, PROs have also distorted price levels in advertising and broadcasting markets globally.

Courts and competition enforcers around the globe in turn, have persistently sought to curve the behavior of PROs by ruling most of such exercises of market power as illegal and by crafting extensive and far reaching behavioral antitrust remedies to keep PROs in check.[31] As I explain below, however, the attempted remedies have been, and continue to be, not only a great burden for governments everywhere, but also remain painfully ineffective.

Of the many distortions created by PROs and their use of blanket licenses, those in broadcasting, and in particular in commercial radio, carry especially serious consequences, both because of the power PROs are able to exercise on radio, but also because of the impact that radio has on the livelihoods of songwriters.

Royalties paid by domestic radio and television stations alone represent today nearly 80% of the total revenues of the two largest PROs in the U.S., ASCAP and BMI, which in turn account for approximately 93% of all performance rights income in the U.S.[32] The relationship between copyright collectives and broadcasting, has therefore not only remained one of life and death for broadcasters, but presently shapes the nature of the rewards that are conveyed by markets to PROs and from PROs to songwriters. To a large extent therefore, the way in which commercial, advertised-based broadcasting values songs, will determine most of the opportunities that songwriters will have to flourish and the types of songs, genres and styles they will be incentivized to produce under such particular business model.

Modern economic analysis of broadcasting markets, we shall see next, to a large extent ignores this relationship, and in missing it, has failed to uncover a wealth of policy alternatives that can improve the welfare of audiences, songwriters and broadcasters.

2.2.2 Two-sided Markets (+1 Cartelized Significant Other)

The leading analysis of media markets in economics, by Anderson and Gabszewicz, portrays radio broadcasting as a two-sided market[33] where commercial

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[31] *See e.g.,* United States v. Am. Soc'y of Composers, Authors & Publishers, 2001 WL 1589999 (S.D.N.Y. June 11, 2011). *See*, GEMA JO (1971) L 134/15, (1971) CMLR D35; Interpar v. GVI, GmbH OJ (1981); case 127/73 Belgische Radio en Televisie v. SABAM (1974) ECR 313; Alden-Rochelle, Inc. v. ASCAP, 80 F. Supp. 888 (S.D.N.Y. 1948).

[32] *See* M. WILLIAM KRASILOVSKY ET AL., THIS BUSINESS OF MUSIC: THE DEFINITIVE GUIDE TO THE MUSIC INDUSTRY 142 (10th ed. 2007).

[33] *See* Simon P. Anderson & Jean J. Gabszewicz, *supra* note 22; s*ee generally,* Jean-Charles Rochet & Jean Tirole, *supra* note 22; Jean-Charles Rochet & Jean Tirole, *Platform Competition in Two Sided*

radio stations act as platforms catering to two sides: listeners that consume the broadcasted programs and advertisers who try to reach those listeners with commercial messages.[34] Because radio stations cannot decide who listens to their broadcasts but only what content to air—radio broadcasts are in this sense non-rival and non-excludable[35] in their consumption by listeners—stations maximize revenue by extracting it from only one of the sides: advertisers—the group they can easily exclude.[36]

Before being able to use the radio spectrum to broadcast their programs however, radio stations need to secure from the FCC one of a limited number of licenses available to broadcasters.[37] Because the demand for radio wavelengths suitable for wireless transmission (of radio programming in this case) is larger than the available spectrum, the FCC licenses the rights to use particular frequencies through auctions. The highest bidders are granted the licenses and hence generally forced to either recoup the bid amount through advertising or exit the market by transferring or selling their license to new entrants. The surviving radio stations tend, as a consequence, to be those that are best at maximizing profits through the sale of advertising space in their programming. In this sense, not only are advertising profits tied to the very life of stations, but it is simply not enough for stations to be able to cover their costs: they need to outperform most of their competitors competing not only *within* but *for* the market.

Advertisers seeking to reach large audiences with their commercial messages or ads are often willing to pay radio stations for the opportunity to do so, but to attract the other side—audiences with purchasing power that can appeal to advertisers—radio stations need to select an optimal mix of songs (expected to appeal to an audience likely to purchase advertised products) and advertising space.[38] While content is delivered to audiences by the platform, the platform is simultaneously delivering audiences to advertisers. The platform, in this sense, is simultaneously selling two products to two different groups. On the one hand, it is selling advertising space to advertisers (or put differently, delivering potential "shoppers" to advertisers), and on the other is delivering content (music, news, etc.) to audiences.[39]

The quality of both products is essential for maximizing the value of the platform—the radio station—and consequently the value of the bid for the broadcast license that the radio needs in order to operate.[40] Too much advertising is likely to annoy listeners and reduce the size of the station's audience and hence advertising

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Markets, 1(4) J. EUR. ECON. ASS'N. 990 (2003); Marc Rysman, *The Economics of Two Sided Markets*, 23(3) J. ECON. PERS. 125 (2009).

[34] *See* Simon P. Anderson & Jean J. Gabszewicz, *supra* note 22.

[35] *See* DAVID BESANKO & DONALD R. BRAEUTIGAM, MICROECONOMICS 659 (2d ed. 2005); *see also,* Simon P. Anderson & Stephen Coate, *Market Provision of Public Goods: The Case of Broadcasting* 1(NBER Working Paper 7513, 2000), http://www.nber.org/papers/w7513.pdf (last visited Feb. 6, 2010).

[36] *See* Simon P. Anderson & Stephen Coate, *supra* note 16 at 949.

[37] *See* FCC, About Auctions, http://wireless.fcc.gov/auctions/default.htm?job=about_auctions&page=1 (last visited Feb. 9, 2010).

[38] *See* Simon P. Anderson & Stephen Coate, *supra* note 16.

[39] *Id.* at 955.

[40] *See* FCC, About Auctions, *supra* note 37.

profits.[41] Too little allotted space for advertising might mean that the radio will not be able to extract any of the value they produce for listeners.

The ratio between songs (including Taylor Swifts') and plain advertising is therefore examined within the two-sided market literature as the resulting equilibrium reached when the marginal revenue of adding an additional ad would be zero.[42] That is, when the benefits of added returns of increasing advertising levels would be lost by losing a part of the audience at which those ads would have been aimed.[43] In this sense, when a Taylor Swift song is played on radio subsequently accompanied by some sort of advertising which audiences dislike, the analysis of broadcasting as a two-sided market currently concedes that this level of nuisance is likely a necessary evil if we are to listen to any songs at all by Taylor Swift or anyone else for free.

For this reason, for instance, advertising caps in either radio or television are often seen as risky regulatory undertakings.[44]

Furthermore, should some radio stations choose a less annoying but also less profitable path in programming, other radio stations that maximize profits through advertising would be able to outbid them in the purchase of their radio licenses. The FCC auction process, acts in this way as an effective police system that constantly forces radio stations to select the programming that can command the most profits (i.e. the programming where advertising is most effective). Because product sales are only a crude proxy for audience utility, we will examine below how this represents a problem. Before that, however, a more fundamental flaw needs to be examined.

While the two-sided market analysis of broadcasting, and in particular its modeling, is both elegant and commanding in explanatory power, it currently suffers from a rather critical shortcoming: the analysis is missing a side, entirely.

The missing side is songwriters, like Taylor Swift, who are neither the consuming audience nor your typical type of advertiser. Modeling a Taylor Swift song simply as an input, captures the fact that audiences seek her songs and derive utility from them, but it fatally misses that Swift also benefits from the airing of those songs, not only because she collects royalties as a provider of an input to radio, but as an advertiser of concerts, CDs, downloads and a vast number of other products. In this latter role, Swift is really no different than MacDonald's or Geico, save from the fact that her ads tend to be (for many at least) more pleasant than those of traditional advertisers.

This omission in modeling the dual role of songwriters as advertisers and content providers—which has the effect of squaring a multi-sided market into two-sided shoes—has important consequences for the analysis of how competitive structure and government regulation in radio broadcasting affect content and advertising levels. One such consequence, as we shall see in the next section, is to deprive courts and antitrust agencies of a theory of antitrust harm, which captures the effects of the pricing of music licenses on advertising levels and the distribution of

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[41] *See* Simon P. Anderson & Stephen Coate, *supra* note 16 at 952.

[42] *Id.* at 956.

[43] *See* Catherine Tyler Mooney, *A Two-Sided Market Analysis of Radio Ownership Caps*, 21 (2009), http://faculty-staff.ou.edu/T/Catherine.A.Tyler.Mooney-1/democaps.pdf.

[44] *See* Simon P. Anderson, *Regulation of Television Advertising*, 26 (2005), http://www.virginia.edu/economics/RePEc/vir/virpap/papers/virpap363.pdf.

songwriters' income. Another consequence is to obscure from view not only present market dynamics, but more importantly, what markets could look like under a better regulatory structure.

As mentioned above, commercial radio broadcasters need to reach an optimal mix of ads and songs (or other desirable content).[45] Modern merger analysis of commercial radio markets indeed attempts to predict how concentration will affect advertising levels in part trying to predict whether "the merged firm gains market power over listeners or advertisers."[46] A station with market power over audiences will be able to increase advertising time, and one with power over advertisers will likely be able to increase advertising prices by reducing available air-time for ads.

The role of the radio station and other platforms is, in this sense, to measure and understand the types and value of the externalities that each side (audiences or advertisers) imposes on the other and to balance them in such a way that the value of the platform is maximized.[47] Radio stations are thought to achieve this mainly through setting the *quantity* of ads and letting demand determine its price.[48] As advertisers annoy audiences with their ads in their effort to reach audiences, the analysis goes, they are willing to pay a price for such a right of intrusion which results in the financing of content that audiences enjoy but do not pay for. Songs in a way are held for ransom by advertisers, the price of the ransom being ads.

In a competitive market, a radio station with two air-time inputs, ads and songs, would continue to increase or reduce one input until the marginal revenue of adding say one additional ad equal the marginal revenue of adding an additional song. The problem here is that neither the advertising market nor the input market are competitive. By missing how songwriters—curious market chimeras, part content providers, part advertisers of records, concerts and the like—collectively price songs, modern economic analysis misses important market dynamics.

First, it fails to recognize that the price of advertising is set in two different pricing systems. On the one hand, traditional ads (generally less attractive to audiences) are supplied and priced in a competitive market where the advertiser that values air-time the most, will convey such value to the radio station through a bidding process subject to the maximum time constraints imposed by the radio station. On the other hand, non-traditional ads—i.e. songs—are priced by cartels of authors which effectively control, and supra-competitively price, nearly all the supply of songs in the market. This results, for instance, in having songs that could otherwise be priced negatively in a competitive market, priced instead at positive values. In the case of non-traditional ads, radio stations may still limit the available air-time for songs, but such limits will have no effect on song prices, they will only affect the prices of traditional ads.

Naturally, traditional ads are not perfect substitutes for songs but both types of ads do compete with each other over a range of potential output choices by

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[45] *See* Simon P. Anderson & Stephen Coate, *supra* note 16 at 956.

[46] *See* Andrew Sweeting, *The Effects of Mergers on Product Positioning: Evidence from the Music Radio Industry*, 18 (2010), http://econ.duke.edu/~atsweet/SWEETING_mergersJan10.pdf.

[47] In the case of radio, as measured by profits from advertising.

[48] *See* Sheila M. Campbell, *supra* note 12 at 17.

broadcasters—e.g. radio stations probably can't profitably run entirely on traditional ads and they need a minimum number of songs, but once that minimum number is reached, they are at liberty to select the optimal share of ads and songs that maximize profits.

Second, present models miss that as a consequence of competition within these two different types of ads, equilibrium levels of traditional ads are determined on the one hand by implicit song prices (concealed within a blanket license) which are determined in a cartelized market (not modeled), and on the other hand by competition between traditional advertisers, which even though they are able to capture a larger portion of available airtime—given high prices of songs—still have to compete among themselves. In other words, ads that are likely to please audiences (songs) are priced in a cartelized market while traditional ads, which are likely to annoy audiences, are priced in a competitive market. Radio stations, selecting inputs in the present market, will therefore consume more traditional ads and fewer songs than what they would if both advertising markets were competitive.

Given that the mechanisms that determine song prices are not contemplated in current models, these models may reasonably predict how changes in concentration levels in commercial radio may shift market power from advertisers to radio stations, and from audiences to radio stations, but the welfare effects of such shifts can only be poorly calculated without understanding how market power would shift between songwriters and radio stations. Furthermore, the models miss an even more important feature: the ability to predict what would happen to advertising levels if song prices were competitively set.

While incorporating song prices, pay-for-play and payola is useful for current economic modeling, for purposes of informing antitrust analysis, however, a simpler and more rudimentary approach suffices. One needs not determine precisely the magnitude of the shift in advertising levels but, as we shall see below, simply the direction of such change for anti-competitive effects to be presumed likely.

Current economic models predict that radio stations will set the levels of ads and songs at a profit maximizing level.[49] The profit maximizing distribution of advertising and programming time is therefore reached when the marginal revenue of an additional add equals the marginal revenue of an additional song. A supra-competitive price for songs, therefore necessarily shifts equilibrium to a level where more ads and less songs are used than in a competitive market.

In the graph below we can see that given an isocost curve C1 (the competitive market), a radio station will produce programming A (the profit maximizing ratio of song to ads at C1), consisting of an amount of songs per hour (or year) S1 and an amount of ads per hour A1. However, when the price of songs increases relative to ads (the cartelized song market), the radio station will now face an isocost curve C2, which will cause a reduction in the amount of songs played (S2) and an increase in the amount of ads aired (A2).

[49] For ease I do not include news because songs are by far the largest part of radio programming, but the level of songs versus ads should also be presumed to be set by stations at a profit maximizing level.

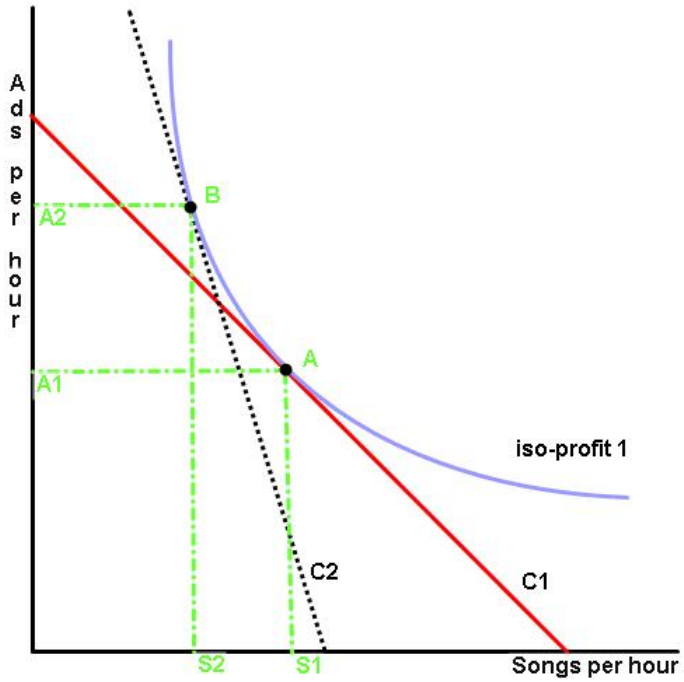

Figure 1

One way of understanding this phenomenon is to think that from the perspective of radio stations, songs and ads are simply the same type of two-dimensional input (just like labor and capital). The input provides a level of utility/disutility (first dimension) at a price either positive or negative (second dimension). Songs and ads, under this framework are indistinguishable to broadcasters, save for the fact that they tend to be situated at different ends of the utility (that they elicit from audiences) spectrum. Whichever combination of the two inputs maximizes profits will be the combination selected by the station.

Presently, these two types of inputs are also situated at different points of the price spectrum. But this location is an arbitrary one, as it does not reflect the differences in the capacity of particular inputs to elicit utility, but rather is the product of pricing anomalies in a cartelized market (that happens to be a group of high-utility input producers). Under such a system, annoyance costs are therefore priced differently than what they would be in a competitive market. In other words, it is cheaper for radio stations to annoy audiences than what it would be absent a songwriters' cartel.

What are the welfare consequences of this shift? First, radio stations seem to be worse off. Because traditional ads are not perfect substitutes for songs, songwriters retain market power, and their collusion can in fact raise song prices. The cartel is therefore likely to extract higher royalty payments from commercial broadcasting than what songwriters as a whole would get in a competitive market.

Individual songwriters however, do not all benefit from this shift in equilibrium levels. In fact, most don't. Unlike a traditional monopolist, who is capable of reducing its output to increase profits, when PROs increase prices and

force broadcasters to air more ads, the output that the PRO is restricting is both individual songs and songwriters. Those songwriters that are excluded from the market, importantly, don't get to participate in the larger royalty pie they helped generate by colluding, because all PROs distribute royalties based on actual air-time. Therefore, only songwriters whose songs are played receive the benefit of supra-competitive prices that all colluding songwriters helped create.

Depending on the structure of the market, traditional advertisers may either benefit from a cartelized song market, as competition with songwriters is less fierce and therefore available air-time for traditional ads is expanded, or may actually suffer from it if more competitors are allowed to advertise competing products on radio and such competition results in a zero sum game where advertising results in business stealing rather than in expansion of demand. In this sense, while songs are a type of advertising with positive externalities on traditional advertising (the more songs the more valuable traditional advertising becomes), if songwriters became more competitive, advertising spots on radio would become more expensive for traditional advertisers. As traditional ads impose negative externalities on other advertisers however—either through business stealing or by saturating the audience with ads that annoy them—it is unclear whether the gains from avoiding such negative externalities would be higher than the price increases in advertising spots.

Whatever gains traditional advertisers might have, however, those gains will be at best a wash considering the loss in advertising value that the excluded songwriters suffer—if they did not, then traditional advertisers would have been able to outbid songwriters to begin with, without the additional help of the cartel. This assumes, of course, that both traditional and non-traditional advertisers would be equally able to turn the additional value they receive from radio advertising (e.g. increased product sales) into higher bids for advertising time.

Audiences and broadcasters, on the other hand, are necessarily worse off. Audiences, because they are served more annoying ads than a competitive market would provide, and broadcasters because they are paying artificially inflated prices for songs. Additionally, depending on own-medium and cross-media elasticities, commercial radio stations may also be suffering additional losses if the current profit maximizing equilibrium (in a cartelized market) is leading some listeners to switch to CDs, iPods, to other competing platforms or to not listen at all. Reduced profitability of commercial broadcasters further trickles down to the value they are willing to pay for broadcast licenses in FCC auctions, which further hurts tax-payers.

Therefore, if the gains of traditional advertisers are offset by losses from excluded songwriters and the deadweight loss of higher song prices (e.g. a radio station that would have been able to operate at lower song prices or reduced ad levels), and audiences, broadcasters and tax-payers are worse off, then social welfare under the current system is undoubtedly reduced and the present level of ads is sub-optimally high.

In this sense, present analysis misses that this way of pricing music has a dramatic and negative effect on the equilibrium levels of advertising in radio and television and, perhaps most importantly, it fails to provide insight into how this pricing system of global reach can be in fact changed in a way that improves social welfare worldwide. The system, we shall see, depends on faulty legal analysis, and

improvements in such analysis should render current pricing practices no longer viable.

But how does extending the model in this way bring us closer to answering the Taylor Swift paradox? Taylor Swift and most other songwriters often produce songs which audiences like and for which they are willing to endure the traditional annoyances imposed by advertising on radio and television. For all intents and purposes, songs by Taylor Swift are often considered content.

At the same time, as mentioned earlier the same song that audiences crave often constitutes a type of advertising for Taylor Swift who is engaged in the production of a bundle of products and services—which for the most part display often positively correlated demand functions—of which the broadcasted song is only one element. The other parts of Swift's bundle of products are, for example, concerts, downloads, CDs, t-shirts, ringtones, clothing, perfumes, musical instruments, game soundtracks, movie soundtracks, and countless other products.[50]

Naturally, I don't mean to suggest that the fact that songs constitute a type of advertising has been missed by the economic literature. Professor Coase[51] eloquently stated as much when condemning the effort to reduce payola[52] in the music industry as inefficient. Recent economic analysis, while more ambivalent in its judgment of the practice[53] and its welfare consequences,[54] also acknowledges this advertising relationship—even when recent commentary narrows the scope of the advertising effects of radio airplay to the individual artists, rather than, for example, the record industry as a whole.[55]

My contribution rather is to suggest that Professor Coase missed then, and economic analysis of payola still fails to grasp today[56] three fundamental aspects of the payola and pay-for-play markets:

(a) that payola and pay-for-play are only a tiny part of the still largely inactive song-advertising market whose vast magnitude has not yet been fully captured by markets—to do so, we need to design the new type of market that relies on modern transactional platforms. Blanket licenses surely distort a large domain of payola

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[50] *See e.g.*, Jon Pareles, *Songs from the Heart of a Marketing Plan*, N.Y. TIMES, AR1 Dec. 24, 2008, available at http://www.nytimes.com/2008/12/28/arts/music/28pareles.html?_r=2&ref=arts, noting how the value of the bundle increasingly affects creative behavior and timing of release.

[51] *See generally*, Ronald H. Coase, *Payola in Radio and Television Broadcasting*, 22(2) J. L. & ECON. 269 (1979).

[52] Payola is the practice of making undisclosed payments in exchange for airtime. Under FCC rules, payola is punishable by a fine not to exceed $10,000 or imprisonment for up to one year or both. On the other hand when authors make direct payments to stations in exchange for airplay, the practice is commonly called *pay-for-play* and it is legal if adequately disclosed.

[53] *See* Marie Connolly & Allan B, Krueger, *Rockonomics: The Economics of Popular Music*, 48, http://www.irs.princeton.edu/pubs/pdfs/499.pdf, for instance suggests that "[p]ayola is analogous to a professor paying bribes."

[54] *See id.*, stating "[w]hether or not the current laws are optimal for the society is a good question for economists."

[55] *See id.*, stating "Liebowitz (2004a) points out that even though radio spins seem to increase sales of the particular record being spun, it does not mean that the recording industry as a whole benefits from radio broadcasting. Indeed, record sales fell in the first half of the 1920s after the popularization of the radio."

[56] *Id.*

prices. But even with relative prices for songs in place, songwriters would not be able to transact with every possible radio station that may want to play their songs. This being so, because while blanket licenses solved some transactional inefficiencies arising out of trading in the positive domain of song prices—all radio stations can easily *pay* for music—they have not solved the transactional hurdles of matching authors and radio stations when songwriters would be willing to pay, and stations willing to *get paid* for the airing of a song—the domain of negative song prices. Payola, in this sense, is as primitive a market approach as we can possibly have without resorting to barter;

(b) that payola creates a safety-valve for efficient flow of information related to audience listening preferences[57]—a positive externality suppressed in the current pricing system that most other types of ads do not exhibit and that only becomes apparent when payola is examined in conjunction with blanket license pricing;

(c) that payola is more efficient than other types of advertising because it inexpensively conveys information as to both product consumption *and* listening utility (and how intense this utility is as measured in willingness to pay for downloads, for example) which benefits broadcasters and audiences in ways that traditional advertising does not. These externalities will become clear momentarily within the context of a three-sided market analysis, but the way to remedy them lies, not primarily in the elimination of anti-payola regulations (which much like Coase, I advocate should be eliminated), but in changing drastically the way in which music is licensed.

Now, returning to the analysis of the Taylor Swift paradox, if songs constitute a type of advertising for other products in Swift's product bundle, how is it that the price of her songs, as determined by the blanket license, is always positive? After all, songwriters are interested in maximizing the value of the bundle, rather than any particular part of it—such as the value of the royalties derived from radio air-time. If not Swift, shouldn't we expect that at least some songwriters, less successful than Swift, be charging negative prices and be more willing to compete for radio air-time?

Songwriters not charging negative prices are an anomaly caused by the blanket license. Song prices should (and can) *constantly* affect advertising levels, or at least as frequently as changes in demand conditions affect the prices of spots for all other types of ads. That they don't is a reflection of the poor performance of a cartelized market (allowed by poor enforcement of antitrust laws); that they can, suggests that pricing songs efficiently can lead to reducing the levels of advertising globally while increasing the efficiency of commercial broadcasting and the welfare of audiences. But why would hundreds of thousands of authors worldwide abide by a system of blanket licenses that harms most of them? The answer offered in the next section is that songwriters do not abandon the blanket license or PROs for that matter because they can't do so and remain profitable.

Before going into the reason why songwriters behave in this way however, the more immediate reason why song prices under this system currently don't affect advertising levels in real–time, is because PROs, by adopting blanket licenses, are in fact executing a type of hands-tying agreement by which songwriters refuse to engage

[57] It increases market information as to intensity of utility and enhances programming efficiency.

in price competition with all other songwriters, and all other advertisers (non-songwriters) who compete against them for radio air-time.

On the one hand, PROs make take-it-or-leave-it offers to radio stations, which each year must secure public performance licenses from PROs to be able to play any and all songs contained in their repertory.[58] The cost of this license is therefore a sunk and fixed cost for radio stations, and regardless of whether they play many or no songs at all, they will still have to pay the blanket license fee and the price of the license will be the same regardless of its use.

This take-it-or-leave it offer successfully restrains competition between songwriters and all other types of advertisers, who are otherwise required to bid constantly for advertising spots on radio throughout the year. The reason the scheme succeeds is because radio stations simply can't air only common ads and no songs. Songs are, as mentioned above, a superior form of advertising that also produces utility for audiences.

On the other hand, through blanket licenses PROs are able to suppress competition between songwriters which would drive down the price of songs for radio stations. PROs are able to do this, because the group of songwriters that ends up getting air time will be able to charge supra-competitive prices for those aired songs. On the other hand, the group of songwriters (the majority) which as a consequence of the higher price and restricted output will not be able to earn any revenues at all, will still be bound by the blanket license for exiting the blanket license, as we shall examine in the next section, is a practical impossibility. Furthermore, this cartel mechanism is furthered by anti-payola regulations which by making it more expensive for songwriters to advertise on radio (pay-for-play) than for any other type of advertisers, actually serve to protect blanket licenses from price competition.[59]

By increasing the price of a vast number of songs implicitly above their competitive level the blanket license creates a variety of harms. First, as past market behavior suggests, many authors are willing to offer their songs for free[60] and even incur costs for airplay that they do not recoup with public license royalties. Because this is often a rational profit maximizing strategy meant to stimulate sale in adjacent product markets such as CD sales or concert sales,[61] we can infer that at least some songs would be available at zero cost and some also at negative prices but for the existence of the blanket license. Higher (positive) licensing prices naturally make it impossible for a radio station to subsist entirely on music programming funded by songwriters, and so the market is immediately deprived of such type of competition and is forced to pay higher prices for songs and increase advertising levels.

Second, the blanket license distorts competition between songwriters *vis-à-vis* all other advertisers. As we have seen, radio stations will normally select the optimal ratio of songs-to-advertising that maximizes profits. The minimum amount of songs a radio will air is constrained at the bottom from competition from other radio stations

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[58] For a discussion of direct licensing *see* Section 3.

[59] Marie Connolly & Allan B, Krueger, *supra* note 53, notes "[m]ost of the pressure to outlaw payola came from ASCAP, which lost ground to BMI-licensed rock and roll records from small independent record labels during the 1950s."

[60] *See* CHRIS ANDERSON, FREE: THE FUTURE OF A RADICAL PRICE (2009).

[61] *See* M. WILLIAM KRASILOVSKY ET AL., *supra* note 32 at 380.

and competing media, and at the top by the fact that radio stations, at the moment, can only profit (mostly) from ads, which they need to include in their broadcasts. Radio stations, will therefore increase the amount of ads until the marginal revenue of adding an additional ad equals the marginal revenue of adding an additional song to their program. This ratio will consequently be affected by songwriters' inability to bid for airtime and adjust their prices to compete with other advertisers, as the marginal revenue of adding an extra song is directly related to the price of that song. In the graph below, we can see how P1 which marks the profit maximizing point at a given ratio of ads and songs gets displaced to a new equilibrium level P2, where the higher relative costs of songs (or higher revenues conveyed by other types of ads) force radio stations—which maximize profits, not audience utility—to decrease their usage of songs below socially optimal levels.

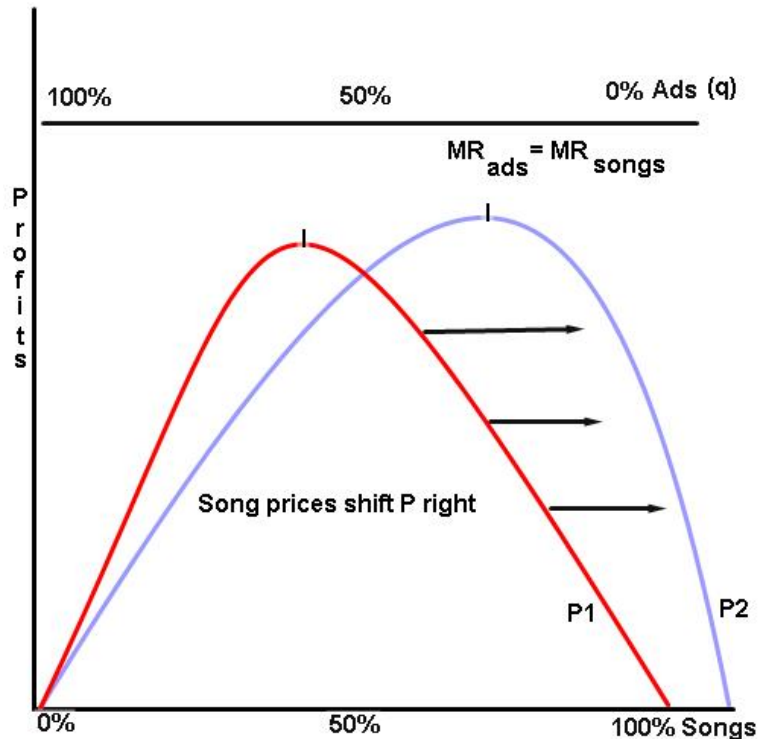

Figure 2

The effects of the blanket license described above are indeed harmful in additional ways. Because radio stations demand more regular ads than songs as a consequence of the cartel pricing, radio programming delivers less utility to audiences. This decrease in utility does not result in higher profits for the station (or in higher bids for broadcast licenses in FCC auctions) but is only partially captured by PROs in the form of a higher price for the blanket license. So audiences are hurt, broadcasters are hurt (because they have higher licensing costs or receive lower bids for air-time), but surprisingly, most songwriters are also worse off.

In what is perhaps the most powerful, enduring and absurd cartel ever devised, most songwriters, which collaborate to license all output under a blanket license, are actually harmed by the blanket license which concentrates market power to increase prices but distributes the proceeds of those increased royalties only to the few songwriters that were lucky enough to get air-time. Because air-time for songwriters is, as we just saw, substantially reduced as a consequence of higher song prices—which force radio stations to air more ads—concentrating market power only benefits the few lucky winners of the blanket "lottery."

Remarkably, when the National Association of Broadcasters (NAB) sought to reach an industry-wide agreement to reduce advertising levels—which were considered "excessive"—the Antitrust Division of the DOJ successfully challenged the conduct and dwarfed the efforts of broadcasters,[62] under the theory that maximum advertising caps would increase advertising prices in violation of Section 1 of the Sherman Act.

The government theory—still dominant—would have perhaps been a sensible one if the government had not rejected advertising caps while simultaneously allowing a cartel imposing higher prices for songs, the main competitor of "regular" ads. But in the context of a DOJ-structured song cartel, the ban on advertising caps simply results in implicit, welfare-reducing subsidies for advertisers, which hurt audiences and songwriters.[63]

On the other hand, granting antitrust immunity to broadcasters developing "conduct codes," as proposed by Minow and Lamay,[64] may indeed present complex problems related to the threat of anticompetitive agreements (allowing broadcasters to exercise market power over advertisers), but tackling the problem from the songwriters' side—as proposed here—while perhaps not achieving all outcomes envisioned by Minow and Lamay, would surely help diminish both the concerns raised by these authors and any competitive concerns the DOJ may have regarding the competitiveness of broadcasted advertising markets.

In the context of asymmetric antitrust enforcement, and collective action problems that hurt most songwriters *vis-à-vis* a few lucky songwriters and all other types of advertisers, it is easy to understand why markets developed "payola itches" from the blanket lice(nse). The blanket lice(nse) suctions market power from individual songwriters to grow in size and in price, but this parasitic relationship does not serve the majority of the hosts well.

First, most songwriters suffer from output reductions in radio airtime (shifted to advertisers) as a consequence of forcefully diminished price competition *vis-à-vis* advertisers. Second, because radio airplay is positively correlated with demand of

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[62] *See* United States v. Nat'l Ass'n of Broadcasters, 553 F.Supp. 621 D.D.C., 1982.

[63] While the systemic effects of this enforcement action have never been properly examined in conjunction with the effects of the DOJ-sponsored songwriters' cartel, the action of the DOJ was nevertheless fiercely criticized at the time, and remains under attack today by authors such as Minow and LaMay who advocate for an antitrust exemption to broadcasters allowing them to develop a code of conduct that would protect audiences and children from excessive advertising. NEWTON N. MINOW & CRAIG L. LAMAY, ABANDONED IN THE WASTELAND: CHILDREN, TELEVISION, AND THE FIRST AMENDMENT 53 (1995).

[64] *Id. at* 168.

other products in the songwriters' product bundles (such as CD sales or song downloads), songwriters also experience losses in these neighboring markets. These two harms naturally elicit the development of coping mechanisms such as payola, which from another perspective, is simply a manifestation of the tendency of songs to gravitate towards "sticky" competitive market prices—that are attracted to the more competitive orbits of the other items in the bundle.

2.2.3 Revisiting Superstardom in Three-sided Markets: Two Additional Explanations on Why Artists' Revenues are Skewed in Welfare Decreasing Way

The behavior of this bizarre cartel, in which most of its members suffer, brings us to the second strand of literature that has examined the phenomenon of superstars for decades, without paying much attention, in the case of the music industry, to how the prices of songs—determined in this case by the blanket license and by anti-payola regulations—actually trigger many of the familiar features associated with superstar markets.

In 1981 Sherwin Rosen inaugurated a new domain of economic inquiry with the following prologue:

> The phenomenon of Superstars, wherein relatively small numbers of people earn enormous amounts of money and dominate the activities in which they engage, seems to be increasingly important in the modern world … in certain kinds of economic activity there is concentration of output among a few individuals, marked skewedness in the associated distributions of income and very large rewards at the top.[65]

Enormous amounts of money alone, however, were not enough to describe the economic phenomena Rosen envisioned, "talent" needed to be the driver of those earnings, the reason why some individuals and not others amassed disproportionate wealth. The popular music and the recording industry—identified by Rosen as likely candidates for the appearance of stardom effects—have since been a favorite playground for testing empirically the superstardom hypothesis, but the task has proven difficult and proof for this hypothesis remains elusive.[66]

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[65] *See* Sherwin Rosen, *The Economics of Superstars*, 71(5) AM. ECON. REV. 845 (1981).

[66] For a review of the most recent empirical work *see* David E. Giles, *Superstardom in the U.S. Popular Music Industry Revisited*, 92(1) ECON. LETTERS 68 (2006). *See generally,* William Hamlen, *Superstardom in Popular Music: Empirical Evidence,* 75 REV. ECON. & STAT. 729 (1991); William Hamlen, *Variety and Superstardom in Popular Music*, 32 ECON. INQUIRY 395 (1994); Sherwin Rosen, *supra* note 65; Sherwin Rosen, *The Economics of Superstars*, 52 Am. Scholar. 449 (1983); Moshe Adler, *Stardom and Talent*, 75 AM. ECON. REV. 208 (1985) and W. Mark Crain & Robert D. Tollison, *Consumer Choice and the Popular Music Industry: A Test of the Superstar Theory,* 29 EMPIRICA 1 (2002). *See* Raymond A. Cox et al.*, The Concentration of Commercial Success in Popular Music: An*

William Hamlem[67] delivers a sharp reminder of this failure in the analysis of the popular music industry:

> The end result is that while quality is rewarded, the rewards, on average, are less than proportional to the quality differences. In this case superstardom exists only in the "layman" sense of the term, not in the sense described by Marshall and Rosen. Those who believe they have found empirical evidence of superstar phenomenon in different enterprises are frequently examining only the measures of success and are failing to compare these to some objective and external measure of quality or ability.

Furthermore, beyond the difficulties entailed by empirical inquiry, the core assumptions as to how superstars emerge are also disputed. While Rosen anticipated that small differences in talent would be able to account for larger than proportional differences in the income of creators—given that technology would make the replication and massive supply of the "best" works (e.g. the best songs) feasible and efficient—Adler suggested that factors other than talent, namely popularity and past consumption, could create similar skewed income distributions for authors.[68] These two competing theories of superstar formation still divide much of the economic literature that focuses its inquiry on the process of formation of superstars, authors occasionally referring to *Adler Stars* or *Rosen Stars* to suggest which theory appears to account for specific instances of superstardom more accurately.[69]

The examination of artists' earnings and air-play within the context of three sided-markets presents two novel explanations as to why earnings may be concentrated in a few superstars and nevertheless not correlate robustly with the theory that small differences in talent or trend account for more than proportional increments in earnings. These two additional explanations, I should note, are not meant to replace but rather complement the hypothesis of talent and popularity in explaining economic phenomena that must likely recruit all explanatory theories.

The first factor contributing to concentrated revenues is reduced airplay for songwriters. If airplay available for songwriters decreases as a result of the blanket licenses—which stifles competition between songwriters and other types of advertisers—and anti-payola regulations—which make songs more expensive to stations and airplay more costly to songwriters—and if airplay is positively correlated with sales of other products in the songwriters' product bundles such as concerts,

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Analysis of the Distribution of Gold Records, 19 J. CULTURAL ECON. 333 (1995). As recently as 2007 a team of researchers at Columbia University tried to identify, in a study that presented some methodological problems, the relationship between peer effects and absolute talent differences in the success of a sample of artists, *see* Mary Beckman, *supra* note 23.

[67] *See* William A. Hamlen, *supra* 66.

[68] *See generally,* Moshe Adler, *supra* note 66.

[69] *See* Egon Franck & Stephan Nüesch, *supra* note 23.

downloads, etc. then it seems likely that reduced available airtime restricting song-advertising might also concentrate sales in all related markets in fewer artists.

This is indeed especially likely given that the two other product markets in which nearly all songwriters operate, and from which they generally obtain a large share of their royalty payments,[70] song downloads[71] and record sales, are also dominated by uniform pricing systems and seem prone to "creative" pricing methodologies.[72]

At a higher level of generality, the following analogy may be instructive for understanding why revenues are skewed in this way: songwriters are inputs for two types of firms, PROs and Record Companies (the majors). It is the latter two rather than songwriters who price song licenses, records and downloads. As any monopolist would do, these firms maximize profits by restricting output and increasing prices. The output here are songwriters—and their songs—and the way in which these firms increase price (and reduce output) is by preventing competition between their output units, songwriters. In traditional markets, we don't pay much attention to the lucky units that get sold or the unlucky ones that are shelved by the monopolist to keep prices high. In music markets, however, we call the first type of unit "superstars," and the shelved one the "average songwriter."

The second factor that contributes to concentrated revenues is the fact the profits of songwriters are now an externality for radio stations who cannot profit from CD sales or downloads, as much as they can profit from the sale and consequent advertising of all other products such as cars, insurance or fast food. Because less songs are aired, and radio stations profit less from airing those songs, (they either pay positive prices or it is much more expensive to advertise songs for songwriters than any other product because of disclosure requirements in anti-payola regulations of which other products are exempted) stations will favor other advertisers, and will select the songs that attract only those audiences that can purchase the group of products that the station advertises. Songs with commercial appeal—i.e. the ability to attract audiences that purchase advertised products—will be selected rather than songs that result in CD or concert sales. Songs that attract richer demographics will be preferred to songs that attract poorer demographics, even if the former result in lower aggregate listening utility than the latter.

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[70] *See* M. WILLIAM KRASILOVSKY ET AL., *supra* note 32 at 120, table 14-2 shows a breakdown of publishers' income which in most cases closely matches the breakdown of an average songwriter. EMI music for instance: 54% Mechanical, 35% performance, 10% Synchronization, 12% Print.

[71] *See* Ben Shiller & Joel Waldfogel, *Music for a Song: An Empirical Look at Uniform Song Pricing and its Alternatives*, (NBER Working Paper No. 15390 2009), http://www.nber.org/papers/w15390.

[72] *See* Chad Bray, *Recorded Music Price-Fixing Suit Reinstated*, WALL ST. J., Jan. 14, 2010, http://online.wsj.com/article/SB10001424052748704675104575001152036653136.html. *See also,* Starr v. Sony BGM Music Entm't, F.3d , 2010 WL 99346, (2d Cir. Jan.. 13, 2010); Claudia H. Deutsch, *Suit Settled over Pricing of Recordings at Big Chains*, N.Y. TIMES, October 1, 2002, http://www.nytimes.com/2002/10/01/business/media/01DISK.html?scp=2&sq=price%20fixing%20records%20cd&st=cse. *See also,* Record Companies Settle FTC Charges of Restraining Competition in CD Music Market: All Five Major Distributors Agree to Abandon Advertising Pricing Policies, May 10, 2000, http://www.ftc.gov/opa/2000/05/cdpres.shtm. *See also*, Federal Trade Commission, Analysis to Aid Public Comment on the Proposed Consent Order, http://www.ftc.gov/os/2000/05/mapanalysis.htm (last visited Feb. 27, 2010).

In other words, since not all songs have the same commercial appeal for broadcasters—some songs attract more profitable demographics or demographics more likely to purchase advertized products and this is not necessarily correlated to audience utility[73]—but songs are nevertheless priced equally within the single blanket license price, broadcasters have distorted incentives to select the commercially appealing songs while songwriters with less "commercial" appeal—but songs that nevertheless may elicit higher utility in audiences—are unable to compete in prices. Additionally, because song-advertising through payola is inefficiently discouraged, they are also less likely to compete in this way. This variety-reducing effect of blanket licenses provides a culturally worrying explanation for a type of superstardom that unlike the talent-based or popularity-based versions, is less likely to enhance audience utility and social welfare.

Because neither one of these explanations has ever been advanced to illuminate stardom effects, the appeal of the superstardom theory as a natural byproduct of differences in talent empowered by technological advances still holds a lot of appeal in both law and economics. In this sense, beyond enriching economic inquiry in the field of superstars, the existence of *undesirable* superstardom effects has important normative implications for the analysis of income distribution among PRO members.

Recently the *superstar phenomenon* in its Rosen incarnation was advanced by Katz as a potential explanation for the fact that "only a small minority of copyright holders receive most of the royalties" distributed by PROs[74] suggesting that given the existence of the "superstar phenomenon (which the blanket license, might accelerate, but not necessarily create) … the skewed distribution [of royalties of PRO members] itself does not disprove the utility of the blanket license, which allows the user to get timely licenses from every superstar."[75]

The examination of licensing practices presented in this article suggests exactly the opposite result. It should be blanket licenses and anti-payola regulations rather than superstar effects that should be considered the *prima facie* suspects in distorting royalty distributions. Today, there is simply no empirical evidence confirming superstardom effects in the sense economic theory proposes. Surely, there are highly concentrated revenues in the hands of a few, but the economic theory of superstardom requires that these differences be explained by differences in talent, or some other factor such as bandwagon effects, etc. On the contrary, skewed income distributions, can be easily traced to blanket licenses (under a multi-sided market analysis) under the rationales examined above, without the need to attribute income differentials to *any* differences in talent—that is, even assuming talent constant, the introduction of blanket licenses in a market is likely to skew the distribution of income of songwriters in a way that decreases social welfare.

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[73] *See* Philip M. Napoli, *Audience Valuation and Minority Media: An Analysis of the Determinants of the Value of Radio Audiences*, 42 J. BROADCASTING & ELECTRONIC MEDIA 169 (2002).
[74] *See* Ariel Katz, *The Potential Demise of Another Natural Monopoly: Rethinking the Collective Administration of Performing Rights*, 1(3) J. COMPETITION L. & ECON. 541, 573 (2005).
[75] *Id*. at 573.

After the unnecessary and misguided distortions introduced by blanket licenses and anti-payola regulations are removed it will surely make sense to reassess royalty distributions under the light of a superstar theory attentive to talent, past consumption and "commercial appeal." Section 3.2 proposing a new market structure based on auctions (and adding the trading of exclusive rights) on the other hand, augurs difficult times ahead for those trying to predict future income distributions based on superstar dynamics.

2.2.4 Economic Analysis of Copyright Collectives

Commercial radio is one of the leading determinants of CD sales and music downloads, and yet, while economic literature has focused on the symbiosis between radio and CD sales, and also on the pricing of blanket licenses, it has failed to integrate the analysis of CD sales and other products in the bundles produced by songwriters with the pricing of blanket licenses. The most troublesome complication that such isolated analysis has produced resides in praising the use of blanket licenses as efficient pricing mechanisms by collectives (better indeed than *à-la-carte* pricing), while simultaneously lamenting how excessive use of songs by the radio industry actually cannibalizes CD sales, all without linking the pricing of songs in broadcasting, with song usage, and ultimately substitution.

Unfortunately, the economic analysis of copyright collectives as isolated market institutions, which continues to dominate both the legal and economic literature, remains also a powerful influence within modern antitrust analysis. The main effect of such influence is that the very legality of PROs and their pricing practices, remains evaluated under a fragmented analytical framework which is incapable of detecting the grave harms that the multi-sided market analysis presented above exposes. Conversely, the main advantage of this situation, is that a proper evaluation of the harms and relative efficiencies of blanket licenses, are already well within the framework of a balancing regime that is capable of declaring the practice illegal. In the next section I examine why such declaration provides indeed a welfare maximizing outcome, and why declaring blanket licenses illegal is not only efficient but indeed compelled by proper antitrust analysis.

3 THE LEGAL DETERMINANTS OF THE PRICE OF FAME ANOMALY

The legal analysis and policing of broadcasting, advertising, and music licensing markets is presently burdened with both unsystematic and self-defeating efforts which result in large and unnecessary welfare losses. U.S. Courts, the DOJ and the FCC regularly pursue policies which not only undermine the efforts of one another, but that are in fact internally inconsistent with their stated goals.

At the heart of the enforcement anomalies in these markets, lies the legal status of PROs and their licensing practices, which initiate the cycle of pricing distortions that we examined in the previous section, collectively referred in this article as "the price of fame anomaly." The price of fame anomaly has as much a legal life as it has an economic one, with effects that, while pervasive, still elude the legal analysis and regulation of broadcasting, advertising and music licensing markets.

As we discussed earlier, because the price of fame anomaly entangles cause in one market to effect in another, isolated policies by the FCC—which undermine the quality and diversity but increase the price of songs in one market[76]—presently interfere with DOJ policies struggling to foster competition between songwriters in the issuing of public performance licenses.

Furthermore, the effect of coalescing FCC and DOJ policies is not only to disturb market dynamics in the supply of music by songwriters and the demand of music by broadcast, but also to sub-optimally increase advertising levels in commercial broadcasting—thereby reducing the welfare of audiences. In response to high advertising levels, the FCC has successfully capped the amount of advertising directed to children, but has found itself unable of capping all other types of advertising—in other words, the FCC has so far failed to curb high advertising levels which the agency itself is triggering, at least partly, through anti-payola regulations. The control of excessive advertising, in this sense, has been for the most part a lost legal battle for advocates of advertising caps—the protection of commercial speech largely shaping the arguments defeating advertising caps.[77]

To untangle this largely Sisyphean regulatory enterprise, we need to defuse the price of fame anomaly, both by improving markets and their licensing platforms, and also by modifying the laws, agency policies and misguided judicial analysis that help generate the anomaly. The argument of this article is to suggest that, to elicit changes in market structure, we must first reexamine the legal analysis that preserves current licensing structures. Proper legal analysis, I argue, compels a declaration of

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[76] For example, anti-payola regulations.

[77] *See* NEWTON N. MINOW & CRAIG L. LAMAY, *supra* note 63 at 76 and *see also,* Matt Getz, "*Drowned in Advertising Chatter": The Case for Regulating Ad Time on Television*, 94 GEO. L. J. 1229 (2006). *See also* Cass R. Sunstein, *Free Speech Now*, 59 U. CHI. L. REV. 255, 258 in THE BILL OF RIGHTS IN THE WELFARE STATE: A BICENTENNIAL SYMPOSIUM (Geoffrey R. Stone, Richard A Epstein & Cass R. Sunstein eds. 1992).

current licensing practices as illegal under U.S. antitrust laws and opens the way to several remedial alternatives—notably among them the deployment of modern transactional platforms—which can obviate the need for rate courts and government oversight by turning markets competitive for the first time in nearly a century.

The analysis in this section therefore challenges dominant theories related to the desirability of PROs and the competitive effects and legality of their licensing practices.

3.1 PROs and the Blanket License: Testing Legality under the Rule of Reason

The blanket license, the culprit behind most of the distortions identified in the preceding section, remains today the single most important mechanism for licensing music worldwide: nearly every copyrighted song in the world is covered under a blanket license. In the U.S., blanket licenses have survived more than six decades of antitrust litigation, perhaps unsurprisingly so, given that most of the leading scholars in the areas of antitrust law, intellectual property law, and economic analysis of intellectual property defend the use of such licenses, not only as the only practical solution for licensing massive amounts of copyrighted songs, but indeed as an unusually efficient mechanism with exceptional welfare-enhancing characteristics.[78] As we shall see, a critical number of the assumptions that undergird this scholarly work are simply misguided, and when properly accounted for and dispelled, the resulting antitrust analysis of current licensing practices compels a declaration of blanket licenses as unreasonable restraints of trade.[79] Antitrust analysis provides in this sense an elegant structure to assess not only the legality of the practice, but indeed its welfare effects.

Professor Elhauge summarizes the nature of the rule of reason review in the following terms:

> Under the rule of reason, courts consider on a case by case basis whether the agreement has a plausible procompetitive justification. If it does, then the plaintiff must prove an anticompetitive effect either through direct proof or by showing market power that can be used to infer the anticompetitive effect. If the

[78] *See generally,* Douglas Lichtman & William Landes, *Indirect Liability for Copyright Infringement: An Economic Perspective*, 16 HARV. J. L. & TECH. 399 (2003); Richard A. Posner, *Transaction Costs and Antitrust Concerns,* 4 J. MARSHALL REV. INTELL. PROP. L. 325 (2005); William M. Landes & Richard A. Posner, *The Political Economy of Intellectual Property Law*, AEI BROOKINGS JOINT CENTER FOR REGULATORY STUDIES (2004), http://www.aei.org/docLib/20040608_Landes.pdf; Robert P. Merges, *The Continuing Vitality of Performing Rights Organizations*, BERKLEY PUB. L. RES. PAPER NO. 1266879, 2-3 (2008) at http://ssrn.com/abstract=1266870. *See* Stan J. Liebowitz & Stephen E Margolis, *Bundles of Joy: The Ubiquity and Efficiency of Bundles in New Technology Markets,* 5(1) J. COMPETITION L. & ECON. 1, 21 (2009).

[79] Section 1 of the Sherman Act, 15 U.S.C. and Section 5 of the Federal Trade Commission Act, 15 U.S.C. §§ 41-58, as amended.

> anticompetitive effect is shown, the defendant must prove the procompetitive justification empirically and that the challenged restraint is the least restrictive means of accomplishing that procompetitive virtue. If that is proven, the court must determine whether the anticompetitive effects outweigh the procompetitive effects.[80]

Under the general framework of this inquiry, I argue that there are two distinct reasons why blanket licenses should fail a modern rule of reason analysis. First, when the anticompetitive effects of blanket licenses are properly examined they appear likely to outweigh the procompetitive ones. In spite of abundant judicial, governmental and scholarly analysis of this licensing modality, to date there has simply been no work adequately examining the theoretical efficiencies advanced in support of blanket licenses and comparing them to the actual costs and harms imposed by this licensing system. Second, modern transactional platforms vastly outperform blanket licenses today in utility and efficiency while suffering none of the shortcomings associated with collective pricing of songs. Hence, because a less restrictive alternative is now available, blanket licenses also fail a rule of reason analysis on this ground alone.

I will examine the first claim in the paragraphs immediately below, and introduce modern transactional platforms as a less restrictive alternative in Section 3.2.

3.1.1 Claimed Procompetitive Effects

Consider first why blanket licenses have been legally allowed at all. The Supreme Court examined the legality of the blanket license in 1979 when deciding *Broadcast Music, Inc. v. Columbia Broadcasting Systems*.[81] While lyricists, composers and publishers appeared to be subjecting their entire collective output of songs to a common price under a blanket license, the Supreme Court suggested that the practice, rather than constituting a *per se* violation of the antitrust laws, should be subject to a rule of reason analysis by the lower courts and remanded the case with such instructions. The core of this ruling rested strongly on the understanding that courts had not had enough experience dealing with such novel licensing regimes so as to be able to rely on their experience in previous cases and automatically deem blanket licenses illegal.[82]

On remand, in a truly surprising turn, the Court of Appeals, plainly discarded both the analysis in the majority opinion and the insightful analysis of Justice Stevens, and ruled that blanket licenses were not even a restraint on competition. That is, while Justice White writing for the majority suggested that the blanket license was a restraint, and Justice Stevens in his dissent that such restraint was indeed

[80] *See* EINER ELHAUGE, UNITED STATES ANTITRUST LAW AND ECONOMICS 50 (2010).
[81] *See* Broadcast Music, Inc. v. Columbia Broadcasting Sys., 441 U.S. 1, 99 S.Ct. 1551 (1979).
[82] *Id.* at 1557.

unreasonable, the appellate court took the curious analytical route of finding no restraint at all. The court found that blanket licenses had indeed many procompetitive effects and that countervailing sources of market power—namely competition from direct licenses—were likely to keep the price of the blanket license at competitive levels.[83]

Since then, much has been written in support of PROs and their blanket licenses, and the U.S. example has deeply influenced how competition agencies and courts evaluate the welfare effects of this type of licensing in most parts of the world. Unfortunately, this influential analysis had many and substantial flaws when produced, and became simply inapplicable by the mid 1990's, perhaps earlier—a fact that the last decade of scholarly commentary has simply missed. Let us examine first the alleged procompetitive justifications for blanket licenses and their shortcomings.

3.1.1.1 Alleged Procompetitive Justification I: The "New Product" that Radically Lowers Transaction Costs

The strongest argument for blanket licenses was then and remains today the capacity of these licenses to deliver large savings in transaction costs. Without performing the rule of reason test itself, the Supreme Court conveyed as much stating that "A middleman with a blanket license was an obvious necessity if the thousands of individual negotiations, a virtual impossibility, were to be avoided."[84]

While modern commentators who generally favor the operation of PROs such as Lichtman,[85] Landes, Posner,[86] and Merges[87] incorrectly believe that transaction costs remain prohibitively high for individual transactions to take place, surprisingly, even those who are otherwise sharp and eloquent critics of PROs such as Katz[88] and Epstein[89] are nevertheless persuaded by the myth of the impracticability of individual negotiations. Epstein as recently as 2007 illustrates the belief in the following terms:

> If each present member of ASCAP or BMI were to reach out directly to each end user, even with ASCAP's 1979 membership, members would need 2.2 billion contracts to cover this market segment, while for the same year BMI would need 3.0 billion. Today the numbers would be roughly tenfold. The stupendous transaction costs would overwhelm the gains from trade, and the entire industry would massively constrict, as only the majors players on either side of the market

[83] *See* Columbia Broadcasting Sys., Inc. v. Am. Soc'y of Composers, Authors and Publishers et al., 620 F.2d 930 (1980).
[84] *See* Broadcast Music, Inc. v. Columbia Broadcasting Sys., 441 U.S. 1, 99 S.Ct. 1551, 1563 (1979).
[85] *See* Douglas Lichtman & William Landes, *supra* note 78.
[86] *See* Richard A. Posner (2005), *supra* note 78.
[87] *See* Robert P. Merges, *supra* note 78 at 2-3.
[88] Ariel Katz, *supra* note 75 at 590, states "I have shown that direct negotiations between writers and users are indeed highly impracticable.…"
[89] *See* RICHARD EPSTEIN, ANTITRUST CONSENT DECREES IN THEORY AND PRACTICE (2007).

> would be able to afford to hammer out individual deals … [U]norganized individual agreements would be chaotic and inconsistent.[90]

With minor variations, the transaction costs justification for blanket licenses is indeed consistently formulated in terms that resemble the preceding example both by leading legal scholars and economists.[91]

3.1.1.1.1 Two Critical Flaws in the Analysis of Transaction Costs (Past and Present)

There are two main flaws with this assessment: (a) past and present commentators never assess the full costs of blanket licenses, and so the gains of the blanket license system seem enormous; and (b) modern commentators have so far failed to notice that less restrictive alternatives, which allow direct negotiations and individual pricing of songs by individual authors, are not only readily available, but indeed impose much lower transaction costs than blanket licenses.

3.1.1.1.1.1 Myopic Balancing: The Unexamined Costs of Blanket Licenses

While blanket licenses may have delivered transactional efficiencies, they undoubtedly created novel and costly inefficiencies which were never properly examined or accounted for in the early days of the blanket license and puzzlingly are still not analyzed and balanced today. As Justice Stevens acknowledged at the time in his dissent in *Broadcast Music, Inc. v. Columbia Broadcasting Systems*,[92] even if the costs of individual transactions were high, (a) given that song usage was still reported by each station on a per song basis under the blanket license system for purposes of royalty distributions, it is unclear that prices would not have been able to be set also individually on a per song basis at no higher transaction costs (even a system of uniform prices such as the one presently imposed by statutory fees would have conferred substantial advantages over the all-or-nothing, take-it-or-leave-it blanket license system which imposed larger indivisible costs on radio stations)[93] and (b) even if this had not been possible, replacing the market price system with a blanket price entails its own set of additional costs, which were not balanced against the alleged cost reductions from the blanket license. Indeed from a social welfare perspective, it is not enough that some costs are saved by songwriters or even broadcasters, if the new pricing system simply shifts the burden of those costs by imposing oversight costs, rate courts and anticompetitive threats on the government and tax-payers. Furthermore, as we will see below, there is every reason to think that the new structure of blanket licenses indeed dramatically *increased* the costs—of

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[90] *Id.* at 31.
[91] *See e.g.,* Marie Connolly & Allan B, Krueger, *supra* note 53 at 39.
[92] *See* Broadcast Music, Inc. v. Columbia Broadcasting Sys., 441 U.S. 1, 99 S.Ct. 1551, 1566 (1979).
[93] *Id.*. at 1569.

transactions and beyond—of music licensing, and entirely excluded many songwriters from the market.

The costs omitted from this necessary balance are substantial and include the organization and permanent operation of rate courts (responsible for setting the price of the blanket license when it is, and it often is, disputed); six decades of antitrust litigation (and counting, mainly resulting from the market power that blanket licenses confer upon PROs); the opportunity costs of large investments made by the DOJ directed towards drafting, redrafting, monitoring and enforcing industry-wide consent decrees; and the negotiation inefficiencies (e.g. legal fees, cost uncertainty, delays, lobbying) resulting from bargaining under the threat of rate-setting court proceedings, which have often left the entire U.S. broadcasting industry in a deadlock that has forced every radio and television station in the country to operate without prices for decades at a time without knowing what the price of its inputs were.[94] Of course, this list only includes transaction costs proper, and does not even begin to address the actual *harms* caused by blanket licenses with regard to the price, output level, and quality of songs produced, and the way in which revenues are distributed and creative incentives provided—all great misfortunes that could then, and certainly can now, be avoided with individual pricing.

Commentators both then and now systematically fail to account for the costs of having blanket licenses, which were likely higher than their efficiencies to begin with, and are absurdly higher than their alternatives today. Indeed, while declarations of drastic cost savings abound in support of the implementation of blanket licenses, no single study to date has undertaken the necessary step of balancing the hypothetical efficiency gains of blankets (and we shall see how profoundly hypothetical these are) against the *actual* enforcement and regulatory costs imposed by reason of concentrating so much market power in so few hands, as required by this type of licenses. Insofar as proponents of blanket licenses make the case for cost savings, it is upon them to prove that the procompetitive metaphor of transaction costs savings, results indeed in net societal savings, and it is upon courts to require such proof before reaching any conclusion as to actual rather than simply "claimed" savings.

While advocates of blanket licensing should probably endeavor to examine these costs more carefully, it would be premature for policy makers to do so. Even though the analysis so far has been manifestly one-sided, the exposition of the vast harms imposed by the blanket as well as the availability of modern transactional platforms examined below, simplify the inquiry into the reasonableness of tolerating these licensing restraints to the extent of not requiring a balancing of these costs.

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[94] *See* United States v. Am. Soc'y of Composers, Authors, and Publishers, No. 13-95, 1993 WL 60687, 2 (S.D.N.Y Mar. 1, 1993); Radio Music Licensing Committee, Radio Music License Committee and ASCAP Reach Accord On Temporary License Fee Decrease, http://www.radiomlc.org/pages/4795848.php.

3.1.1.1.1.2 Less Restrictive Alternatives to Blanket Licenses: The Modern Transactional Platform Turns 15

Markets have come a long way since 1941 when the ASCAP and BMI consent decrees were first put in place, but the last 15 years have been particularly eventful with regard to transactional platforms. While the ASCAP and BMI consent decrees have been updated several times[95]—most recently in 2001—these changes have largely represented modest patches in an outdated regulatory structure. Online automated licensing and transactional platforms with massive reach have been a fact of life for more than a decade, and yet the modest—by today's standards—licensing hurdles that beset the industry decades ago, continue to play a dominant role in governmental and academic debate today. Regulators, economists and legal scholars, it seems, need to reassess what markets are and are not capable of achieving and question whether the *lesser evil* hypothesis of blanket licenses still accurately describes current market conditions.

If each radio or television station had to send a handwritten letter requesting a price quote to each songwriter, await an answer and later agree on a price, all before being able to air a particular song, then clearly the transaction cost savings of the blanket licenses would be astonishingly high. The problem with this example, and with modern commentary, is that this painful way of doing business exists no longer. Whether these insurmountable transactional hurdles existed at all, it seems unclear, especially in light of Justice Stevens' analysis noted above.[96] But the only relevant question now is whether these hurdles exist today, and the answer to that question seems to be a decisive "no."

Transactional platforms, such as eBay—operating since 1995—which provide an online marketplace for the sale of goods and services, and to put the activity of PROs in perspective generate revenues several times larger than all U.S. PROs combined,[97] have no influence on the individual pricing decisions of those who use their platform. By 2005 eBay enabled its more than 180 million users to perform more than 4.4 million daily transactions[98] amounting to more than 40 billion dollars

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[95] The first consent decree with ASCAP was entered in 1941 *see* United States v. Am. Soc'y of Composers, Authors & Publishers, No. 13-95, 1941 U.S. Dist. LEXIS 3944 (S.D.N.Y. Mar. 4, 1941); modified by United States v. Am. Soc'y of Composers, Authors & Publishers, 1950 U.S. Dist. LEXIS 1900; 1950 Trade Cas. (CCH) P62, 595 (S.D.N.Y. Mar. 14, 1950), was again modified in 1960 United States v. Am. Soc'y of Composers, Authors & Publishers, 1960 U.S. Dist. LEXIS 4967; 1960 Trade Cas. (CCH) P69, 612 (S.D.N.Y. Jan.7, 1960). The last modification to the ASCAP consent decree was in 2001, *see* United States v. Am. Soc'y of Composers, Authors & Publishers, No. 41-1395, 2001 WL 1589999, 2001 U.S. Dist. LEXIS 23707 (S.D.N.Y. June 11, 2001). The first consent decree with BMI was entered in 1941, *see* United States v. Broadcast Music, Inc., 1940-43 Trade Cas. (CCH) P56, 096, 381 (E.D. Wisc. 1941). This consent decree was amended by the Amended Final Judgment entered in United States v. Broadcast Music, Inc., 1966 U.S. Dist. LEXIS 10449, 1966 Trade Cas.(CCH) P71, 941 (S.D.N.Y.1966), which was modified in 1994, *see* United States v. Broadcast Music, Inc., WL 901652, 1994 U.S. Dist. LEXIS 21476, 1996-1 Trade Cas. (CCH) P71, 378 (S.D.N.Y. Nov. 18, 1994).

[96] Broadcast Music, Inc. v. Columbia Broadcasting Systems, 441 U.S. 1, 99 S.Ct. 1551 (1979).

[97] *See* Yahoo finance, eBay Inc., http://finance.yahoo.com/q/ks?s=EBAY (last visited Feb. 6, 2010).

[98] *See* Damon Darlin, *EBay Expected to End Fees for Third-Party Developers*, N.Y. TIMES, Nov. 14, 2005,

in annual gross merchandise volume[99] without interfering with the determination of prices—that were either set independently by each seller or determined by auctions through competition between potential buyers. In this context, the rhetoric of insurmountable transaction costs should seem rather weak for music licensing.

For an even closer example, let us examine advertising markets today. Under the analysis provided in the previous section, songs can be understood simply as a particular form of ad—ads only varying with regard to the products they sell and how much audiences actually like the ad, common ads generally being less pleasant than songs. Ad-selling platforms need only be customized to account for particular features that would improve upon selling songs as a type of ad. The complexity of this task, is not much different than what advanced ad-selling platforms, such as "Google TV ADS," do today.

In 2007, Google deployed an automated system allowing television advertisers to bid for advertising spots, selecting the day, time and channel in which they wanted their ads aired, and also whether they wanted national or regional coverage. The system was indeed "open to advertisers of any size."[100] In light of potentially massive submissions however, Google warned: "[t]he review process can take up to two business days." [101]

The simple example of how television ads can currently be bought and sold, should deal a devastating blow to any efficiency claim presented by advocates of blanket licenses. Furthermore, the use of auctions, I suggest below, not only solves many unfortunate distortions introduced by blanket licenses, but allows novel ways for authors to capture more efficiently the value they produce for broadcasters, advertisers and listeners.

Let us consider next another popular argument exalting the unprecedented benefits of blanket licenses.

3.1.1.2 Alleged Procompetitive Justification II: Blanket Licenses Optimally Increase Output (In a Way which is Superior to à-la-Carte Pricing)

Beyond transaction cost savings, subsequent economic analysis extending to recent work, has postulated additional advantages derived from the use of blanket licenses. Added support for blanket license is garnered under these theories first, from the fact that blanket licenses increase output efficiently,[102] as a byproduct of pricing

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http://www.nytimes.com/2005/11/14/business/14ebay.html?ex=1289624400&en=a54d8bbd12c283aa&ei=5088&partner=rssnyt&emc=rss.

[99] *See* EBay, 2005 Annual Report on Form 10-K, http://investor.ebay.com/annuals.cfm (last visited Feb. 6, 2010).

[100] *See* Rafat Ali, *Google to Sell Ads Across Clear Channel's 675 Stations*, http://paidcontent.org/article/419-google-to-sell-ads-across-clear-channels-675-stations/.

[101] *See* Google, What is the ad approval process, and how long does it take?, http://adwords.google.com/support/aw/bin/answer.py?hl=en&answer=159475 (last visited Feb. 7, 2010).

[102] *See* HERBERT HOVENKAMP, MARK D. DAVIS & MARK A. LEMLEY, IP AND ANTITRUST: AN ANALYSIS OF ANTITRUST PRINCIPLES APPLIED TO INTELLECTUAL PROPERTY LAW 3-8 (2001), stating

songs at marginal cost (zero)[103] and second, from the fact that because songs are thought to be public goods non-rival in consumption, buyers of the blanket license are efficiently encouraged not to economize on their use of music, a result that only blanket licenses—and not *à-la-carte* pricing—are capable of achieving.

Professor Liebowitz, summarizes these popular notions in the following terms:

> The bundle, in this case, has economic attributes that are superior to those that we might expect from a-la-carte pricing...Because a musical composition is an information good—a non-rivalrous good with zero marginal reproduction cost—there are no social benefits to excluding users from using particular songs or in having them economize on the use of already created music. This means that the blanket license induces the efficient use of music for all consumers who take the license. This is a case where it is efficient to have all of the customers eat until they are satiated. An a-la-carte model, on the other hand, would reduce a customer's consumption of each product below the efficient level.[104]

In a similar vein, professor Picker writes that "[t]he blanket license separates use decisions from price, a virtue given the public-good nature of music compositions.…"[105] These scholars—representing the dominant view on output effects[106]—suggest therefore, not only that blankets result in vast cost savings, but indeed that (a) blanket licenses increase output; (b) they stimulate consumption optimally; and (c) that despite their collusive appearance—this last point made by Landes—blanket licenses are subject to inner competition from individual

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"[b]ut even though [the blanket license] may have involved price-fixing, it was almost certainly output-enhancing and therefore ancillary."

[103] *See* William M. Landes, *Harm to Competition: Cartels, Mergers, and Joint Ventures* in COLLABORATIONS AMONG COMPETITORS: ANTITRUST POLICY AND ECONOMICS 23, 30-31 (Eleanor M. Fox & James T. Halverson eds., 1991). *See also* Michael A. Einhorn, *Intellectual Property and Antitrust: Music Performing Rights in Broadcasting*, COLUM. L. J. & ARTS, 350 (2002), http://ssrn.com/abstract=336045 or doi:10.2139/ssrn.336045.

[104] *See* Stan J. Liebowitz & Stephen E. Margolis, *supra* note 78 at 25. *See also,* Paul Audley & Marcel Boyer, *The 'Competitive' Value of Music to Commercial Radio Stations*, 4-2 REV. ECON. RES. COPYRIGHT ISSUES 29, 29 (2007).

[105] *See* Randal C. Picker, *Unbundling Scope-of-Permission Goods: When Should We Invest in Reducing Entry Barriers?*, 72-1 U. CHI. L. REV. 189, 196, (2005). *See also,* Michael A. Einhorn, *supra* note 103 stating "blanket licenses … efficiently price each additional performance unit at zero, which is the immediate marginal cost of provision."

[106] Richard A. Posner, *Transaction Costs and Antitrust Concerns, supra* note 78 at 333 states "[a]n additional economic virtue of the blanket licenses for performing music—besides economizing on transaction costs—is that they avoid the misallocation of resources that would occur if some musical compositions, being unique and protected from competition by copyright, were priced far above marginal cost..."

songwriters that would abandon collective licenses should the price of the blanket become excessive.

3.1.1.2.1 Three Critical Flaws of the Optimal Output/Consumption/Price Claims

There are three main reasons why these arguments are misguided: (a) marginal cost pricing is not efficient when negative prices provide higher dynamic incentives for creation and simultaneously increase output; (b) consumption of songs by radio stations is overwhelmingly rival; and (c) the price of the blanket license is not constrained by competition from individual songwriters, hence the price of the blanket itself is higher than optimal and output decreasing. We will examine each of these critiques in turn.

3.1.1.2.1.1 Negative Prices (Negated by Blanket Licenses) are *Necessary* for Achieving Optimal Creative Incentives (Dynamic Efficiency) and Optimal Consumption/Output Levels

Because songwriters sell bundles of goods—of which public performance licenses are simply one—and because public performances serve as a type of advertising for the other products in the bundle, it is not only possible, but indeed likely, that the price of a vast number of songs, and even a blanket license of a subgroup of songs could be negative or zero rather than have a positive value. Consider for example, the case of recent payola litigation[107] (amounting to millions of dollars, channeled to circumvent the uniform pricing system imposed by the blanket) and indeed the early history of BMI.

In 1939, broadcasters angered at what they perceived to be extremely high prices being charged by ASCAP, decided to create BMI and with it their own blanket license. The novel enterprise struggled at first, especially given that ASCAP did not allow many of its members to leave the organization[108] (depriving BMI of critical mass), but even though BMI had to compete in a market where most songwriters were already members of ASCAP, jazz musicians who had been either excluded from radio airplay or not adequately represented by ASCAP, decided to offer BMI their music for free in order to get airplay and in this way promote their records and concerts.[109]

The proposition that using broadcasting as simply one element in a profit maximizing strategy aimed at maximizing the value of a bundle of products can be successful, appears in fact to have enjoyed its own natural experiment at the time BMI was created. Once BMI acquired a sufficient number of compositions,

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[107] *See* M. WILLIAM KRASILOVSKY ET AL., *supra* note 32 at 380.

[108] *See* John W. Ryan, *Organizations, Environment and Cultural Change: The ASCAP – BMI Controversy,* 115 (1982) (unpublished Ph.D. dissertation, Vanderbilt University) (on file with Jean and Alexander Heard Library, Vanderbilt University).

[109] *See* CHRIS ANDERSON, *supra* note 60 at 44; John W. Ryan, *supra* note 108 at 115.

broadcasters decided to boycott ASCAP music in 1941 and stopped playing songs from ASCAP's repertory on radio. In the chart below, Ryan usefully compiled data on music sheet sales (an important commercial part of the bundle then) and radio plugs (or spins) to examine the competitive impact of BMI's entry. The data however, is also useful as a proxy for the effect of air-time or spins on music sheet sales:[110]

TABLE 6

BILLBOARD'S "SHEET MUSIC LEADERS" 1940-1944
BY LICENSING ORGANIZATION (PERCENT)

Year	N	ASCAP	BMI	Other
1940	(15)	100	0	0
1941	(15)	6	94	0
1942	(15)	80	6	13
1943	(15)	80	20	0
1944	(15)	87	13	0

TABLE 7

BILLBOARD'S "TOP RADIO PLUGS" 1940-1944
BY LICENSING ORGANIZATION (PERCENT)

Year	N	ASCAP	BMI	Other
1940	(29)	97	0	3
1941	(20)	0	100	0
1942	(30)	80	16.6	3.3
1943	(30)	73.3	20	3.3
1944	(29)	86.2	13.7	0

[111]

Data for 1940 shows that when ASCAP's songs were played on radio, ASCAP sheet music sold the most, however, when broadcasters boycotted ASCAP and started playing BMI music on radio (1941), then sheet music by BMI songwriters sold the most.

Another remarkable fact that can be inferred from this event is that not only are demands positively correlated, but it seems indeed that radio performances *drive* sheet music purchases and not the other way around. The fact that it was radio stations and not sheet music publishers that started the boycott in 1941 shows causality in the demand of products in the bundle. First radio airplay fell and then sheet music followed.

The present day analysis of record sales is unfortunately not as easy to identify, and some authors do indeed argue that radio stations are not only effective advertisers of music, but that in fact, they also react to popular trends, and hence it is

[110] *See* John W. Ryan, *supra* note 108 at 174-175.
[111] *Id.*

unclear how much record sales are affected by radio. Some airplay may be the result of a feedback relationship.[112]

Montgomery and Moe, for example, suggest:

> We find that it could potentially be very profitable if music labels could pay to increase radio airplay. For the thirteen albums studied in this paper we found that 2 million additional GRPs [Gross Rating Points] could increase the average album by 4,135 units (see Table 3). If each album has a gross profit margin of $8 and 2 million GRPs sell for $8,800 then these incremental sales could increase profits by $315,700 (=$24,300 average profit per album x 13 albums), which would be a handsome return. At the same time we understand that radio airplay is a limited resource. Increasing airplay for one album will necessarily decrease the airplay that is available for other albums.[113]

This story seems consistent with the direction of causality implied by a 2001 survey in which "55% of respondents said hearing a song on the radio was the most influential factor in purchasing music."[114]

While Liebowitz challenges the claim that radio airplay benefits the recording industry as one flawed by a "fallacy of composition"—whereby analysts mistakenly infer from the positive effect of radio airplay on the sales of a particular record, that all airplay will have a positive effect on total record sales—he nevertheless acknowledges that particular records do benefit from radio airplay (thereby creating a prisoner dilemma scenario for the record industry as a whole, in which songwriters by trying to improve their own bundle profits, reduce the profits of the industry as a whole). Therefore, if a songwriter sets negative prices for airplay until what she pays in radio (payola or pay–for-play) matches the supra-normal profits in records and in all other products in the songwriter's bundle, then this is precisely the desirable outcome of a competitive market.

The case for negative prices is even clearer in the content of television broadcasts directed at children, where content such as cartoons or other children programming is developed and offered to stations for free by companies such as Mattel, in order to boost toy sales.[115] Recent examples include "Transformers," whose manufacturers have recently launched a successful "advertising" campaign in movie theaters.

Framing the analysis in the context of a multi-sided market where songs compete for airtime with all other types of advertising, the point of impairing

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[112] *See* Alan L. Montgomery & Wendy W. Moe, *Should Music Labels Pay for Radio Airplay? Investigating the Relationship between Album Sales and Radio Airplay*, 1 (2002).
[113] *Id.* at 27.
[114] *See* Jayne Charneski, *R&R National Record Buyer's Survey Edison Media Research*, 2001 cited in SAME OLD SONG, MUSIC COALITION, http://futureofmusic.org/files/FMCplaylisttrackingstudy.pdf.
[115] *See* NEWTON N. MINOW & CRAIG L. LAMAY, *supra* note 63.

competition between authors *vis-à-vis* other types of advertisers illustrates even more clearly how the blanket license necessarily has output *reducing* effects. Authors competing against themselves and against other kinds of advertisers would necessarily bring the price of public performance licenses down, shifting the station's ratio of ads to songs to a new profit maximizing equilibrium where there are either more songs aired or, for the same amount of airtime advertisers are forced to offer higher bids. These effects will depend in part on whether stations would be more likely to exercise market power over listeners than over advertisers.

Either way audiences are better off through a higher ratio of songs to ads, or taxpayers are better off from higher bids for the consequently more profitable radio station licenses and spectrum bids. Conversely, lack of competition (i.e. the blanket license) reduces the number of songs used by radio stations (as shown in figure 1 above).

When Landes proposed that "CBS will expand the number of performances until its added revenue at the margin is zero,"[116] he adequately considered the two-part pricing nature of blanket licenses—an access charge to the blanket license plus a variable charge of zero for each additional song—and noted the potential exclusion that could be created by an excessively high blanket price, but neglected to consider that given that negatively priced songs are often profitable to songwriters, CBS would *only* be able to achieve an efficient output of songs in the absence of a blanket license. That is, CBS under a positively priced blanket licensing regime, will be unlikely to reach the profit maximizing output of songs that would prevail in a competitive market, as excessively priced songs (e.g. those that would have otherwise carried negative prices) will lose out to better priced ads and may exclude stations that would have been able to operate funded also by song advertising.

A better way to understand this is to suggest that, radio stations, will play songs until the marginal revenue of airing a song equals the marginal revenue of airing the highest bidder from all other types of ads. If songs carry negative prices, then songwriters will be able to outbid all other advertisers up to the point where the advertising value of the radio performance is matched by that of their closest competitor (either another songwriter or a typical advertiser). A price of zero, on the contrary, cannot achieve this result.

Naturally, because transaction costs are likely to be substantially lower through the use of modern transactional platforms, collective licensing is, all else equal, also reducing output by increasing costs and pricing out demand that modern platforms could actually satisfy. Imagine the incredible gains that not having to wait decades negotiating with ASCAP or litigating them in rate courts would represent for most radio and television stations in the country.

The point is even clearer when enforcement costs (mandatorily charged to songwriters for songs that could be priced at zero or a negative price) are factored in. Even if transaction costs where the same for blanket licenses (which require reporting from radio stations, and imply the market-power surcharge) than for modern

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[116] *See* William M. Landes, *Harm to Competition: Cartels, Mergers, and Joint Ventures* in COLLABORATIONS AMONG COMPETITORS: ANTITRUST POLICY AND ECONOMICS 23, 31 (Eleanor M. Fox & James T. Halverson eds., 1991).

platforms (which automatically perform usage "reporting" as licenses are obtained in real-time), *à-la-carte* pricing would still outperform blankets because pricing songs competitively and according to the value radio stations place on them (or the lower price that songwriters may be willing to charge under competition) means that those songs carrying zero or negative prices necessarily incur lower enforcement costs (even holding monitoring costs equal), as not litigating unnecessary infringement cases lowers costs absolutely.

3.1.1.2.1.2 Consumption of Songs by Radio and Television Stations is often Rival

The proposition that public performances are non-rival, as espoused by Liebowitz above,[117] is indeed of widespread acceptance in legal and economic scholarship as well as by competition agencies,[118] which as recently as 2007 have relied specifically on Liebowitz's non-rivalry position to examine, and leave undisturbed, the pricing practices of PROs.[119]

There are, however, two main objections to the non-rivalry hypothesis. On the one hand advertising profits depend on the particular demographics at which ads are targeted. Because audiences are attracted to specific content (songs), replicating the same content on competing radio stations necessarily divides audiences,[120] reduces advertising profits and consequently affects the profitability of the station. There is, in this sense, a tragedy of the commons in the exploitation of copyrighted songs given that overuse cannot be curbed by the current pricing system. Songwriters cannot currently use the pricing system to encourage use of their songs by particular radio stations only at particular times through, for example, congestion pricing. Yet, it is easy to see that this can lead, for example, to saturating listeners with excessive exposure to a particular song over a short period of time resulting in a less profitable—for both songwriter and stations—and shorter broadcasting life for a song than what congestion pricing would have allowed.

The other objection builds, surprisingly, on earlier work by Professor Liebowitz himself, which in examining the economics of the record industry has argued that airing songs on the radio reduces record sales industry-wide.[121] According to Liebowitz, the results of his research "indicate that radio play does not have the

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[117] *See* Stan J. Liebowitz & Stephen E Margolis, *supra* note 78 at 25.

[118] *See* Nederlandse Mededingingsautoriteit [Dutch Competition Authority], *De NMa en het toezicht op collectieve beheersorganisaties [The NMa and the Supervision of Collective Management Organizations*] (2007), http://www.nmanet.nl/Images/Cbo%20s%20conclusies%20NMa_tcm16-99888.pdf. *See also,* RBB Economics, Pricing Schemes of Performing Rights Organisations, Final Report and Annexes, http://www.nmanet.nl/Images/Pricing%20schemes%20of%20Performing%20Rights%20Organisations%2C%20final%20report%20annexes%20(RBB%20Economics)_tcm16-99873.pdf.

[119] *Id.*

[120] This point is often noted in the literature and it was made long ago by seminal work by Peter Steiner, *Program Patterns and Preferences, and the Workability of Competition in Radio Broadcasting*, 66 Q. J. ECON. 194 (1952).

[121] *See* Stan J. Liebowitz, *Don't Play it Again Sam: Radio Play, Record Sales, and Property Rights* (2007), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=956527.

positive impact on record sales normally attributed to it and instead appears to have an economically important negative impact, implying that overall radio listening is more of a substitute for the purchase of sound recordings than it is a complement."[122] Insofar as this statement suggests that there are negative effects from the station's use of copyrighted songs, it seems that Liebowitz's claim that radio harms record sales (and therefore creative incentives) is inconsistent with his other claim that the blanket license is optimal because "there are no social benefits to excluding users from using particular songs or in having them economize on the use of already created music."[123]

The reasons why radio airplay reduces record sales have not been thoroughly examined or exhaustively tested empirically, but three main mechanisms appear to be good candidates: satiation, substitution and melioration.

First, most people appear to experience "satiation." Empirically, work by Kahneman & Snell, showed that repeated exposure to a song selected by the participants of an experiment resulted in a decline in the liking of the chosen song by most participants.[124] In this sense, a recent poll asking radio listeners about the listening habits seems consistent with the experimental results. When 73% of polled radio listeners said they listened to more than one radio station, pollsters asked these listeners *why* they switched stations they obtained the following answers:

Table 5-2: Listening to More Than One Station, by Age

"Which of the following statements comes closest to why you listen to more than one radio station?"

		Age		
	Total	Under 30	30 to 49	50+
I like variety	43%	48%	40%	41%
Different stations serve different functions for me	24	7	30	37
To avoid commercials	22	31	22	13
To avoid repetition in music	8	11	7	5
Other/Don't know	3	3	1	4
	100%	100%	100%	100%

[125]

At least those responding "to avoid repetition in music" would appear to be alluding to some type of satiation.

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[122] *Id.*

[123] *See* Stan J. Liebowitz & Stephen E Margolis, *supra* note 78 at 21.

[124] *See* Daniel Kahneman & Jackie Snell, *Predicting a Changing Taste: Do People Know What They Will Like?,* 5 J. BEHAVIORAL DECISION MAKING 187 (1992).

[125] *See* Future of Music Coalition, *Radio Deregulation: Has It Served Citizens and Musicians? A Report on the Effects of Radio Ownership Consolidation following the 1996 Telecommunications Act*, 73 (2002), http://futureofmusic.org/files/FMCradiostudy.pdf.

Second, radio airplay appears to act as a substitute to recorded music on at least some occasions for some consumers, so one could expect that such consumers would be disinclined to purchase a CD if said CD were constantly being played on the radio.[126] Think for example about the economics of free-samples: as Liebowitz's own work suggests, airplay is especially likely to benefit creators if consumers are unfamiliar with their work. Given that the aired song is a type of free sample of the product itself, if free-samples are pervasively available, airplay can substitute more effectively the on-demand nature of records (or downloads).

Third, music consumption appears to be potentially subject to melioration and other utility maximizing strategies inconsistent with the profit maximizing strategies that drive song selection by broadcasters. Kahn, Ratner and Kahneman explain the phenomenon as follows:[127]

> Consider how a consumer decides which songs to play at a jukebox. If only one song is going to be played, the decision is easy: choose the song that brings the most enjoyment. Frequently, however, a consumer chooses to listen to several songs over time. What happens when individuals are making a series of choices and there is one clear favorite song? Does the customer play the favorite song over and over or instead choose to listen to some songs that are clearly inferior? There is a range of possible listening behaviors the individual could engage in, from listening to the favorite on every trial (potentially resulting in overconsumption) to refraining completely from listening to the favorite. Near the overconsumption end is a behavior Herrnstein (1990a) defined as melioration. Melioration occurs when an individual overconsumes the favorite until its enjoyment level is decreased to that of an initially inferior option.[128]

Regardless of the direction of preferences however, underuse or overuse of songs by broadcasters becomes a form of externality (either positive or negative) that can't be controlled or harnessed by authors because they lack the ability to set optimal prices: they can't lower their prices even if additional airplay will increase overall profits (for example if they would gain more by selling CDs than what they would

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[126] *See* Stan Liebowitz, *The Elusive Symbiosis: The Impact of Radio on the Record Industry,* 39 (University of Texas at Dallas, 2004).

[127] *See* Barbara E. Kahn et al., *Patterns of Hedonic Consumption Over Time*, 8:1 MARKETING LETTERS 85, 85-86 (1997).

[128] Remarkably, in the experimental setup developed by Barbara E. Kahn et al., subjects appeared to be over-emphasizing variety-seeking in a way that seemed to deviate from utility maximization, but the authors did not find evidence of melioration. In examining why "[m]elioration and protecting one's taste for the favorite do not appear to provide complete explanations for the observed behavior" the authors suggested that "difficulties in the prediction of taste may induce variety-seeking."

lose in public performance royalties) and they can't increase prices if radio airplay is lowering CD profits by more than what it would increase public performance royalties. Importantly, only songwriters have the capacity to optimize the value of their product bundles, because broadcasters ignore how the value of such bundles correlates with their song choices (partly, indeed, because anti-payola regulations force some of this detachment).

The social costs of pricing songs at zero therefore contradict the non-rivalry hypothesis advanced by Liebowitz. Because radio airplay clearly alters how audiences consume music and is indeed likely to be able to satiate or saturate audiences altering their general desire to listen to songs, radio airplay could be either excessive or insufficient and therefore socially undesirable in at least two respects: first, whenever it cannibalizes on record sales (or downloads, etc.), reducing the value of one of the products in the songwriters bundle[129] it may potentially reduce the value of the entire bundle as a whole, reducing in turn dynamic incentives to produce further songs, or recoup costs of the songs already produced; second, the fact that all radio stations can play the same song at no extra costs, as mentioned in point one, not only may lead to suboptimal airplay in the sense of reducing songwriters' profits, and radio stations' profits, but indeed given that blankets necessarily offer non-exclusive rights to radio stations, radio stations may be discouraged from continuing to play or even begin playing a particular song if many other radio stations do it or are likely to do it, and this in turn could lead to sub-optimally low airplay for a particular song. Both excessive and insufficient airplay can be tackled in well-functioning markets by two strategies that are currently suppressed by blanket licenses: (a) congestion pricing and (b) exclusivity. I examine how modern transactional platforms can be modified to incorporate both strategies in music licensing, and offer additional pricing improvements in Section 3.2.

3.1.1.2.1.3 Songwriters are not Able to Compete Effectively against the Blanket License

It is extremely unlikely that direct competition from authors within the PRO constrains blanket license prices in any significant way. This question bears not only on whether the cartelized authors are capable of raising the price of the blanket license above competitive levels, but goes indeed to one of the core pillars under which courts continue to assess whether blanket licenses are legal at all. That authors do not engage in direct licensing in any significant number appears today an undisputed fact[130] and yet, courts and, as we have seen many scholars, continue to suggest that direct licenses do indeed constrain the prices of blanket licenses.

As mentioned earlier, when *Broadcast Music, Inc. v. Columbia Broadcasting*

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[129] Such as CD sales or song downloads, s*ee* Jon Pareles, *supra* note 50.

[130] *See* Department of Justice, Memorandum of the United States in Response to Public Comments on the Joint Motion to Enter Second Amended Final Judgment, http://www.usdoj.gov/atr/cases/f8200/8224.htm (last visited Feb. 6, 2010), "under a traditional blanket license, a music user has little incentive to substitute non-ASCAP music or to direct-license because the music user will pay the same fee to ASCAP regardless of how many ASCAP songs are used or how many performances are direct licensed." *See also,* Ariel Katz, *supra* note 75 at 573.

Systems was re-examined on remand, the Court of Appeals found that one key aspect of ASCAP's licensing practices shielded the blanket license from illegality: direct licensing.[131] The court stated:

> If the opportunity to purchase performing rights to individual songs is fully available, then it is customer preference for the blanket license, and not the license itself, that causes the lack of price competition among songs...a practice that is not a per se violation, and this blanket license has authoritatively been found not to be such, does not restrain trade when the complaining customer elects to use it in preference to realistically available marketing alternatives.[132]

Under the theory of a simple, well functioning cartel, authors should have indeed very little incentives to compete against their own cartel and erode the price of the blanket license. Superstars, profiting the most from the cartel, probably have the least incentives of all members to exit the blanket license. This should be an immediate concern for courts today. But what about the vast majority of authors who barely make any money at all under the blanket license system?

Under the theory of a dysfunctional cartel—that serves only a few of its members at the expense of the many—espoused in this article—it would seem that most authors would indeed have strong incentives to leave the cartel. After all, there are simply too many authors earning miserable or no profits under the cartel for there not to be a significant number of them willing to compete against the blanket license.

The skewed revenue distributions are in this sense rather bizarre in PRO cartels around the world. Unlike a traditional cartel, authors agreeing to sell their songs through a blanket license do not share nicely in the supra-normal profits. When a traditional cartel fixes prices, for instance, there generally is some sort of "fair distribution" rule, under which conspirators decide to divide the earnings of supra-competitive prices. Often the conspirators that have more capacity are allowed to sell more items at supra-competitive prices or get a bigger share of the revenues in some other way, or there may be a division of geographic markets, but all involved generally get something out of their effort to collude.

As discussed in Section 2, authors, on the other hand, don't share nicely. Under the blanket license, PROs channel the market power of all authors into a single blanket license price, but distribute the earnings of that license according to what songs get played more. So even though all authors contribute market power to the PRO, they all enter a lottery for a share of the inflated royalties in which only a few of them can win.[133] Since most authors lose most of the time, some of them should be attempting to compete against the blanket license in terms of price, given that quality

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[131] *See* Columbia Broadcasting System v. Am. Soc'y of Composers, Authors and Publishers, 620 F.2d 930 (1980).
[132] *Id.* at 935.
[133] *See* discussion on distribution of royalties *supra* Section 2.

alone does not seem to be getting most of them any royalty earnings. So why aren't they?

This question can indeed be divided in two parts, first addressing competition between collectives, and second with regard to competition between authors and other authors grouped in a blanket license.

In previous work[134] I began answering this question by challenging the aptitude of the *natural monopoly* hypothesis to account for current market structure and subsequent literature has taken a similar path.[135] My argument then was to suggest that the exercise of market power resulting from the presence of strong network effects in the licensing of music was more likely to account for the enduring dominance of few PROs (or one in most countries) than the natural monopoly hypothesis. As both songwriters and music users are naturally interested in belonging to the largest PRO—music users because they want access to the largest repertoire and songwriters because administration costs are spread over a large number of songwriters and also because users prefer the larger repertories—PROs in the early years tried to exploit these network effects in what could be called early platform wars.

An example of these platform wars happened when, having reached a critical mass long before BMI, ASCAP indeed attempted to get rid of the competition both by depriving it of the necessary critical mass of domestic songwriters[136]—offering its members take-it-or-leave-it agreements that made it difficult to switch to another PRO later—and by rapidly deploying exclusivity agreements with PRO's in foreign markets.[137]

There are, however, two additional obstacles that prevent authors from competing against the blanket license either individually or by forming their own collective. The first one is related to the decreasing marginal value of the songs added to a blanket license (Obstacle 1) and the second one is related to the structure of sunk costs imposed by blanket licenses (Obstacle 2). The legality of the blanket license depends importantly on courts simply ignoring how serious these two obstacles are to healthy competition against the blanket license.

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[134] *See generally,* Ivan Reidel, *Competition and Deregulation in the Music Industry*, (June, 2003) (unpublished LLM Thesis) (on file with Harvard Law School Library).

[135] *See* Ariel Katz, *supra* note 75 at 573; Ariel Katz, *The Potential Demise of Another Natural Monopoly: New Technologies and the Administration of Performing Rights*, 2(2) J. COMPETITION L. & ECON. 245 (2006).

[136] *See* John W. Ryan, *supra* note 108 at 115.

[137] In the case of ASCAP these exclusivity agreements gave rise to a complaint in 1947 alleging that the exclusive agreement executed among PROs had the "purpose and effect of restraining competition" among the PROs in the U.S. For a discussion of how artificial switching costs (e.g. contractual restrictions) can be leveraged to deter entry in industries with network effects, *see* Paul Klemperer & Joseph Farrell, *Coordination and Lock-In: Competition with Switching Costs and Network Effects*, 1999 & 2001 in INDUSTRIAL ORGANIZATION HANDBOOK, (Mark Armstrong & Robert Porter eds., 2007).

Obstacle 1: Decreasing Marginal Value of Songs and the Chicken-and-Egg Problem

Given that the marginal contribution of songs (or additional authors) to the overall value of a blanket license diminishes as the size of the repertory under a blanket license increases, the value of the single song (or author) that attempts to compete against the blanket is bound to be small when compared to the value of the closest song within a large repertory. Because PROs' repertories are already large, music users—that overwhelmingly *subscribe* to these repertories in their entirety by way of blanket licenses with PROs—are likely to find additional songs outside these repertories of modest value.

On the other hand, the single *maverick* author (or song), faces alone the modest (though considerably high for a single author) transaction costs imposed by direct licensing and offers minimal value to the users that need to keep the blanket license anyway. A massive exodus of authors from the blanket license may overcome this particular problem, but collective action problems, along with Obstacle 2, make this result highly unlikely. Hence, while for example digital transactional platforms (such as Google's terrestrial radio ad platform)[138] require high but relatively modest development and implementation costs compared to the size of the market served, individual composers won't exit the blanket license until these platforms are developed, and these platforms are less likely to be developed without a base of authors and users that would use them and provide the platform with a "critical mass" that would make it profitable/viable. This is the chicken-and-egg problem.

In the literature of market-design, this problem is referred to as "thickness," which Professor Roth defines as the "need to attract a sufficient proportion of potential market participants to come together ready to transact with one another."[139] While formal economic modeling of critical mass requirements in the context of multi-sided markets is now developing and is likely to soon offer valuable insights to this problem,[140] the approach in this article is to tackle this problem by taking a more radical approach unavailable in most other platform markets: forced exit.

Once blanket licenses are declared illegal—and as we shall see courts are compelled to declare them so—the chicken-and-egg problem becomes a matter of efficient market *migration* rather than market development.

Obstacle 2: The Blanket Penalty and the Music Users' Prisoners Dilemma

Beyond the blanket license, a radio station can either try to obtain direct licenses from authors that do not belong to PROs or try to persuade those authors that are members of the PRO to circumvent the blanket license and deal directly with the

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[138] Google's terrestrial radio ad platform is already used for the allotment of radio advertising space.

[139] *See* Alvin Roth, *What Have We Learned from Market Design?,* Hahn Lecture 3, http://kuznets.harvard.edu/~aroth/papers/2008_Hahn_Lecture_EJ.pdf.

[140] *See* David S. Evans & Richard Schmalensee, *Failure to Launch: Critical Mass in Platform Businesses*, (2009) http://ssrn.com/abstract=1353502.

radio station (I will call both types of authors that attempt to compete against the blanket license *mavericks*). However, regardless of whether they use some or all songs within the PRO repertory, radio stations are obligated under the terms of the licensing agreements to pay the same price for the blanket license, which they therefore need to assess as fixed cost upon which to add the *variable* cost incurred by playing maverick songs.

This type of agreement in which "penalty clauses" determine a pricing structure that discourages use of a competitor's product was examined by Gilbert and Shapiro when assessing the penalties Microsoft imposed upon PC manufacturers through its *per-processor pricing* of Windows OS.[141]

The penalty clause employed by Microsoft forced PC manufacturers to obtain Windows OS licenses not based on the number of computers loaded with the Windows OS, but rather on the number of computers sold, regardless of whether they had Windows, Linux or something else installed on them. Under per-processor pricing, Gilbert and Shapiro noted, "the cost to the buyer of the seller's product is an increasing function of the amount that the buyer purchases from a different seller."[142]

Presented with a choice of whether to select a song from within the repertory under blanket license or license one from outside that repertory the station will only select the song from the maverick composer if and only if:

$$V_m - C_m > V_r$$

Where V_m is the value of the maverick song not covered by the blanket license (derived from the advertising revenue that this song is able to generate for the station), C_m is the cost of licensing directly with the maverick (itself composed by p the price of the song charged by the maverick and t the transaction cost generated by direct dealing such that $C_m = p_m + t_m$); V_r is the value of the next best song in the repertory covered by the blanket license.[143]

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[141] *See* Richard Gilbert & Mike Shapiro, *Antitrust Issues in the Licensing of Intellectual Property: The Nine No-No's meet the Nineties,* BROOKINGS PAPERS ON ECON. ACTIVITY MICROECON. 283, 310 (1997).

[142] *Id.*

[143] In a market where a radio station were licensing songs for the first time we would also add C_r the cost of dealing with the PRO, itself composed by the price of the blanket license P_b and the cost of transacting with the PRO t_b such that $C_r = P_b + t_b$. The costs of dealing with the PRO, C_r, are however not considered in the choice above, because I assume in a way consistent with PROs being the first movers, that the PRO has already recruited most authors in the market and that the radio station has already accepted an all-or-nothing offer for the entire repertory of the PRO and hence has already paid P_b. Additionally, t_b is also excluded because once the licensing and reporting mechanism of the PRO is put in place, the transaction cost for playing an additional song within the repertory of the PRO is negligible.

As the radio station increases the proportion of maverick songs, it foregoes use of songs contained in the PRO repertory for which it has already paid, and instead needs to increasingly incur incremental cost $\sum C_{m1} + C_{m2} + C_{m3}$.

But what about per-program licenses?, one may ask. Don't per-program licenses represent a lower cost alternative to the blanket license that reduces the penalty imposed on mavericks? As it turns out, it is a rather thorny endeavor to reap the benefits of the per-program option. A typical radio station plays approximately 12 songs per hour.[144] According to the terms agreed upon by most radio stations and PROs,[145] radio stations seeking to avail themselves of per-program licenses must at least be able to secure two thirds of the total programming from direct licenses. The use of any song (or part of it) within the PRO repertory, for however brief a period, within a 15 minutes program computes the entire program as using the PRO repertory.

More precisely, out of a total of 273 weighted programming periods available per week, usage of PRO songs in more than 90 periods (even if only one PRO song is used per period) automatically requires stations to obtain a *blanket license* and precludes the option of a per-program license. In other words, any radio station wishing to deal directly with authors, would be forced to pay a "penalty price" and incur the extra expense of direct licensing until capable of securing more than two thirds of its weighted programming periods from maverick authors without interrupting a single time any of those periods with a song from the PRO. Furthermore, under the current Radio Music License Committee (RMLC) agreement, radio stations can only request per-program licenses once every 6 month period, implying that the stations would have to secure at least 66% of their weighted programming periods from direct licensing for those entire 6 months (having to give 60 days advanced warning to the PROs, and wait for approval before changing the licensing scheme).[146]

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[144] *See* Paul Mahoney, *Many Questions Left Unanswered by CARP "Appendix B" Document* (2002), http://www.kurthanson.com/archive/news/022202/index.shtml (last visited Feb. 6, 2010).

[145] *See* BMI Local Radio Station License Extension Agreement, http://www.radiomlc.com/BMI-RMLC%20Settlement%20Letter.pdf (last visited Feb. 6, 2010) and ASCAP 2004 Radio Station License Agreement, http://www.ascap.com/licensing/radio/pdf/RMLC_License.pdf (last visited Jul. 25, 2010).

[146] *See* Radio Music License Committee, *Methodology For ASCAP Industry-Wide License Fee Allocation for the Period January 1, 2004 through December 31, 2009,* 6, http://www.ascap.com/licensing/radio/FeeMethodology.pdf (last visited Jul. 25, 2010) [hereinafter ASCAP Industry-Wide Fee]. For BMI, *see* Radio Music License Committee, *Methodology For Industry-Wide License Fee Allocation for the Period January 1, 2001 through December 31, 2009,* 5, http://www.radiomlc.com/RMLC%20Allocation07.pdf (last visited Feb. 6, 2010). The industry-wide license agreement negotiated between ASCAP and the RMLC for the period January 1, 2001 to December 31, 2009 has expired. On its website ASCAP notes that "[s]tations that are represented by the RMLC for the period commencing January 1, 2010 will be licensed on an interim basis as of that date. Stations currently licensed by ASCAP under the 2001 - 2009 agreement are being offered an extension of that agreement, pending the outcome of negotiations with the RMLC or any decisions on this matter from the Rate Court." *See* ASCAP, Radio Licenses, http://www.ascap.com/licensing/radio/

The substantial number of maverick composers that would be *immediately* required by a radio station to be able to shift to a per-program licensing scheme clearly makes the prospect of avoiding the penalties imposed by the blanket licenses very unlikely. It appears there is still a long way to go before per-program licenses could be considered (as suggested by the current consent decrees) a *genuine choice* for radio stations.

Considering that high earning authors have less incentives than low earning authors to compete against the cartel that secures supra-competitive profits, and that hence only authors with low earnings are the ones most likely to make use of direct licensing, the effects of Obstacle 1, and Obstacle 2, seem particularly troubling regarding the likelihood of direct licensing effecting any kind of competitive pressure upon PROs.

An additional and interesting implication of this penalty effect is that it exacerbates the undesirable effects of anti-payola regulations. I suggested earlier that anti-payola regulations increase the cost of advertising for authors. This increase in the cost of advertising for authors reduces the demand for radio ads by authors. As radio stations choose the highest bidder between MacDonald's and CDs, by excluding bids from CDs producers (songwriters), anti-payola regulations necessarily decrease the value of advertising time for radio stations. If the total value of advertising time is lower for a radio station, that means in turn that the value of songs as an input is also lower, as they are capable of generating lower profits for radio stations. In other words, the value of songs, from both mavericks and repertory authors will be lower with anti-payola regulations in place than without them. As the value of each song decreases, the transaction costs (which are independent of the value of a song) increase relative to song value.

Conversely, if the cost of transacting with the maverick C_m remains constant (as does the cost of dealing with the PRO), and the value of songs by both mavericks V_m and repertory V_r authors increase under payola, then the penalty imposed by the blanket becomes less relevant and may even be negligible if the songs are very valuable. In short, the more valuable the songs become by allowing payola, the milder the penalty that transaction costs impose on the maverick (in relative terms).

The radio stations' prisoners' dilemma in this scenario is the following: all radio stations would like to pay lower prices for songs, their basic input. One station alone, trying to maximize profits inter-temporally may realize that exiting the blanket license would likely be a worthwhile endeavor, even if it meant incurring the blanket penalty for a limited number of periods, given that in the long run stimulating a competitive market for songs would render returns in the form of lower licensing costs. While such radio station, however, would have to incur all the costs of nurturing a competitive market for songs, all other competing radio stations would be

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(last visited Feb. 6, 2010). The current BMI Agreement has expired and according to disclosure in the extension agreement, BMI and RMLC have been unable to agree on the terms of the licensing agreement for 2010. According to BMI's website, "BMI and the Radio Music License Committee have been meeting to discuss the terms of a new license agreement for the radio industry which will commence as of January 1, 2010." *See* Radio, 2010 Radio License Extension, http://www.bmi.com/radio/?link=navbar (last visited Feb. 6, 2010).

able to reap the benefits of such competitive market without incurring any costs. Depending on how long it would take the radio station, the first mover, to develop a competitive market for songs, the station would have to endure extended periods of higher costs than all of its competitors, earning lower profits or in competitive markets even becoming unprofitable.

Such reduced profits would in turn hamper the ability of the radio station to compete in subsequent auctions for its broadcast license, as all other competitors not willing to invest in a more competitive song licensing market would be able to easily outbid the forward looking radio station, with higher short-run profits secured through the blanket license (and no blanket penalties).

The logic of collective inaction, in this scenario, suggests that radio stations are trapped in a suboptimal equilibrium where they could all benefit from lower licensing costs in the future, but no station is likely to be the first one to invest alone in the enterprise.[147]

The preceding section has made clear that the pro-competitive benefits of blanket licenses, not only range from unproven to non-existent, but indeed that most of the arguments that support blanket licenses conceal substantial shortcomings that obscure the very substantial costs and even harms that blanket licenses invite. In view of the obvious pricing restrictions imposed by blanket licenses, the absence of robust pro-competitive effects should be enough to declare blankets illegal. The harms just discussed, however, pale in comparison to the most dramatic and harmful effects of blanket licenses. I examine those next.

3.1.2 Anticompetitive Harms

3.1.2.1 Price, Output and Quality

The shortcomings of the pro-competitive arguments examined above point to a variety of harms related to price, output and quality effects.

3.1.2.1.1 Price

There are three main reasons why the blanket license price is high: (a) direct licensing does not constrain the blanket's price;[148] (b) rate courts are incapable of constraining pricing;[149] and (c) price discrimination, which has actually ceased to exist, never assured a modest relation to actual competitive prices.

Seen from the perspective of multi-sided markets, many of the pro-competitive justifications advanced in defense of the blanket license reveal themselves as shortcomings rather than advantages. First, marginal-cost pricing sub-

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[147] *See* Einer Elhauge, *Antitrust Analysis of GOP Exclusionary Agreements*, 2 (2003), http://www.law.harvard.edu/faculty/elhauge/pdf/statement_ftcdoj.pdf.

[148] *See* Landes *supra* note 103, arguing that direct licenses constrain the price of the blanket license.

[149] *See* United States v. Am. Soc'y of Composers, Authors, and Publishers, No. 13-95, 1993 WL 60687, 2 (S.D.N.Y Mar. 1, 1993) and *see also,* Daniel A. Crane, *Optimizing Private Antitrust Enforcement*, VAND. L. REV. (forthcoming) 53-54, http://ssrn.com/abstract=1474956.

optimally decreases output by suppressing a pricing system where many songs would otherwise carry negative prices. Prices tied to marginal costs, or zero, are in this sense *too high* and the unavoidable result of blanket licenses being priced at positive prices. Second, regardless of whether songs, absent a pricing system, are played too little or too much (given rivalry between radio stations and substitution between broadcasts and CDs), the value of songwriters' bundles will necessarily decrease if radio usage departs from the optimal (as it must whenever songs are priced uniformly) and the creation of songs will be lower than with an *à-la-carte* system.

As discussed earlier, the argument of competition keeping prices in check, espoused by Landes and many others, does not survive thorough scrutiny. But there are, however, two additional lines of defense meant to appease concerns about supra-competitive price levels. One, most recently espoused by Professor Crane, suggests that rate courts[150] are indeed capable of doing a decent job at pricing blanket licenses.[151] The second one, espoused by Professor Liebowitz suggests that price discrimination, by tying the price of blanket licenses to industry revenues, loosely maintains a linkage to actual value.

Professor Crane summarizes the first of these points in the following terms:

> When an antitrust court intervenes to set a rate for music licensed by ASCAP or BMI..., the court effectively acts as a rate regulator, allowing BMI, ASCAP, and the artists they represent a price that reflects the exclusivity rights granted by Congress but not any incremental market power from the aggregation of multiple copyrights.[152]

This is an important claim, not only because it remains influential in modern antitrust analysis—as Professor Crane exemplifies—but because the idea that rate courts can actually perform an adequate job is an important building block supporting the adequacy of the consent decrees that create these courts along with many other remedies.

Since 1941, most transactions related to public performance rights for radio stations and television stations—and most other places where music is publicly performed—have taken place in the shadow of rate courts, resulting in one of the most enduring rate setting activities by any court in U.S. history. The claim therefore that rate courts can set prices that do not reflect "any incremental market power from the aggregation of multiple copyrights"[153] is highly consequential and if believed, should provide a good quantum of peace of mind to courts and regulators concerned with cartel prices.

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[150] As Michael A. Einhorn, *supra* note 103 at 359 explains "[a] fee setting Rate Court was established in the District Court for the Southern District of New York for hearing license disputes, with the burden of proof upon ASCAP to show reasonableness (IX). The Justice Department and BMI modified their respective Decree in a similar fashion in 1966 and instituted a Rate Court provision in 1994."

[151] *See* Daniel A. Crane, *supra* note 149 at 53-54.

[152] *Id*.

[153] *Id*.

Unfortunately, this claim is misguided in important respects. Indeed, rate courts themselves appear rather skeptical about their ability to determine the "reasonable" rates they are asked to elucidate. In Judge Dolinger's terms:

> As noted on a prior occasion, a "'reasonableness' inquiry does not lend itself to the application of a clear and simple formulation and ultimately involves some conceded arbitrariness on the part of the rate setter." Indeed, the testimony...in this proceeding confirms the absence of any readily available formula dictated by generally recognized economic principles. It is to be assumed that, in the absence of more precise standards in the Decree, the court will be left principally with a range of prior agreements by these or other parties, which are to be invoked as concededly imprecise analogies...[154] (internal citations omitted)

Regrettably, while seeking refuge in past negotiations may at first seem a more reliable alternative, in view of the lack of clear guidance from economics, the effort is bound to be equally unsuccessful given that the "prior agreements" meant to be used as guidance, were also reached in conditions where PROs were already exercising market power. As a result, not only can rate-setting courts determine prices that bear no possible resemblance with how markets would likely price licenses, but indeed these proceedings impose transactional inefficiencies hardly matched by any other industry anywhere in the world: for example, radio and television stations and copyright collectives have been unable to agree on the price of blanket licenses for decades at a time. In 2004 the RMLC and ASCAP reached an agreement to set the prices of the blanket licenses retroactively.[155] In 1993, the rate court set fees for 963 television stations determining the value of fees which had been disputed since 1978![156]

With regard to linkage between the price of blanket licenses and actual market performance, Liebowitz presents the argument in the following way:

> One major saving grace of most performing rights tariffs is that they are linked to the overall size of the market. The performing rights tariff rate for radio, for example, is a percentage of advertising revenues. Therefore, the royalty payments will change as the industry grows or declines. This assures some modest

[154] *See* United States v. ASCAP, 1993 WL 60687 18, 40 (S.D.N.Y. Mar. 1, 1993).
[155] *See* ASCAP Industry-Wide Fee *supra* note 146.
[156] *See* United States v. Am. Soc'y of Composers, Authors, and Publishers, No. 13-95, 1993 WL 60687, 2 (S.D.N.Y Mar. 1, 1993); Michael A. Einhorn, *supra* note 103 at 359.

> linkage between them and is likely to keep the royalty payments from getting too far out of line.[157]

While this argument is currently technically moot as PROs have moved away from price discrimination and currently negotiate flat rates for the industry as a whole, it is still valuable to examine its shortcomings as the flat fees are likely to continue tracing historic values for a long time.

This argument misses that the size of the market and the amount of royalties collected by PROs provide no meaningful guidance when trying to ascertain what competitive prices would look like. In most competitive markets the price of inputs used in creating products or services bears no relationship to the value of the products these inputs help produce. This is especially true in creative industries or markets with high-skilled labor.

If corn-starch producers had their way, for example, they would probably charge top restaurants a percentage of the restaurants' profits. No doubt, a successful corn-starch cartel would see its revenues increase with those of the restaurant industry. However, it would be a mistake to think that these price levels would therefore be reasonable or "not out of line." The adequate benchmark for determining prices in these industries is the competitive but-for-world rather than the successfully cartelized market.

3.1.2.1.2 Output

There are four reasons why output is lower under the present pricing system than what it would be in a competitive market without blanket licenses: (a) because cartelized songwriters compete against advertisers operating in a competitive market; (b) because high blanket license fees price people out of the market, (c) because uniform prices for songs fail to maximize the value of the sum of the products in the songwriters' bundles; and (d) because modern transactional platforms (deterred by high entry barriers) could sell exclusive rights, help authors maximize value of their bundles, and create optimal ex-ante incentives to create and adequate incentives (no worse than blankets) to consume. We will now analyze each of these reasons in turn.

(a) As mentioned above, both higher prices for songs and higher prices for blanket licenses are likely to have an impact on output. When songs that would have carried a negative price are priced above zero, they inefficiently reduce demand of songs by a radio station (and simultaneously the content output of that station) in a measure related to the own-price elasticity of demand of songs. Furthermore, when regular ads are included in the analysis and cross-price elasticity of demand considered, the overall content output of a radio station is likely to be even lower as traditional advertising is priced in a competitive market (that tends to elicit higher bids for advertising time for radio stations) and songs are priced in a cartelized market (that elicits lower bids for advertising time). Holding the price of ads constant, a supra-competitive price for songs will mean that more ads will be played, and song

[157] *See* Stan Liebowitz, *MP3's and Copyright Collectives*, 55 in DEVELOPMENTS IN THE ECONOMICS OF COPYRIGHT: RESEARCH AND ANALYSIS (Lisa Takeyama, Wendy J. Gordon & Ruth Towse eds. 2005).

output reduced. Given that the traditional advertising market seems competitive, it therefore seems likely that more advertisements are currently replacing songs than what it would be the case in a competitive market.

(b) High blanket license fees price people out of the market because stations and other music users that would be willing to pay zero or even get paid in order to play music are deterred by an inefficient positive price.

(c) On the other hand, choosing an arbitrary price (such as one tied to marginal cost) without regard to the price that maximizes the value of the bundle of products produced by a particular songwriter decreases the value of the bundle and is therefore likely to decrease, by the same measure, the incentive to produce that bundle to begin with. This also reduces the expected output.

(d) Selecting prices that would maximize the value of the bundle, however, is in the present system a terribly complex task. It would be extremely difficult (indeed, probably impossible) for a songwriter to predict how the price of a particular song would stimulate demand by a given radio station, and subsequently how the use of such song by that station would affect the song's usage by competing radio stations and how these reactions would in turn influence the behavior of the first radio station.

One of the reasons why this task is incredibly complex is because a songwriter, under the present system, cannot assign exclusive rights to a single radio station. If songwriters could allow radio stations to bid for exclusive rights to particular songs, auction markets would be able to calculate more accurately the value of airing a particular song, and songwriters would be able to ascertain and control prices within ranges that would more closely approximate bundle maximization.

While a transactional platform allowing the trading of exclusive rights in this sense, has to my knowledge, not been developed, in Section 3.2 I will discuss how modest improvements over the state of the art in transactional platforms appear to be able to enable a type of auction market that can indeed go even beyond this first step, allowing bids for exclusive rights over bundles of songs and bundles of territories simultaneously.

3.1.2.1.3 Quality

Regardless of whether it is the quality of the program, or the quality of the songs created what is examined, quality always decreases under a blanket license:

(a) first, if we define the quality of broadcasted programs as their capacity to induce utility in audiences, and then note that any given program contains a share of content proper and a share of ads, then reducing the share of ads in a particular program while holding the quality of content equal, as every economic article and audience poll we are aware of seems to suggest, will almost certainly increase overall audience utility and therefore program quality.[158] This effect simply results from improving competition between advertisers and songwriters. Quality is therefore lower under a blanket than under workable levels of competition.

(b) second, as to the content of the program itself, there is actually no reason to believe that the quality of songs will remain the same. The quality of songs—

[158] *See* Future of Music Coalition, *supra* note 125 at 73.

defined as the ability of a song to elicit utility in audiences—created and broadcasted is actually likely to increase if blanket licenses are eliminated and songs are priced competitively. After all, audiences are only likely to purchase CDs, t-shirts or music online if they actually like the free sample of the song they hear on the radio. Because sales of the songwriter's product bundle are an efficient way to convey information as to listening preferences as well as information about the intensity of such preferences (magnitude of utility measured in willingness and ability to pay, for instance, for higher CD prices), the willingness of songwriters to adjust the prices (negative or positive) of songs is an efficient (indeed, probably the most efficient) way to convey to broadcasters information about how to improve their programs to maximize audience utility (something they cannot do as accurately with the information they get from most other product sales, say for instance of detergent.)

3.1.2.2 Further Harms

The combination of price, quantity and quality effects described above result in a myriad of additional harms. Because the workings of PROs are not the ones of a typical cartel, the restrictions examined above also reduce the welfare of the vast majority of songwriters who are forced into complying with PRO pricing decisions. The few authors that do benefit from the arrangement are further elevated to superstardom under a fallacy of talent whereby audiences are deceived into believing that top earners are made so under a meritocratic system that rewards talent, rather than one that rewards the ability of songwriters to tap into valuable demographics with high purchasing power.

The welfare of audiences, as examined earlier is also decreased. Contrary to what dominant theories portraying broadcasting markets as two-sided suggest, much, perhaps most of the content available for broadcasting, need not be funded by traditional and annoying advertisements, but could indeed be financed by content producers themselves who would remain profitable through sales of other goods in neighboring markets (concerts, t-shirts, etc.).

Furthermore, depriving radio stations of higher quality information (that payola and competitive prices for songs would convey as to the listening utility and purchasing habits of audiences) the current system is simply decreasing the ability of platforms to serve all their clients (traditional advertisers, songwriters and audiences) to overall decreasing market efficiency.

Such reduced market efficiency coupled with higher input prices, depending on the particular assumptions one chooses to adopt, are either hurting broadcasters through decreased overall profits, tax-payers through reduced bids for spectrum or both.

Enforcement costs (e.g. 60 years of DOJ oversight and consent decree drafting), transaction costs (e.g. several decades of industry-wide stalemates on royalty prices), as well as unnecessary litigation burdening music users, songwriters and the court system (e.g. the uninterrupted operation of rate courts since 1950) are also vast under the current system. Furthermore, enforcement costs not only arise out of the many governmental efforts and expenditures—that would not be necessary but

for the abuses of market power arising out of the existence of blanket licenses—but also emerge out of the vast unnecessary enforcement of copyrighted works which would have been priced at zero or negative prices but for the blanket license, and which under the current system are nevertheless enforced at a cost to songwriters.

Furthermore, the fact that songwriters are in practice often forced to join PROs to be able to access many markets at all (for the reasons we explored earlier), and forced to enforce all of their works even if such enforcement decreases the value of their bundles suggests that PROs are actually triggering large global inefficiencies through suboptimal copyright enforcement policies. In this sense, the optimal copyright enforcement strategy that would be selected by individual songwriters is replaced by one all-enforcing policy by PROs in the U.S. and around the world that likely results in the policing of markets that would not otherwise be monitored.

3.1.3 The Need for a Proper Rule of Reason Analysis

As examined above, when undertaken at all[159] the rule of reason balancing made by courts and advocated by U.S. agencies has been ostensibly flawed. Invariably, the analytical frameworks deployed have ignored many substantial harms created by blanket licenses, exaggerated most of their efficiencies, and systematically failed to balance even the well known costs of blankets against their theoretical benefits. The legal analysis of blanket licenses as crystallized in modern case law therefore, even without considering the now radically better alternatives that can replace blankets, should be considered suspect, and immediately challenged.

The result of a proper balancing, this paper suggests, would likely lead to a declaration of illegality based on the anti-competitive effects of blanket licenses outweighing pro-competitive ones. Indeed, the obvious exclusion of vast numbers of authors from the market who are entirely denied the ability to afford even the most basic livelihoods through creating music—all this as a consequence of mandated pricing anomalies—seem indeed to make any balancing of transaction efficiencies gained at the expense of total exclusion from the market at least a fragile if not dubious enterprise.

The above, however, is the weaker of the two challenges to the legality of the blanket presented here. The stronger challenge is presented simply by the availability of less restrictive alternatives to the blanket license, that under the second prong of a rule of reason analysis, presently compels courts to ban blankets. There is simply no argument that supports collective pricing in the current stage of technological development. Advertising markets, of which songs are a part, already operate under competitive transactional environments and there is no reason why this particular type of ad (songs) should be excluded from the rigors of price competition. As shown earlier, the welfare consequences of the blanket regime are both grave and pervasive.

[159] *See* Columbia Broadcasting Sys. v. Am. Soc'y of Composers, Authors and Publishers, 620 F.2d 930, 935 (1980).

3.2 Proposed Market Design: Music Licensing Markets 3.0

Using online auctions for music licensing requires little else than applying the licensing technology already in use by widespread global platforms such as Google or eBay to performance rights licensing. As noted earlier, Google has recently deployed an auction system allowing for the automated sale and allocation of advertising space in offline radio broadcasting.[160] If, as suggested in this article, authors were to be allowed the same transactional freedoms as regular radio advertisers, then application of advertising through online platforms would be straightforward.

Naturally, online licensing platforms *do not* require the use of auctions. Individual prices for songs can just as easily be set by authors allowing as many radio stations as desired to purchase public performance licenses and air the licensed songs in an automated way. While as I will suggest shortly, using auctions to determine the price of songs has some advantages over having authors determine the price of each of their songs, an additional advantage of online licensing platforms is that different pricing mechanisms can simultaneously be used for different songs without introducing unmanageable complexity into the system. One of the key advantages of modern markets is their ability to adopt and fluidly alter a variety of pricing schemes with ELEGANCE, that is, with Electronic Licensing Engines that Grant Authors Non-Collusive Environments.

This system which entirely displaces PROs from pricing songs has the advantage of creating an environment where different platforms, say EBay, iTunes and Google, simultaneously compete for serving buyers and sellers of music, which are nevertheless able to price their products individually. Also, minimal interoperability standards could be used to induce competing platforms to adopt uniform standards that would allow free flow of songwriters and users between competing platforms preventing the proliferation of the lock-in effects that have beset PRO members since these organizations began operating.

Modern transactional platforms already allow for most of the pricing characteristics proposed in this paper, but three novel features currently not present in auction markets, I suggest, are likely to further improve the performance of these markets: (a) the introduction of negative prices for songs, deployed in the form of negative reservation prices for particular songs (think of a per-song advertising budget); and (b) the introduction of exclusive rights and (c) congestion pricing. The first feature, negative prices, would capture the positive features of payola, but instead of forcing songwriters or record companies to transact with each station individually to purchase air-time, it would allow all radio stations to compete simultaneously for "payola" customers in a competitive environment that could actually turn the initial payola offer into a positive price paid for a song by the radio station. Given that the distinction between negative and positive prices for songs, as we have seen, has always been an artificial one, this feature would allow markets to become truly competitive across the entire spectrum of prices.

[160] *See* Rafat Ali, *supra* note 100.

The second feature, exclusive licenses, restores to songwriters the ability to license public performances—a *de facto* impossibility under the blanket license regime—to limited groups for specific prices, and arbitrary periods of time, allowing songwriters to maximize the value of the entire bundle of products they produce and providing optimal creative and consumption incentives for songwriters and radio stations respectively.

Further enhancing the ability to grant exclusive licenses, the third feature, congestion pricing, can allow songwriters to determine optimal levels of simultaneous song usage by radio stations within specific geographic markets, and optimally price total song output.

The system may work in the following way: a radio station wishing to acquire licenses for playing songs would log onto an online licensing platform, let us call it "eBay Songs" and would browse or search for a given song under any of an array of possible categories including price, genre, artist, year, etc. Once the desired song has been identified, the radio station would verify whether the author has set a specific price for the right to publicly perform the song at a given time, or whether the author has left the pricing to an auction system by which radio stations are allowed to bid for particular songs to be played at a particular time (performance licenses for playing songs during primetime would likely cost more than the rights to play the same songs during less popular hours). So far, the only departure from any ordinary eBay transaction would be the addition of multiple airing times for a single song. This, however, may be thought of as different products auctioned separately, each product being "the right to perform publicly a specific song during a specified framework" (e.g. the right to play "Across the Universe" by the Beatles once on August 17, anytime between 5:30 pm and 6:00 pm).

Beyond the fairly ordinary pricing system just described, however, auctions allow for a significant qualitative improvement over current licensing: the ability to place bids for exclusive rights and non-exclusive rights simultaneously. As noted earlier in this article, both positive and negative externalities pervade radio broadcasting. In turn, the presence of negative externalities turns songs into rival goods in their consumption by radio stations. This rivalry is not determined by the limited availability of the resource *songs*, but rather due to the fact that concomitant use of a particular song by multiple radio stations may decrease the advertising revenues a radio station can extract by using that song. For example, if all radio stations decided to play the same songs simultaneously, advertisers may begin to see radio stations as perfect substitutes for each other in terms of advertising, and the price of advertising on some radios would fall as a consequence. Under a blanket license system this may also decrease the revenue authors extract from airing songs on radio (as revenues are directly dependent on advertising revenue by radio stations and the sale of CDs or other complementary goods).

These externalities, as we examined earlier, have in all likelihood, a profound impact on the livelihood of authors. Under the blanket license system any or all radio stations may decide to play a particular song, for as long as they wish, owing PROs exactly the same fee for their public performance licenses. Those programming decisions—which authors are unable to influence through pricing variations—

represent a type of externality that has potentially both positive and negative effects on authors.

Some amount of airplay is likely to stimulate CD sales by the featured author, while excessive airplay may actually hurt CD sales as radio performances substitute for the need of CDs. Overuse of songs by radio stations may create in this sense a tragedy of the commons scenario harming both stations and authors with decreased advertising revenues, and potentially harming authors through decreased sales of complementary goods such as CDs. As an extreme example, if the song "Across the Universe" by the Beatles were the only song continuously played by all radio stations during the entire day, people would probably be less inclined to buy the corresponding Beatles CD, and radio stations would likely experience a decrease in advertising revenue.[161]

As positive and negative externalities emerge at different levels in a continuum of airplay time (by a single or multiple radio stations), the current pricing system provides no ascertainable mechanism to reap the benefits of positive externalities and avoid the harms of negative externalities. Auctions, on the other hand, may provide such an option.

[161] *See* substitution and satiation discussion in Section 3.1.1.2.1.2 .

4 CONCLUSION

If, as suggested earlier, blanket licenses are likely to fail a *rule of reason* analysis it seems that there are a few ways to correct the under-enforcement by courts and government. Perhaps a natural start would be to modify the consent decrees that preserve the current pricing system and depend upon rate setting proceedings before New York courts. There are three possible ways in which consent decrees can be modified.[162]

The first option, which is also the easiest and less costly, would be for the DOJ to compel the necessary modifications in the consent decrees. Convincing the DOJ to alter its enforcement strategy (replacing the current pricing system along the lines of the auction system I describe above) has, as I have suggested earlier, the additional benefit of providing reliable signals to courts, which do take the expertise of talented DOJ analysts into account when examining the market of PROs.

A second option would be direct legislative action[163] which seems uncertain but not necessarily unlikely given the existence of reasonably well matched interest groups with antagonistic positions. The third option, private litigation, seeking to declare blankets illegal,[164] seems the more likely candidate but it is also more expensive for any given music user, given that the plaintiff, if not collectively representing users, is likely to absorb litigation costs on its own, and share the benefits of the competitive licensing system with all other users.

Because the stakes are high and also often sufficiently concentrated in the hands of some powerful music users (such as Clear Channel in the case of radio stations, or CBS in the case of television networks), it seems likely that some plaintiffs, even when entirely absorbing the costs of litigation, may be able to reap sufficient benefits from the altered market place so as to pursue a challenge to the blanket license defeating collective action problems. Naturally, modification of the consent decree itself may not be necessary for most plaintiffs. In this sense, the Supreme Court in *Broadcast Music, Inc. v. Columbia Broadcasting Systems*[165] held that the consent decrees entered into by the DOJ and BMI and ASCAP did not work as an immunity against claims "that violate the rights of non parties" to the consent decree and would therefore allow others to bring actions for the violation of their rights.[166]

Fortunately, the arguments supporting anti-payola regulations—mainly related to song quality—are so perfectly misguided, that the best (and least expensive) effort

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[162] *See* Noel L. Hillman, *Intractable Consent: A Legislative Solution to the Problem of the Aging Consent Decrees in United States v ASCAP and United States v. BMI*, 8 FORDHAM INTELL. PROP. MEDIA & ENT. L. 733 (1998).

[163] *Id.* at 766, according to Hillman this option would be barred in regard to broadcast media due to previous litigation between the government and ASCAP, although at the same time he recognizes that changed circumstances and passage of time could allow for new litigation on these issues.

[164] As current litigation in relation to the Google Books Search project suggests, optimal market design is made more complex in the context of litigation.

[165] Broadcast Music, Inc. v. Columbia Broadcasting Systems, 441 U.S. 1, 99 S.Ct. 1551 (1979).

[166] *Id.*

to achieve anything in the vicinity of the policy goals intended by these regulations is to simply repeal all anti-payola enforcement wherever it exists. Surprisingly, this is a good and low-cost start that leads to better performing markets regardless of whether one shares the goals of anti-payola regulations or not.

Although the present state of the broadcasting, advertising and music licensing markets is indeed dire, in this article I have suggested that it is nevertheless susceptible of transformations which are substantial, welfare enhancing, and fairly inexpensive. The remedies proposed, if implemented, could go a long way to improve the livelihoods of songwriters, improve the utility of audiences—by improving the quality of programming while simultaneously reducing the pervasiveness of advertising—save costs to taxpayers, reduce unnecessary government expenditures and reorient scarce resources to more valuable uses.