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ARTICLE

Reconceptualizing Compulsory Copyright Licenses

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Abstract. United States copyright law generally assumes that by providing property entitlements in creative works, the free market will balance between two competing priorities: incentivizing creators to produce works and ensuring the public has adequate access to this content. But the Copyright Act also outlines several detailed compulsory licensing schemes requiring the owners of certain copyright interests, musical works in particular, to license to anyone at government-set prices. Consistent with broader property theory concepts, scholars tend to treat compulsory copyright licenses as liability rules used only to address market failures caused by transaction costs. This Article questions that account, arguing that compulsory licensing also plays an important and underexplored role in furthering copyright's specific policy agenda.

A close analysis of the music regulatory regime and its history shows that its primary function has been to recalibrate the balance between creators' financial incentives and public access to expressive works in situations where free market licensing would yield problematic outcomes. Unlike liability rules designed only to address transaction costs, for which regulators generally try to mimic market rates using market proxies, the compulsory music licensing regime traditionally used rate-setting criteria oriented around copyright policy. Applying these criteria, regulators often chose low royalty rates

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explicitly designed to allow access-expanding music dissemination technologies—from the player piano to digital radio—to flourish.

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

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

Reconceptualizing Compulsory Copyright Licenses
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Introduction

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

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

1. 17 U.S.C. § 106 (2018) (listing copyright owners' exclusive rights, including rights to control copies, sales, and public performances of works); *see also* U.S. COPYRIGHT OFFICE, COPYRIGHT AND THE MUSIC MARKETPLACE: A REPORT OF THE REGISTER OF COPYRIGHTS 19 (2015), https://perma.cc/A8NT-W4SE.

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

3. 17 U.S.C. § 801; COPYRIGHT ROYALTY BOARD, https://perma.cc/4SAD-BPCY (archived Feb. 3, 2020). While parties may forgo the compulsory licensing regime and negotiate licenses directly or via intermediaries, the shadow of the compulsory licensing regime usually leads the CRB rate to become a de facto cap on any negotiated deals. *See* U.S. COPYRIGHT OFFICE, *supra* note 1, at 29; Mark A. Lemley, *Contracting Around Liability Rules*, 100 CALIF. L. REV. 463, 479 (2012).

4. For examples of literature and media coverage that criticize compulsory licensing and propose deregulation of the music industry, see generally ROBERT P. MERGES, CATO INST., NO. 508, COMPULSORY LICENSING VS. THE THREE "GOLDEN OLDIES": PROPERTY RIGHTS, CONTRACTS, AND MARKETS 4-5, 9-11 (2004), https://perma.cc/4V2C-GLW6; Aloe Blacc et al., *A Sustainable Music Industry for the 21st Century*, 101 CORNELL L. REV. ONLINE 39 (2016); Thomas M. Lenard & Lawrence J. White, *Moving Music Licensing into the Digital Era: More Competition and Less Regulation*, 23 UCLA ENT. L. REV. 133 (2016); Editorial Board, Opinion, *Deregulate the Music Industry*, BLOOMBERG (Dec. 16, 2015, 5:00 AM PST), https://perma.cc/2TTB-KQE7; John Seabrook, *Will Streaming Music Kill Songwriting?*, NEW YORKER (Feb. 8, 2016), https://perma.cc/B29P-3A5N.

5. U.S. COPYRIGHT OFFICE, *supra* note 1, at 145.

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

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

6. *See, e.g.*, 17 U.S.C. §§ 111, 119 (establishing cable and satellite rebroadcast compulsory licenses); *see also infra* notes 66, 154-58 and accompanying text (explaining how these compulsory licenses fit more neatly into the conventional transaction costs justification for compulsory licensing, whereas those from the music regime do not).

7. *See infra* Part I.A. *See generally* Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972) (explaining the role of property rules and liability rules in enhancing efficiency).

8. *See* Robert P. Merges, Comment, *Of Property Rules, Coase, and Intellectual Property*, 94 COLUM. L. REV. 2655, 2661-62 (1994) [hereinafter Merges, *Of Property Rules*] ("[A] common rationale for the several statutory compulsory licenses in copyright law is that they are needed in order for certain types of exchange to take place. Transaction costs preclude the formation of a market for certain types of rights; in the absence of statutorily mandated transactions, none would take place." (footnote omitted)); *see also, e.g.*, U.S. COPYRIGHT OFFICE, *supra* note 1, at 163-64; Daniel A. Crane, *Intellectual Liability*, 88 TEX. L. REV. 253, 270 (2009); Richard A. Epstein & F. Scott Kieff, *Questioning the Frequency and Wisdom of Compulsory Licensing for Pharmaceutical Patents*, 78 U. CHI. L. REV. 71, 85 (2011); Kristelia A. García, *Private Copyright Reform*, 20 MICH. TELECOMM. & TECH. L. REV. 1, 39 (2013); Wendy J. Gordon, *Fair Use as Market Failure: A Structural and Economic Analysis of the* Betamax *Case and its Predecessors*, 82 COLUM. L. REV. 1600, 1613 (1982); Mark A. Lemley & Philip J. Weiser, *Should Property or Liability Rules Govern Information?*, 85 TEX. L. REV. 783, 825 (2007); Lenard & White, *supra* note 4, at 142-43; Yafit Lev-Aretz, *The Subtle Incentive Theory of Copyright Licensing*, 80 BROOK. L. REV. 1357, 1378 (2015); Robert P. Merges, *Contracting into Liability Rules: Intellectual Property Rights and Collective Rights Organizations*, 84 CALIF. L. REV. 1293, 1306-07 (1996) [hereinafter Merges, *Contracting into Liability Rules*]; Pamela Samuelson, *Justifications for Copyright Limitations & Exceptions*, *in* COPYRIGHT LAW IN AN AGE OF LIMITATIONS AND EXCEPTIONS 12, 38 (Ruth L. Okediji ed., 2017).

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

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

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

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

10. *See, e.g.*, Howard B. Abrams, *Copyright's First Compulsory License*, 26 SANTA CLARA COMPUTER & HIGH TECH. L.J. 215, 250-51 (2010); Merges, *Contracting into Liability Rules*, *supra* note 8, at 1311, 1314-15; Merges, *Of Property Rules*, *supra* note 8, at 2662.

11. United States patent law permits the government to grant compulsory licenses on a case-by-case basis. But these licenses tend to be limited to specific circumstances, such as where the federal government has funded the research leading to a patent and where the compulsory license is needed to address a public health or safety concern. *See* 35 U.S.C. § 203 (2018) (laying out the government's march-in rights where the government has funded the research leading to a patent); *see also* 28 U.S.C. § 1498 (2018) (establishing that when the government or its contractors infringe a patent, the patent holder's only remedy is reasonable compensation as determined by the Court of Federal Claims).

12. For the purposes of this Article, copyright's "policy" agenda is to balance between these utilitarian goals. *See infra* Parts I-II (examining how copyright benefits the public by providing incentives to create new works but also creates costs in the form of deadweight loss and barriers to positive externalities); *see also infra* note 44 (discussing alternative nonutilitarian conceptions of copyright's aims).

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

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

providing the public with access to creative works.[15] Through this unique approach to rate setting, the regime has fostered technologies that expand and enhance access to existing copyrighted works by allowing these new industries to sometimes take advantage of below-market[16] royalty rates.[17] In this respect, compulsory licensing—like the more frequently discussed copyright limitation, fair use[18]—has provided an essential safety valve for preventing the exclusive rights provided by copyright from overly impeding public access to creative works. But unlike fair use, which provides no compensation to copyright owners,[19] the regime has accounted for copyright's incentive function by ensuring that copyright owners receive some licensing revenue.

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

The original compulsory music license, the "mechanical license," was created in the 1909 Copyright Act to regulate the reproduction of sheet music into mechanically playable forms like player piano rolls and records.[20] Though sometimes understood as a response to sui generis monopolization problems in the early recording industry,[21] the mechanical license is better understood

15. 17 U.S.C. § 801(b)(1) (2017); *see also infra* Part II.B.

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

17. Private licensing of copyright interests covered by the regime is common, but the statutory rates almost always function as a de facto cap. In this respect, the regime has facilitated low rates for disseminators that use the compulsory licenses as well as disseminators that engage in private licensing negotiations in the shadow of the compulsory rate. *See supra* note 3; *infra* note 112 and accompanying text.

18. Fair use allows for uncompensated use of a copyrighted work on a case-by-case basis. *See* 17 U.S.C. § 107 (2018). Fair use can also be thought of as a solution to transaction-cost-related market failures, but many have argued that it is better understood in more copyright-specific terms. *See infra* Part I.B. On this account, fair use directly recalibrates the incentives/access tradeoff, enabling specific innovative uses to occur as long as the copyright owner's incentive to create is not disproportionately damaged through harm to her market. *See infra* Part II.

19. *See infra* note 72 and accompanying text.

20. Act of Mar. 4, 1909, ch. 320, § 1(e), 35 Stat. 1075, 1075 (repealed 1976).

21. *See, e.g.*, Abrams, *supra* note 10, at 219-20 (explaining the conventional understanding that the license was created out of fears that a manufacturer of player piano rolls would

footnote continued on next page

through the lens of copyright's policy agenda. By requiring copyright owners to license their works at a fixed royalty rate, the regime allowed access-expanding technologies of music dissemination—the player piano and phonograph—to flourish, while still ensuring that copyright owners received some compensation.[22] In the 1976 Copyright Act, Congress allowed for a more flexible approach to rate setting that would balance copyright's priorities by replacing the fixed rate with an adjustable rate informed by the 801(b) factors.[23] Regulators ultimately applied the 801(b) factors to set rates designed to ensure that burgeoning dissemination industries, such as digital radio, could avail themselves of royalty rates that would allow them to thrive, even if those rates were lower than those suggested by free market proxies.[24]

In recent years, however, legislative changes have made the compulsory music licensing regime less equipped to enable access-expanding technologies of dissemination to succeed. In particular, the regime's scope has been narrowed: Some new forms of dissemination, such as on-demand streaming, are now only partially subject to compulsory licensing.[25] Additionally, the rate-setting regime's original focus on copyright policy has been limited in favor of a focus on free market proxies. For example, the recently passed Music Modernization Act (MMA) replaced the 801(b) policy-oriented standard with a market-mimicking "willing buyer-willing seller" standard.[26] The CRB's rate-setting decisions also have begun to limit the role played by copyright policy. While past rate-setting decisions recognized that facilitating balance between incentives and access sometimes requires departure from market benchmarks, the recent *Phonorecords III* decision for streaming *only* considered ostensibly free market proxies.[27] This led to a dramatic rise in royalty rates for streaming services, which will likely limit consumers' access to music.[28]

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monopolize the piano roll market and shut out competitors); Lydia Pallas Loren, *The Dual Narratives in the Landscape of Music Copyright*, 52 HOUS. L. REV. 537, 548-49 (2014) (same). *But see infra* Part II.A (arguing that the monopoly account is incomplete).

22. *See* Jane C. Ginsburg, *Copyright and Control Over New Technologies of Dissemination*, 101 COLUM. L. REV. 1613, 1627 (2001) (discussing this compromise approach); Timothy Wu, *Copyright's Communications Policy*, 103 MICH. L. REV. 278, 303 (2004) (same).

23. *See infra* Part II.B.

24. *See infra* Parts II.B, III.B.1.

25. *See infra* Part III.A.3 (discussing differences between interactive and noninteractive streaming services).

26. Orrin G. Hatch-Bob Goodlatte Music Modernization Act, Pub. L. No. 115-264, § 102(a)(1)(B), 132 Stat. 3676, 3680 (2018) (codified at 17 U.S.C. § 115(c)(1)(F) (2018)); *see also infra* Part III.A.5.

27. Determination of Royalty Rates and Terms for Making and Distributing Phonorecords (Phonorecords III), 84 Fed. Reg. 1918, 1933 (Copyright Royalty Bd. Feb. 5, 2019) [hereinafter *Phonorecords III*].

28. *See* Paula Parisi, *Copyright Royalty Board Boosts Songwriters' Streaming Pay Nearly 50%*, VARIETY (Jan. 27, 2018, 11:23 AM PT), https://perma.cc/474D-NFJY. Spotify, Google,

footnote continued on next page

Music streaming provides an example of why this erosion is problematic and why compulsory licensing remains a necessary tool for ensuring a well-functioning copyright system. Recent copyright cases in other contexts have highlighted how technologies like streaming benefit the public by expanding and enhancing access to existing copyrighted works.[29] In the music licensing context, however, reliance on unregulated markets—particularly thanks to music copyright owners' market power, which allows them to demand extraordinarily high royalty rates—has limited streaming services' ability to ensure that the broadest range of consumers has access to music.[30] Compulsory licensing remains uniquely equipped to address these problems and restore balance between incentives and access.

The streaming industry also demonstrates why a policy-focused approach to rate setting remains necessary to achieve a balanced copyright system. Recent rate-setting decisions that have privileged market benchmarks, without considering any broader copyright policy goals, have yielded royalty rates ill-equipped to allow new forms of music dissemination to flourish.[31] More importantly, as the D.C. Circuit has recently recognized, market-mimicking rate-setting standards are highly ambiguous when applied to markets, like music, that have always been regulated.[32] Without policy-based guidelines, the proceedings end up at best inconsistent and at worst tainted by manipulation. Indeed, in some prior rate-setting proceedings using market-mimicking standards, copyright owners introduced strategically inflated licensing deals to manipulate the regulators' analysis.[33] Yet the very malleability of market-mimicking rate-setting standards may suggest a way forward. Drawing on some recent willing buyer-willing seller rate-setting decisions that tacitly accounted for policy goals, this Article suggests how regulators could once again use rate setting to help facilitate balance in the music copyright system.[34]

Pandora, and Amazon announced plans to appeal this decision. *See* Jem Aswad & Chris Willman, *Spotify, Google, Pandora, Amazon Go to U.S. Appeals Court to Overturn Royalty Increase*, VARIETY (Mar. 7, 2019, 1:06 PM PT), https://perma.cc/TXZ2-TF4H. In particular, the new rates will likely make it difficult for streaming services to continue to reach the largest range of consumers by offering free ad-supported plans along with subscription plans. *See infra* text accompanying notes 306-08.

29. *See infra* Part IV.A.1 (discussing recent utility-expanding fair use case law).

30. *See infra* Part IV.A.2.

31. *See infra* Parts III.B.2, IV.B.1.

32. *See* SoundExchange, Inc. v. Copyright Royalty Bd., 904 F.3d 41, 56 (D.C. Cir. 2018) (noting "the inherent ambiguity" in the willing buyer-willing seller rate-setting standard (quoting Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd., 574 F.3d 748, 757 (D.C. Cir. 2009) (per curiam))).

33. *See infra* Part IV.B.2.

34. *See infra* Part IV.C.

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

* * *

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

Music is unusual among copyright goods in that it implicates two often separately owned copyright interests. There is the "musical composition," the collection of notes, orchestration, lyrics, and the like; and the "sound recording," the actual recorded, listenable version of the song.[35] These interests may be owned exclusively by the creators of the works—composers and recording artists—but are more often owned in whole or in part by business entities such as music publishers and record labels. Thus, playing Céline Dion's 1996 recording of *It's All Coming Back to Me Now* in the United States can implicate both a sound recording copyright (owned by record label Sony Music Entertainment) and a copyright in the underlying musical composition (owned by music publisher Universal Music Publishing Group).[36]

Every distinct copyright interest also carries with it a number of separately enumerated exclusive rights: most importantly, the rights to "reproduce" a copyrighted work and distribute copies (for example, selling copies of a book);[37] the right to "perform [a] copyrighted work publicly" (for

35. The sound recording copyright is a relatively new creation and remains somewhat limited in scope, as explained further below. *See infra* Part III.A.1.

36. *See Falling into You / Celine Dion*, U.S. COPYRIGHT OFF., https://perma.cc/BLP5-YMFY (archived Feb. 6, 2020); *Song Details: It's All Coming Back to Me Now*, UNIVERSAL MUSIC PUB. GROUP, https://perma.cc/YFU5-DNZA (archived Feb. 6, 2020); Céline Dion, *It's All Coming Back to Me Now*, YOUTUBE (Aug. 24, 2012), https://perma.cc/4CVM-BCVB.

37. 17 U.S.C. § 106(1), (3) (2018).

example, performing a play or broadcasting a song on the radio);[38] and the right to make a "derivative work[]," that is, a work "based upon one or more preexisting works" (for example, translating a poem or adapting a novel into a television show).[39]

The creation and dissemination of a new recording[40]—such as Dion's original recording and sale of *It's All Coming Back to Me Now*—implicates the reproduction and distribution rights of the musical composition copyright owner.[41] As explained in Part II, this relationship has, to a large extent, been regulated by a compulsory license. The resulting sound recording is protected by a copyright distinct from the musical composition.

The dissemination of *existing* recorded songs by third parties implicates both the musical composition copyright and (with some exceptions) the sound recording copyright.[42] But things get particularly confusing because different forms of dissemination involve different exclusive rights. For example, the sale of a digital file of Dion's *It's All Coming Back to Me Now* by iTunes implicates the *reproduction* rights for both the musical composition and sound recording copyrights, but playing the song on a satellite radio station implicates the *public performance* rights for both the musical composition and the sound recording. As Part III explores in more detail, Congress and regulators have often struggled to come up with coherent ways of applying these exclusive rights to new forms of dissemination like music streaming. The result is a highly complex web of regulation that subjects different forms of dissemination, even forms of dissemination that seem nearly identical, to different forms of licensing—either compulsory or free market licensing.

I. Justifications for Compulsory Copyright Licensing

Copyright is predominantly understood as an "instrumentally driven entitlement" designed to incentivize the creation of expressive works.[43] This is certainly not the only account of why the law recognizes property rights in information, but it is one of the most ubiquitous in American law and legal

38. *Id.* § 106(4).
39. *Id.* §§ 101, 106(2).
40. Or any device capable of replaying a piece of music, such as a player piano roll. *See infra* text accompanying notes 115-17.
41. *See* 17 U.S.C. § 101 (defining phonorecords); *id.* § 106(1), (3) (discussing the rights to reproduce and distribute phonorecords).
42. *See infra* Part III.A.
43. Shyamkrishna Balganesh, *Foreseeability and Copyright Incentives*, 122 HARV. L. REV. 1569, 1572 (2009).

scholarship.[44] According to the instrumentalist explanation, by granting property entitlements in works of authorship, copyright law allows creators to charge for access. This ensures that authors are motivated to invest the time and money necessary to create new works without concern that free riding by the public will leave them without any reward for their efforts.[45]

At the same time, copyright law recognizes that propertization has the potential to allow copyright owners to charge a premium for works, which restricts public access and generates social costs.[46] This tradeoff is a central concern of copyright law. As William Landes and Judge Richard Posner explain:

> Unless there is power to exclude, the incentive to create intellectual property in the first place may be impaired. . . . [T]he result is the "access versus incentives" tradeoff: charging a price for a public good reduces access to it (a social cost), making it artificially scarce . . . but increases the incentive to create it in the first place, which is a possibly offsetting social benefit.[47]

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44. There are other nonutilitarian justifications for copyright, including theories that tie copyright to labor desert or personhood concepts. *See generally* William Fisher, *Theories of Intellectual Property*, *in* NEW ESSAYS IN THE LEGAL AND POLITICAL THEORY OF PROPERTY 168-70 (Stephen R. Munzer ed., 2001). But the utilitarian account is by far the most prevalent in Anglo-American copyright law. *See id.* at 169. For that reason, alternative theories are generally outside the scope of this Article.

45. *See* Jeanne C. Fromer, *Market Effects Bearing on Fair Use*, 90 WASH. L. REV. 615, 620-21 (2015). Put another way, copyright addresses a public goods problem. The expressive material covered by copyright is by its nature nonexcludable and nonrivalrous. Whereas chattel can (generally) only be utilized by one person at a time, expressive content can in theory be duplicated and used by any number of people, with creators unable to prevent such use. For that reason, there is a risk that this material will be underproduced unless copyright grants authors a right to exclude that allows them to prevent free riding. *See* WILLIAM M. LANDES & RICHARD A. POSNER, THE ECONOMIC STRUCTURE OF INTELLECTUAL PROPERTY LAW 13-14 (2003); Matthew J. Sag, *Beyond Abstraction: The Law and Economics of Copyright Scope and Doctrinal Efficiency*, 81 TUL. L. REV. 187, 193-94 (2006).

46. In economic terms, copyright generates deadweight loss: Authors can charge prices well above the marginal cost of producing the good (in the case of subsequent copies of goods like songs or novels—especially digital copies—these costs are often close to zero), which are higher than the price that some users would be willing to pay. *See* Mark A. Lemley, *Property, Intellectual Property, and Free Riding*, 83 TEX. L. REV. 1031, 1058-59 (2005); Sag, *supra* note 45, at 196. This immediate frustration of users' access is often thought of as a static inefficiency. *See* Balganesh, *supra* note 43, at 1578. Copyright is also accused of creating a dynamic inefficiency by preventing new authors from using existing creative works to create new works. *See id.* Another way of conceiving this dynamic inefficiency is that intellectual property law "privileges initial inventors at the expense of improvers and may therefore actually reduce the size of positive externalities from invention by discouraging the improvements and new uses which generate those externalities." Lemley, *supra*, at 1062.

47. LANDES & POSNER, *supra* note 45, at 20-21.

To effectuate balance, copyright imposes several built-in limitations to any copyright entitlement. For example, copyright entitlements are time-limited, meaning that works will enter the public domain, available for use by anyone, after a certain amount of time.[48] Armed with this and other limitations, copyright entitlements are expected, according to some, to optimally embody a tradeoff between incentives and access, allowing authors to profit off their works through the market while still ensuring that the public and other creators are not unduly restricted from accessing them.[49]

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

A. Compulsory Licensing as a Response to Transaction Costs

Property rights are premised on the assumption that parties will engage in bargaining in the marketplace to facilitate the most efficient allocation of resources.[50] This private ordering presumption is no less true in the case of entitlements, like copyright, strategically granted for instrumental reasons; indeed, markets are essential to allowing copyright to accomplish its goals.[51] But numerous factors can impede the development of efficient markets, and the law has developed various tools to address these problems. In the classic formulation by Guido Calabresi and Douglas Melamed, the state can protect an

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

49. *See, e.g.*, Christopher S. Yoo, *Copyright and Product Differentiation*, 79 N.Y.U. L. REV. 212, 230-31 (2004) (explaining that copyright presumes that the government will "calibrate the level of copyright protection so as to permit the greatest possible degree of access while still providing sufficient incentives for the work to be created in the first place"); *see also* Mazer v. Stein, 347 U.S. 201, 219 (1954) ("The economic philosophy behind the clause empowering Congress to grant patents and copyrights is the conviction that encouragement of individual effort by personal gain is the best way to advance public welfare through the talents of authors and inventors in 'Science and useful Arts.'"); *cf.* LANDES & POSNER, *supra* note 45, at 11 (arguing that the incentives/access tradeoff is important to consider in an economic analysis of intellectual property law, but "to reduce the problem of intellectual property to this tradeoff is to oversimplify greatly").

50. *See* LANDES & POSNER, *supra* note 45, at 414 ("Markets and property rights go hand in hand. Property rights provide the basic incentives for private economic activity and also the starting point for transactions whereby resources are shifted to their most valuable use.").

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

entitlement using either "property rules" or "liability rules."[52] Property rules protect the entitlement holder from nonconsensual takings by using tools such as injunctions (designed to undo the taking) or by using deterrence strategies such as punitive damages.[53] These "strong remedies" are premised on the assumption that the ideal allocation will occur if private parties bargain over resources.[54]

But the state may sometimes govern an entitlement with a "liability rule," namely, a rule that permits the transfer of an entitlement in exchange for a fee set by a court or regulatory body using an "external, objective standard of value."[55] The predominant justification for liability rules is that transaction costs can impede efficient bargaining in any property regime, both real and intangible.[56] As Mark Lemley and Philip Weiser have noted, the transaction costs concept, as developed by Calabresi and Melamed, actually refers to a range of different phenomena. First, there is the difficulty and expense of contracting with multiple parties; at times these costs of doing business can exceed the value of the actual transaction, preventing it from taking place.[57] Second, there is the potential that property owners will "engage in strategic behavior," such as holdout strategies, when they recognize that their bargaining position allows them to charge an inflated price.[58] Holdout problems frequently occur in situations where a buyer must aggregate rights from many different sellers.[59]

In both of these types of cases, courts or regulators can establish a liability rule in order to bypass the market transaction process.[60] The buyer or licensor is able to buy or use the property in question while the owner receives fair

52. *See generally* Calabresi & Melamed, *supra* note 7.

53. *See* BJ Ard, *More Property Rules than Property? The Right to Exclude in Patent and Copyright*, 68 EMORY L.J. 685, 693 (2019); Calabresi & Melamed, *supra* note 7, at 1092, 1105-10.

54. *See* Ard, *supra* note 53, 693-95.

55. Calabresi & Melamed, *supra* note 7, at 1105-06.

56. *See* Lemley & Weiser, *supra* note 8, at 786.

57. *Id.* at 786-87.

58. *Id.*

59. A classic example is a landowner who recognizes her ability to frustrate a large-scale real estate development project and thus holds out for a price higher than what she would otherwise charge. *See* Calabresi & Melamed, *supra* note 7, at 1106-07. Other examples are common carriers or public utilities, which, by virtue of their monopoly position, could demand high prices from consumers absent regulation. *See* Richard A. Epstein, Essay, *A Clear View of* The Cathedral*: The Dominance of Property Rules*, 106 YALE L.J. 2091, 2118-20 (1997) (discussing common carriers and how legislation serves to prevent potential holdouts).

60. *See* Calabresi & Melamed, *supra* note 7, at 1107.

compensation, generally based on the hypothetical rate that would otherwise have prevailed in a market free of transaction costs.[61]

The divide between property rules and liability rules is frequently discussed in the remedies context, but liability rules can also be applied ex ante through government regulation: A government agency or court sets a compulsory price for use of a certain asset that applies across the board.[62] Such ex ante liability rule regimes are more common in copyright, in which they take the form of the several compulsory license regimes outlined in the Copyright Act,[63] than in other forms of intellectual property.

Copyright law's statutory compulsory licenses are frequently justified using transaction cost rationales and, in particular, transaction costs caused by the difficulty of contracting with multiple small copyright-owner entities.[64] As Kristelia García explains, the conventional understanding is that "compulsory licensing occurs in industries such as sound recordings and cable broadcasting in which individual negotiation with numerous, disparate rights holders would be both time and cost prohibitive."[65] To address such transaction costs, "[c]ompulsory licensing in these industries allows for efficient en masse licensing of content and subsequent scalability of service where individual transactions are not practicable."[66] On this account,

61. *See* Ayres & Talley, *supra* note 13, at 1032 (explaining the conventional understanding that when it comes to determining fair value, "liability rules are 'market-mimicking'"); Lemley & Weiser, *supra* note 8, at 815.

62. *See* Lemley & Weiser, *supra* note 8, at 829-30, 834-35 (discussing "liability rules administered by an agency").

63. *See* 17 U.S.C. §§ 111, 114, 115, 118 (2018). The antitrust consent decrees that govern the American Society of Composers, Authors and Publishers (ASCAP) and Broadcast Music, Inc. (BMI)—two performance rights organizations (PROs)—are another form of liability rule used in copyright law, although the structure of these regimes differs from those of many of the statutory licenses contained in the Copyright Act. *See infra* Part III.A.2.

64. *See supra* note 8 and accompanying text.

65. García, *supra* note 9, at 1127.

66. *Id.* For example, when Congress created the compulsory licensing regime for television programs that are first transmitted via broadcast, the House report explained that "it would be impractical and unduly burdensome to require every cable system to negotiate [royalties] with every copyright owner" to obtain content for cable retransmissions. H.R. REP. NO. 94-1476, at 89 (1976); *see also* Joseph P. Liu, *Regulatory Copyright*, 83 N.C. L. REV. 87, 130 (2004); Samuelson, *supra* note 8, at 40. Compulsory licenses are also occasionally—though nowadays rarely—used to address market power imbalances, in particular where a party's aggregation of intellectual property interests allows them to amass market power and charge above-market prices. *See* HERBERT HOVENKAMP ET AL., IP AND ANTITRUST: AN ANALYSIS OF ANTITRUST PRINCIPLES APPLIED TO INTELLECTUAL PROPERTY LAW § 6.05[C][1] (CCH 2019); Crane, *supra* note 8, at 269 (discussing PRO consent decrees, which have been partially incorporated into the Copyright Act); *see also infra* Parts III.A.2, IV.A.2 (discussing, respectively, PROs and the intersection of antitrust and copyright in the compulsory licensing context).

compulsory licenses are expected to ensure the most efficient allocation of copyrighted works. However, as some have argued, they often carry other inefficiencies with them,[67] leading many to believe that private ordering in the marketplace may still be the most effective and more desirable rule.[68]

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

Copyright law also employs mechanisms akin to compulsory licenses that can be understood to be focused on goals distinct from the remediation of transaction costs barriers to free market licensing. In particular, copyright's fair use doctrine permits what would otherwise be an infringing use of a copyrighted work.[69] In the context of an infringement lawsuit, a court can find fair use through an inquiry into a set of subjective criteria: most importantly, the "purpose and character" of the defendant's use and the "effect of the use upon the potential market for or value of the copyrighted work."[70] A paradigmatic example of fair use is the use of a work for news reporting or criticism, but fair use has been found in many other contexts.[71]

Fair use can be conceived of as a "zero-price" compulsory license. Essentially, a court permits a defendant to use the work for a specific purpose while providing no compensation to the copyright owner.[72] Drawing on this conception, a highly influential theory, first advanced by Wendy Gordon, argues that fair use, like the liability rules described above, is primarily concerned with addressing market failures caused by transaction costs.[73]

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67. *See* Epstein, *supra* note 59, at 2093; Merges, *Contracting into Liability Rules*, *supra* note 8, at 1311-17.

68. *See* Merges, *Contracting into Liability Rules*, *supra* note 8, at 1302-03; *see also infra* text accompanying notes 210-19 (discussing Merges's primary example of this trend: PROs like ASCAP and BMI). Scholars in recent years have tried to move past a strict property-liability rules divide by noting that efficient private ordering in intellectual property markets can occur even in the face of liability rules. For instance, some have even argued that certain forms of seemingly inefficient liability rules are conducive to efficient private ordering because the prospect of the application of an unpalatable liability rule (otherwise known as a penalty default) incentivizes parties to reach agreement when parties are uncertain about whom the penalty default would favor. *See* García, *supra* note 9, at 1163-64.

69. 17 U.S.C. § 107 (2018).

70. *Id.*

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

72. *Cf.* Lemley, *supra* note 3, at 480 ("[Zero-price liability rules] are more commonly thought of as exemptions from, or defenses to, copyright liability. They permit the defendant to act, imposing neither an injunction nor damages liability. At the same time, they are not property rules that vest in copyright defendants the right to stop interference with the exercise of the right."); Lemley & Weiser, *supra* note 8, at 790 (calling fair use a zero-price liability rule).

73. Gordon, *supra* note 8, at 1615.

Though the full scope of Gordon's early work in this field is frequently contested, including by Gordon herself,[74] the theory essentially claims that a finding of fair use is most appropriate when secondary users have been unable to engage in a socially valuable use of copyrighted material because transaction costs[75] have prevented market-based licensing from taking place.[76]

An implication of the transaction-cost-focused account of fair use, however, is that the setting of a market price might be a preferable way to remedy transaction costs, as the property-liability rules scholarship described above generally takes for granted. Fair use's zero-price approach fits uneasily with this conclusion.[77] A further implication is that fair use would no longer be necessary in situations where transaction costs could be minimized through means other than judicial intervention, such as technologies that make it easier for licensees to transact with licensors.[78] This has led to several arguments that

74. *See, e.g.*, Wendy J. Gordon, *Excuse and Justification in the Law of Fair Use: Transaction Costs Have Always Been* Part *of the Story*, 50 J. COPYRIGHT SOC'Y U.S.A. 149, 150-51 (2003).

75. While Gordon does not limit her discussion to market failures caused by transaction costs, this was the primary interpretation of her theory. *See* Ben Depoorter & Francesco Parisi, *Fair Use and Copyright Protection: A Price Theory Explanation*, 21 INT'L REV. L. & ECON. 453, 455 (2002) (explaining that under this theory, "the fair-use doctrine effectively 'reallocates' ownership rights in order to minimize the negative efficiency consequences of positive transaction costs in the market"); Sag, *supra* note 45, at 227 ("Applications of Gordon's market-failure framework have largely concentrated on the role of transaction costs in justifying fair use."); *see also, e.g.*, Tom W. Bell, *Fair Use vs. Fared Use: The Impact of Automated Rights Management on Copyright's Fair Use Doctrine*, 76 N.C. L. REV. 557, 583 (1998) ("[T]he scope of the fair use defense rises and falls with the transaction costs of licensing access to copyrighted works.").

76. This theory appeared to be borne out in the Supreme Court's decision in *Sony Corp. of America v. Universal City Studios, Inc.*; the Court found fair use when consumers used Betamax video recorders to watch television content after it had aired. 464 U.S. 417, 454-55 (1984). The Court thus concluded that the makers of the device should not be liable for contributory copyright infringement. *Id.* at 456. Under a transaction cost remediation account, this outcome makes sense: It would have been impossible for consumers or the Betamax manufacturers to secure permission from the copyright owners of every television work (a huge number of licensees and licensors) to record these works for later watching. As voluntary transactions would have been impeded by transaction costs, the fair use doctrine stepped in to allow consumers to continue recording programs, even without permission from the copyright owners. *See* Abraham Bell & Gideon Parchomovsky, *The Dual-Grant Theory of Fair Use*, 83 U. CHI. L. REV. 1051, 1066-67 (2016).

77. Gordon's original article dabbled with the idea of replacing fair use, in certain cases, with a liability rule based on a market-mimicking price, but rejected this idea primarily because of concerns about judicial expertise and deference to legislative action. *See* Gordon, *supra* note 8, at 1623-24.

78. *See* Depoorter & Parisi, *supra* note 75, at 456-57; Gordon, *supra* note 74, at 188-89.

fair use can and will become largely unnecessary as new technology allows for more efficient market transactions.[79]

Seeing these arguments as challenges to fair use's continued existence, many scholars have questioned the transaction costs theory altogether, both in normative and empirical terms. Some argue that, from an economic perspective, an account of market failure focused only on transaction costs is ill-suited to the unique nature of copyright goods. Glynn Lunney, in particular, explains that market failures based on transaction costs are problematic in markets for private goods, which are rivalrous (meaning that the consumption of the good by one consumer inherently prevents others from consuming it).[80] In contrast, works of information are public goods, which are inherently nonrivalrous. In private goods markets, the elimination of transaction costs enhances welfare by ensuring the market can efficiently allocate this limited supply of goods.[81] This logic does not necessarily hold true for copyrights, which are specially created property entitlements designed to render nonrivalrous and nonexcludable works of information excludable.[82] Even if transaction costs in copyright markets are eliminated, copyright will continue to generate costs—in particular, what economists call deadweight loss—by allowing authors to charge above marginal cost for their works and excluding consumers who are unwilling to pay this price.[83]

Lunney recognizes that tolerating this deadweight loss may be warranted to ensure authors have adequate incentive to innovate, as is consistent with the conventional instrumentalist justification for copyright markets.[84] However, he views fair use as a mechanism for renegotiating the incentives/access

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79. *See, e.g.*, Robert P. Merges, *The End of Friction? Property Rights and Contract in the "Newtonian" World of On-Line Commerce*, 12 BERKELEY TECH. L.J. 115, 130-34 (1997); *see also* PAUL GOLDSTEIN, COPYRIGHT'S HIGHWAY: FROM GUTENBERG TO THE CELESTIAL JUKEBOX 202-03 (rev. ed. 2003) (describing transaction-cost-reducing technologies); Frank Pasquale, *Breaking the Vicious Circularity:* Sony*'s Contribution to the Fair Use Doctrine*, 55 CASE W. RES. L. REV. 777, 779 (2005).

80. *See* Glynn S. Lunney, Jr., *Fair Use and Market Failure:* Sony *Revisited*, 82 B.U. L. REV. 975, 992-94 (2002) (noting that the "lack of physical rivalry is . . . the defining difference between copyrighted works and more traditional private goods").

81. *See id.* at 993 (theorizing that "[i]n the absence of transaction costs . . . and the other market imperfections" for private goods, a number of welfare-enhancing transactions would take place).

82. *See id.* at 993, 1030.

83. *See id.* at 994-96 ("Because market failure is inevitable, the concept of market failure cannot serve as a useful guide in determining which uses of a copyrighted work should be fair and which uses unfair . . . ."). Lunney suggests that if copyright owners were able to perfectly price discriminate (generally understood to be impossible in the real world), this deadweight loss would also be remedied. *See id.* at 995.

84. *Id.* at 994-96; *see also supra* notes 44-49 and accompanying text.

tradeoff on a case-by-case basis.[85] Seen through this lens, fair use allows a court to directly balance between the public's interest in unimpeded access to certain works and the harm to authors' incentives that might arise from permitting uncompensated use.[86] This analysis may sometimes track the direction that a licensing market free of transaction costs might lead, but it may also support the conclusion that secondary users should be allowed free use of a work notwithstanding what a market-based allocation of copyright entitlements would dictate.[87]

A similar theory treats fair use as a tool for allowing "spillovers," or positive externalities, generated by uses of copyright goods to occur.[88] Brett Frischmann and Mark Lemley explain that access to existing copyrighted works can generate a range of such spillovers, including the creation of new works that incorporate existing content and the development of complementary technologies that enhance enjoyment of works for consumers.[89] Like Lunney, Frischmann and Lemley also find the transaction costs account of fair use too limiting.[90] Instead, fair use should be understood as a mechanism for balancing between the value of copyright spillovers and the potential loss to copyright's incentive function that would occur by allowing uncompensated use.[91]

The narrow transaction-cost-focused version of fair use rests on different conceptions of how copyright markets fail than the more expansive approach embraced by Lunney, Frischmann and Lemley, and others[92]—though both are

85. Lunney, *supra* note 80, at 998-99.

86. *See id.* at 994-96.

87. *See id.* at 1030. Thus, under Lunney's theory, cases like *Sony* do not rest on the infeasibility of licensing markets, but rather the "competing public interests at stake. On one side of this balance, unauthorized time-shifting 'yields societal benefits' by 'expand[ing] public access to freely broadcast television programs.' On the other, unauthorized time-shifting might reduce the supply and variety of original works available by impairing the incentives for their creation." *Id.* at 981-82 (footnotes omitted) (quoting Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417, 454 (1984)); *see supra* note 76 (discussing *Sony*).

88. *See* Frischmann & Lemley, *supra* note 48, at 288-89 ("Many paradigmatic uses deemed fair involve use of a work to engage in activities that yield diffuse, small-scale spillovers to a community.").

89. *Id.* at 285-86.

90. *See id.* at 288.

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

92. *See, e.g.*, Bell & Parchomovsky, *supra* note 76, at 1056 ("Fair use helps filter protections to ensure efficient allocation of uses to societally favored users while still fully maintaining the incentive effects of copyright protection for authors."); Depoorter &
footnote continued on next page

grounded in economic theory.[93] The former version sees transaction costs as the only meaningful barrier to otherwise efficient allocations of copyright goods in the marketplace, while the latter version considers factors like deadweight loss and positive externalities as relevant to fair use's role in ensuring a well-functioning copyright system.[94] Some other scholars avoid economic analysis but share the view that fair use should be conceived of as a tool for directly weighing the incentives provided by copyright against the social goals founded on public access to works, noting that this balancing approach provides a better explanation of the actual fair use case law in recent decades.

In an empirical study of fair use decisions, Barton Beebe explains that "[i]n practice, judges appear to apply [fair use] in the form of a cognitively more familiar two-sided balancing test in which they weigh the strength of the defendant's justification for its use . . . against the impact of that use on the incentives of the plaintiff."[95] Similarly, Pamela Samuelson has divided fair use

Parisi, *supra* note 75, at 458 ("Fair-use defenses can be regarded as justifiable and instrumental in minimizing the welfare losses occasioned by the strategic behavior of the copyright holders."); Lydia Pallas Loren, *Redefining the Market Failure Approach to Fair Use in an Era of Copyright Permission Systems*, 5 J. INTELL. PROP. L. 1, 33 (1997) (arguing that fair use should address the "market failure that exists when there are diffuse external benefits that cannot be efficiently internalized in any bargained-for exchange"). *See generally, e.g.*, William W. Fisher III, *Reconstructing the Fair Use Doctrine*, 101 HARV. L. REV. 1659 (1988) (providing an alternative approach to fair use analysis to render it more consistent with allocative efficiency, as well as other normative goals).

93. *See* Sag, *supra* note 45, at 227-31 (distinguishing between the transaction costs approach to fair use and what the author calls a "cost-benefit" approach advanced by Lunney, Fisher, and other scholars, but noting that both are grounded in economic reasoning).

94. These competing emphases underscore a deeper debate in copyright scholarship about the limits of markets in facilitating copyright's policy goals. As Shyamkrishna Balganesh has noted, those who champion the transaction costs approach generally assume that the "incentive provided by copyright's promise of exclusivity . . . correlate[s] directly with the overall production of creative expression" and couples these "neoclassical assumptions . . . with property ideas." Balganesh, *supra* note 43, at 1579-80; *see* Bell & Parchomovsky, *supra* note 76, at 1054-55 ("[T]he market-failure theory implicitly presumes that the efficient economic strategy for allocating copyright rights is to grant them in their entirety to the author."). In contrast, a second camp is more skeptical of the possibility that propertization will, in and of itself, yield an optimal distribution of creative works. These scholars generally recognize the importance of markets for incentivizing new works—though some dispute this altogether—but qualify this endorsement with a "concern for copyright's social cost." *See, e.g.*, Neil Weinstock Netanel, *Copyright and a Democratic Civil Society*, 106 YALE L.J. 283, 308-09 (1996). Accordingly, they "question the desirability of expanding copyright beyond the minimum necessary to provide authors with an incentive to produce." *Id.* at 309; *see also* Sag, *supra* note 45, at 226 (noting that some analyses of fair use convey a "deep pessimism in the capacity of market institutions to provide the kind of flexibility that the users of copyrighted works require").

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

cases into several "policy-relevant clusters" but also has explained that the core function of fair use is negotiating copyright's "limited monopoly" by allowing the public to use copyrighted works in situations where the market harm to the copyright owner (and, by implication the harm to her incentive to create) would be low.[96] Neil Netanel has linked this limited monopoly approach to the transformative use conception of fair use, introduced by Judge Pierre Leval in an influential 1990 law review publication,[97] and adopted by the Supreme Court in *Campbell v. Acuff-Rose*.[98] Netanel argues that this approach "overwhelmingly drives fair use analysis in the courts today."[99]

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

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

While the different results of these two approaches are widely acknowledged in the fair use context, scholars generally do not treat the Copyright Act's extant compulsory licensing schemes in copyright-specific terms, instead describing them as addressing the more limited problem of

96. Samuelson, *supra* note 71, at 2615-17; *see also* Pamela Samuelson, Essay, *The Relative Virtues of Bottom-Up and Top-Down Theories of Fair Use*, 83 U. CHI. L. REV. ONLINE 206, 208-09 (2017) (responding to Bell & Parchomovsky, *supra* note 76) (reiterating the "bottom-up limited monopoly theory").

97. Pierre N. Leval, Commentary, *Toward a Fair Use Standard*, 103 HARV. L. REV. 1105, 1110 (1990).

98. *See* Neil Weinstock Netanel, *Making Sense of Fair Use*, 15 LEWIS & CLARK L. REV. 715, 736 (2011) (noting that unlike the market failure approach, "[t]he transformative use paradigm views fair use as integral to copyright's purpose of promoting widespread dissemination of creative expression, not a disfavored exception to copyright holders' exclusive rights"); *see also* Campbell v. Acuff-Rose Music, Inc., 510 U.S. 569, 590 n.21, 591 (1994) (discussing fair use as a balancing of social interests).

99. Netanel, *supra* note 98, at 734; *see also* Bell & Parchomovsky, *supra* note 76, at 1067-69 (calling *Sony* the "the high-water mark for the market-failure theory" and arguing that the Supreme Court and other courts have since embraced the idea that fair use is not an anomaly, only used to address transaction costs, but an "intrinsic and indispensable part of the design of the constitutional copyright system"); Rebecca Tushnet, *Content, Purpose, or Both?*, 90 WASH. L. REV. 869, 875-83 (2015) (discussing the expansion of the fair use doctrine's transformative use paradigm in recent years).

transaction costs.[100] This Article's argument is that the Copyright Act's compulsory licensing regimes are informed by an impulse similar to fair use: to weigh the importance of public access to creative works against the incentive function provided by market-based licensing. In this respect, just as fair use provides a zero-price compulsory license in order to selectively rebalance the incentives/access tradeoff, so too an industry-wide compulsory license can price royalties at rates explicitly designed to foster access, sometimes meaning copyright owners are compensated less than they would be in open markets. In so doing, these regimes can, and, as the next Parts argue, have, attempted to mitigate some of the social costs imposed by copyright's exclusive rights.[101]

Fair use's zero-price approach is of course distinct from the compulsory licensing system's price-setting scheme, which provides some compensation to copyright owners. In this respect, an implication of this Article's argument is that fair use might be considered one of several approaches to intervening in copyright markets. The first approach, embodied in fair use, intervenes in situations where there is social value to a new use and little or no risk to the

100. *See supra* note 8 and accompanying text. The notion that a compulsory licensing regime *could* be used to renegotiate the incentives/access tradeoff is not a new idea from a theoretical perspective. A number of scholars have proposed hypothetical compulsory licensing schemes, designed to replace the traditional property-based approach to copyright, in order to address the importance of public access to creative works. In particular, when peer-to-peer file sharing was poised to disrupt copyright industries in the early 2000s, several scholars proposed the creation of a system that would allow consumers to use shared copyrighted music and films, without the consent of the copyright owners, in exchange for a fixed fee. Drawing on Netanel's work, William Fisher, for example, proposed an administrative compensation system in which users would receive a compulsory license to reproduce or distribute audio and video recordings over the internet, and copyright owners would be compensated, in proportion to the use of their content, via proceeds from a tax placed on digital recording devices, storage media, and internet services. WILLIAM W. FISHER III, PROMISES TO KEEP: TECHNOLOGY, LAW, AND THE FUTURE OF ENTERTAINMENT 203-58 (2004); *see also, e.g.*, Jessica Litman, *Sharing and Stealing*, 27 HASTINGS COMM. & ENT. L.J. 1, 32-38 (2004) (summarizing various compulsory-license-like proposals); Neil Weinstock Netanel, *Impose a Noncommercial Use Levy to Allow Free Peer-to-Peer File Sharing*, 17 HARV. J.L. & TECH. 1, 4 (2003) (providing one of the first proposals for a compensation system for peer-to-peer sharing);. In structuring these compulsory licensing regimes, these scholars invoked an incentives/access-focused conception of compulsory licensing, rather than the transaction costs rationale that is frequently used to explain the Copyright Act's existing compulsory licensing schemes. *See* Netanel, *supra*, at 19-21; *see also* Raymond Shih Ray Ku, *The Creative Destruction of Copyright: Napster and the New Economics of Digital Technology*, 69 U. CHI. L. REV. 263, 299-324 (2002) (discussing how proposed compulsory licensing schemes are grounded in the "incentive-access paradox"). While these scholars were primarily interested in identifying new regimes to *replace* many aspects of copyright's property-centric structure, this Article argues that the Copyright Act's *existing* compulsory licenses also serve to facilitate balance in the incentives/access tradeoff.

101. *See infra* Parts II, III.A.2, III.B.1, IV.A-.B.

copyright owner's established markets (and, by extension, copyright's incentive function). Because there is no market harm to the copyright owner, fair use provides no compensation.

The second approach—the conception of compulsory licensing advanced by this Article—exists outside the limits of fair use, where a use is socially valuable but could harm the copyright owner financially (for example, by providing a plausible substitute for the copyright owner's goods). In such situations, a compulsory licensing regime ensures that the copyright owner receives some compensation, but still allows the use to occur. The specific compensation, however, is calculated with reference to the social value of new use; indeed, as the next Parts explain, rate-setting regulators historically chose rates for new dissemination technologies that were at the lower end of those suggested by market proxies, out of recognition of the importance of these disseminators in facilitating access to copyrighted works.[102]

A third approach—the conventional account of compulsory licensing—is not tied to rebalancing the incentives/access tradeoff but instead focused only on remediating transaction costs. This approach would counsel only in favor of trying to mimic the market rates that might prevail but for the transaction costs.

It is important to note that the second approach does not necessarily mean that a compulsory licensing regime cannot also address transaction costs, such as by providing opportunities for bulk licensing.[103] Indeed, the remediation of transaction-cost-based market failures can further public access to copyrighted works by allowing an exchange where none could exist before.[104] However, as the fair use scholarship has recognized, an *exclusive* focus on transaction costs provides only limited justifications for applying a compulsory license. In contrast, the second approach's focus on the incentives/access tradeoff often counsels in favor of broader and more frequent interventions in the market.[105]

As the next Part explores, the second approach—using compulsory licensing to effectuate copyright policy goals—provides a better explanation of the music compulsory licensing regime's origins and original rate-setting regime than the conventional transaction-cost-focused account.

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102. *See infra* Parts II.B, III.B.

103. *See infra* Part III.A (noting the benefits of bulk licensing, like reduced transaction costs, for digital distributors).

104. *See* Gordon, *supra* note 8, at 1615.

105. *Cf.* Sag, *supra* note 45, at 226 (noting that the transaction costs theory of fair use "[r]est[s] on an initial presumption of efficient private ordering" whereas the alternative approach "manifests a deep pessimism in the capacity of market institutions to provide the kind of flexibility that the users of copyrighted works require"); *infra* Part III.B (discussing the differences between a copyright-policy-focused rate-setting approach and an exclusively market-mimicking approach).

II. The Mechanical License and Copyright Policy

Section 115 of the Copyright Act establishes what is commonly called the "mechanical" compulsory license.[106] When the owner of a musical composition agrees once to allow her composition to be recorded and distributed via a CD, MP3, or any other "mechanically" playable object, she must then agree to license her composition to all additional licensees at a government-set price.[107] Licensees may simply use the copyrighted work and provide notice and payment to the copyright owner through the Copyright Office,[108] a regulatory body that administers copyright registrations and other aspects of the copyright system.[109] Licensees and licensors can also bypass this process by reaching direct licensing deals,[110] which they often do via an intermediary known as the Harry Fox Agency.[111] But the shadow of the compulsory licensing regime informs these negotiations, and the compulsory rate often functions as a de facto cap on privately made licensing deals.[112]

This Part argues that the early history of the mechanical license clarifies its role as a tool for negotiating the incentives/access tradeoff. Part II.A explains that the license was created as a way of allowing new technologies of dissemination—in particular, the player piano and record player—to flourish, while still providing compensation to copyright owners that would allow them to maintain their economic incentive to create new works. While the mechanical license originally attempted to effectuate this balance using a fixed two-cent licensing rate, the 1976 Copyright Act replaced this rate with a rate-setting regime governed by policy objectives known as the 801(b) factors. As Part II.B explores, these objectives appear to have been designed and implemented to allow for periodic readjustment of the balance of incentives

106. 17 U.S.C. § 115 (2018).

107. *Id.* § 115(c)(1)(E)-(F).

108. *Id.* § 115(b).

109. *Id.* § 701.

110. *Id.* § 115(c)(1)(D).

111. *FAQs*, HARRY FOX AGENCY, https://perma.cc/9ECP-SQKJ (archived Feb. 12, 2020); *see also* Sarah Jeong, *A $1.6 Billion Spotify Lawsuit Is Based on a Law Made for Player Pianos*, VERGE (Mar. 14, 2018, 12:28 PM EDT), https://perma.cc/V3N2-U5BT (outlining the role of the Harry Fox Agency in mechanical licensing). The mechanical license now also regulates the digital distribution of recorded music. *See infra* Part III.A.4.

112. U.S. COPYRIGHT OFFICE, *supra* note 1, at 29; *see also* Lemley, *supra* note 3, at 479. In theory, the mechanical license only applies to recordings of compositions that follow the first recording; for this reason, it is occasionally called the "cover license." *See* Peter S. Menell, *Adapting Copyright for the Mashup Generation*, 164 U. PA. L. REV. 441, 465 n.120 (2016). But the regulatory scope of the license is far more expansive than simply allowing cover songs: The determined rates generally create a de facto ceiling on negotiated licensing rates for any recording of a musical composition, including the first recording. *See* FISHER, *supra* note 100, at 48.

and access in the music marketplace, and, in particular, to ensure that access-expanding forms of music dissemination could flourish.

A. The Origins of the Mechanical License

U.S. copyright law has recognized an author's exclusive rights in a written musical composition since 1831.[113] In its early years, this copyright interest was limited to the copying of sheet music and the public performance of musical works, both of which required a license from the copyright owner.[114] In the late 1800s, two new technologies began disrupting this status quo. The first was the record player (originally known as the "talking machine" or phonograph),[115] and the second was the player piano, which used a pneumatic system that allowed conventional pianos to mechanically play music from paper rolls with small perforations.[116] Both record and player piano technologies dramatically and quickly increased the availability of music to consumers: "[B]y 1899, 2.8 million records had been sold," and by 1902, at least a million piano rolls were in circulation.[117]

Records and piano rolls allowed for the fixation of a copyrighted musical composition into an object capable of playing (and replaying) the song. This was new terrain for U.S. law; the Supreme Court had never recognized that existing copyright law extended to such "mechanical" reproductions before.[118] At least one piano roll producer began paying precautionary royalties to music publishers, but the law was unsettled as to whether the unlicensed creation of a record or piano roll infringed the musical composition copyright owner's exclusive rights.[119]

The Supreme Court finally addressed the question in *White-Smith Music Publishing Co. v. Apollo Co.*, concluding that piano rolls did not implicate copyright because they are not "copies within the meaning of the copyright act."[120] The Court, however, invited Congress to extend copyright to

113. Robert P. Merges, *One Hundred Years of Solicitude: Intellectual Property Law, 1900-2000*, 88 CALIF. L. REV. 2187, 2195 (2000); *see also* Act of Feb. 3, 1831, ch. 16, 4 Stat. 436.

114. *See* Lydia Pallas Loren, *Untangling the Web of Music Copyrights*, 53 CASE W. RES. L. REV. 673, 679, 683 (2003).

115. Wu, *supra* note 22, at 297-98.

116. Loren, *supra* note 21, at 545-46.

117. Wu, *supra* note 22, at 298.

118. *See* White-Smith Music Publ'g Co. v. Apollo Co., 209 U.S. 1, 9-18 (1908).

119. *See Revision of Copyright Laws: Hearing on Pending Bills to Amend and Consolidate the Acts Representing Copyright Before the S. and H. Comms. on Patents*, 60th Cong. 225-27 (1908) [hereinafter *Hearing: Revision of Copyright Laws*] (statement of Nathan Burkan, counsel, Music Publishers' Association of America).

120. 209 U.S. at 18.

mechanical reproductions if it so chose.[121] Congress accepted this invitation in the 1909 Copyright Act, which explicitly granted copyright owners the right to exclude use of "parts of instruments serving to reproduce mechanically the musical work."[122] The 1909 Act, however, applied a "condition" to this extension of copyright protection—the compulsory licensing scheme that is now known as the mechanical license or § 115 license.[123] Congress set the compulsory rate at a fixed two-cent royalty per copy.[124]

Some scholars believe that the mechanical license was created to address fears that a large piano roll company, the Aeolian Company, would monopolize the piano roll market and shut out competitors.[125] By allowing all comers to make recordings of the composition following the copyright owner's initial choice to do so, the license would prevent any single piano roll manufacturer from becoming the exclusive licensee of musical composition copyright owners.[126] The monopolization explanation makes sense to a point. The Aeolian Company had indeed entered into an exclusive licensing arrangement with a group of music publishers even before Congress or the Supreme Court had determined whether the musical composition copyright extended to mechanical reproduction.[127] In the lead-up to the 1909 Copyright Act, Congress expressed concern that copyright owners could use their newly secured copyright interests to ally with a single piano roll manufacturer to "monopolize the business of manufacturing [and] selling music-producing machines."[128]

But the monopolization argument does not necessarily provide a full account. As Tim Wu has explained, the early recording industry made a strategic choice to argue against expanding copyright to mechanical reproduction by stoking contemporary fears over trusts.[129] The Aeolian Company, the chosen scapegoat, was painted as the beneficiary of a large global conspiracy designed to further its own wealth at the expense of the nascent recording industry, songwriters, and the public.[130] But concerns about Aeolian's

121. *Id.*

122. Act of Mar. 4, 1909, ch. 320, § 1(e), 35 Stat. 1075, 1075-76 (repealed 1976).

123. *Id.*

124. *Id.*

125. *See, e.g.*, Abrams, *supra* note 10, at 219-20; Loren, *supra* note 21, at 548; Loren, *supra* note 114, at 680-81; Merges, *Contracting into Liability Rules*, *supra* note 8, at 1309; Samuelson, *supra* note 8, at 38; *see also* U.S. COPYRIGHT OFFICE, *supra* note 1, at 26.

126. *See, e.g.*, Loren, *supra* note 21, at 548-49; Samuelson, *supra* note 8, at 38.

127. *See* Abrams, *supra* note 10, at 219-20.

128. H.R. REP. NO. 60-2222, at 7 (1909); *see also id.* at 8 (discussing concerns about the "possibility of a great music trust in this country").

129. Wu, *supra* note 22, at 300.

130. *See id.* (describing contemporary editorials).

monopoly practices were likely overblown: Fewer than half of active music publishing companies had agreed to its license deal; a majority were still willing to license to other player piano roll companies after the law was finally settled.[131] Furthermore, both the choice of a compulsory license and the actual structure of the license are odd from the perspective of the legal regime generally devoted to concerns about monopolization: antitrust law. Congress had long resisted the adoption of compulsory patent licensing as an antitrust remedy.[132] In contemporaneous antitrust cases, a more common approach was simply voiding contracts that were being used to further monopolization efforts.[133]

Several scholars have argued that the monopolization concerns expressed by Congress belied a deeper issue, and that the mechanical license was in fact created to address particular concerns endogenous to copyright. Jane Ginsburg, for example, views the creation of the mechanical license as an effort by Congress to "readjust[] the balance" after *White-Smith* so as to compensate copyright owners while still allowing the new dissemination technologies to flourish.[134] By coupling the extension of copyright to mechanical reproduction with a compulsory licensing scheme, Congress "compensated copyright holders but permitted the development of a recording industry."[135]

In this respect—though not framed as such by these scholars—the birth of the mechanical royalty appears to be an example of Congress reconfiguring the incentives/access tradeoff using a compulsory licensing regime. Congress created a property entitlement where the Supreme Court had found none existed—a right to exclude secondary users from using musical compositions to create mechanical recordings—but then immediately tempered that

131. *See* Abrams, *supra* note 10, at 219-20; *see also* 3 RUSSELL SANJEK, AMERICAN POPULAR MUSIC AND ITS BUSINESS: THE FIRST FOUR HUNDRED YEARS 22-23 (1988). And the deal, which did not preclude copyright owners from licensing to record manufacturers, may have been entered into by Aeolian not as an attempt to shut out competitors, but simply out of fear that its huge investments in piano roll factories could be compromised by a Supreme Court decision finding that existing copyright law extended to piano rolls and that all of Aeolian's planned piano rolls were unlawful infringements. *See Hearing: Revision of Copyright Laws*, *supra* note 119, at 225-27 (statement of Nathan Burkan, counsel, Music Publishers' Association of America).

132. Hartford-Empire Co. v. United States, 323 U.S. 386, 417 (noting that Congress had frequently declined to adopt a compulsory license system for patents), *modified*, 324 U.S. 570 (1945); HOVENKAMP ET AL., *supra* note 66, § 6.05[C].

133. *See, e.g.*, Spencer Weber Waller, Essay, *The Past, Present, and Future of Monopolization Remedies*, 76 ANTITRUST L.J. 11, 17 & n.30 (2009) (citing cases in which contracts were voided).

134. Ginsburg, *supra* note 22, at 1626-27.

135. *Id.* at 1627; *see also* Peter DiCola & Matthew Sag, *An Information-Gathering Approach to Copyright Policy*, 34 CARDOZO L. REV. 173, 202 (2012) (describing the creation of the mechanical license as a compromise); Wu, *supra* note 22, at 303 (same).

entitlement using a scheme requiring licensing to all comers. Under this compromise, the new access-enhancing form of distribution would be allowed to flourish, but the copyright owners would still receive some compensation.

Congress's choice to set the mechanical rate at a fixed two cents is important for understanding this regulatory strategy. In prior versions of the 1909 Act, Congress had in fact considered setting the rate through mechanisms that would more closely track market forces,[136] such as a percentage of the record or piano roll retail price,[137] a percentage of the manufacturer's revenue,[138] or through reference to the rates in existing free market licensing deals.[139] While Congress offered no clear justification for ultimately choosing a fixed rate,[140] this approach makes a little more sense through the lens of copyright policy, as a means of increasing public access to music beyond what market-based ordering might have provided. While the copyright owners were certainly better off than they were after *White-Smith*, when they had no right to royalties for mechanical reproductions at all, the two-cent rate likely provided them with less compensation than they would have received in an open market.[141] The low royalty costs in turn potentially allowed the nascent recording industry to more quickly and cheaply produce records and piano

136. Other countries that enacted compulsory licenses in this period generally chose to price the license using market proxies. For example, the English Copyright Act of 1911 implemented a compulsory mechanical license for phonorecords and piano rolls with rates based on a percentage of retail price and adjustable by the Board of Trade. Copyright Act 1911, 1 & 2 Geo. 5 c. 46, § 19(3) (UK); *see also* ALFRED M. SHAFTER, MUSICAL COPYRIGHT 238 (1932); David J. Brennan, *The First Compulsory Licensing of Patents and Copyright*, 17 LEGAL HIST. 1, 33-35 (2017) (discussing the history of compulsory licenses in the English Copyright Act).

137. *See, e.g.*, H.R. 21,984, 60th Cong. § 31 (1908) (setting the rate as 10% of the "marked retail price" of any device or appliance other than a "talking-machine record"); *see also* H.R. 22,071, 60th Cong. § 31a (1908) (setting the same rate for "any device or contrivance adapted to reproduce mechanically" musical works).

138. *See, e.g.*, H.R. 27,310, 60th Cong. § 1(e) (1909) (setting the rate as "five per centum of the sum derived bona fide by the manufacturer thereof").

139. *See, e.g.*, H.R. 24,782, 60th Cong. § 31a (1908); H.R. 21,592, 60th Cong. § 1(e) (1908); *see also* STAFF OF SUBCOMM. ON PATENTS, TRADEMARKS, & COPYRIGHTS OF THE S. COMM. ON THE JUDICIARY, 86TH CONG., COPYRIGHT LAW REVISION: STUDIES 5-6, at 4-12 (Comm. Print 1960) [hereinafter STAFF REPORT: COPYRIGHT LAW REVISION] (summarizing various bills discussing compulsory licenses).

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

141. A fixed two-cent rate was likely lower than what many copyright owners could have charged in 1909. *See* STAFF REPORT: COPYRIGHT LAW REVISION, *supra* note 139, at 95, 110; *see also id.* at 119 (comments of Ralph S. Peer).

rolls,[142] thus increasing music dissemination. Indeed, some have claimed that the mechanical license scheme was essential to the large amount and wide variety of songs produced by the American recording industry during the twentieth century.[143]

B. The Origins of Policy-Driven Rate Setting

The 1909 Copyright Act's two-cent rate was a blunt instrument; while it certainly restructured the music licensing market to the benefit of access-expanding technologies, its status as a fixed rate, unable even to account for inflation, grew increasingly controversial.[144] As one commentator exclaimed in 1957, the 1909 Act was a "great injustice and . . . extraordinary interference with free competition. If the price of butter had been established at a maximum of 15 cents per pound in 1909, one can well imagine the hue and cry which would have been set up in intervening years."[145]

When the Copyright Act was overhauled in 1976, Congress ultimately decided to replace the fixed rate with one administered by a rate-setting entity.[146] If the mechanical license is understood as a means of limiting (but not eliminating) copyright owners' compensation in order to bolster technologies of dissemination, the rate-setting regime created by Congress makes sense from the perspective of substantive copyright policy.

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142. While this point is difficult to prove conclusively, it became a frequent argument used by the compulsory license's defenders whenever Congress considered revisions to the license. For example, in the 1950s, one commenter speculated to Congress that the license was directly responsible for the rapid growth of the record industry in the early twentieth century. *Id.* at 77-78, 125 (comments of Ernest S. Meyers).

143. *See* KAL RAUSTIALA & CHRISTOPHER SPRIGMAN, THE KNOCKOFF ECONOMY: HOW IMITATION SPARKS INNOVATION 140-41 (2012); Menell, *supra* note 112, at 493-95.

144. *See, e.g.*, SHAFTER, *supra* note 136, at 244-45 (discussing the economic hardship the two-cent rate posed for composers and describing the rate as "arbitrary").

145. STAFF REPORT: COPYRIGHT LAW REVISION, *supra* note 139, at 119 (comments of Ralph S. Peer).

146. *See* Copyright Act of 1976, Pub. L. No. 94-553, § 118, 90 Stat. 2541, 2565-66 (codified as amended at 17 U.S.C. § 118 (2018)). In analyzing Congress's decisionmaking in and leading up to the 1976 Copyright Act, it is necessary to keep in mind Jessica Litman's important observation that the Act's legislative history "reflects an anomalous legislative process designed to force special interest groups to negotiate with one another." Jessica D. Litman, *Copyright, Compromise, and Legislative History*, 72 CORNELL L. REV. 857, 862 (1987). Rent seeking by these groups certainly informed the substance of many of the Act's changes to copyright law, and debates over the mechanical license were likely no exception. *See* Greenman & Deutsch, *supra* note 140, at 15 & n.65 (describing lobbying by the Recording Industry Association of America to prevent the repeal of the mechanical license). Nonetheless, the Act's legislative history, if properly contextualized, can still help illuminate how and why Congress developed the mechanical license's new rate-setting regime.

After considering proposals to eliminate the license entirely or to maintain it with a higher fixed rate, Congress ultimately chose to create a new administrative entity, the Copyright Royalty Tribunal (CRT), to set rates for the mechanical license every ten years.[147] The 1976 Act also provided the CRT with instructions on how to arrive at the mechanical royalty rate. The CRT was instructed to attempt to realize four policy criteria, often known as the 801(b) factors or objectives:

> (A) To maximize the availability of creative works to the public;
>
> (B) To afford the copyright owner a fair return for his creative work and the copyright user a fair income under existing economic conditions;
>
> (C) To reflect the relative roles of the copyright owner and the copyright user in the product made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, risk, and contribution to the opening of new markets for creative expression and media for their communication;
>
> (D) To minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices.[148]

It is difficult to determine the origins of these policy criteria. The congressional record is sparse, but the seeds of what ultimately became the 801(b) factors appear to have been planted in Senate hearings in 1967. During these hearings, Congress entertained the notion that music publishers should be regulated like public utilities.[149] Thurman Arnold, counsel for the Recording Industry Association of America, argued that the mechanical license rate needed to be set using the "accepted standards of statutory ratemaking" applied to public utilities.[150] He argued that such standards included ensuring a

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147. Copyright Act of 1976 §§ 801(a), 804(a)(2)(B), 90 Stat. at 2594, 2597. The CRT, which was also charged with administering the new compulsory licenses created in the 1976 Act, consisted of five "commissioners" appointed by the President with advice and consent of the Senate. *See* Recording Indus. Ass'n of Am. v. Copyright Royalty Tribunal, 662 F.2d 1, 4-5 (D.C. Cir. 1981).

148. Copyright Act of 1976 § 801(b)(1), 90 Stat. at 2594-95.

149. *See Copyright Law Revision: Hearings on S. 597 Before the Subcomm. on Patents, Trademarks, & Copyrights of the S. Comm. on the Judiciary*, 90th Cong. 383 (1967) [hereinafter *Hearings: Copyright Law Revision 1967*] (testimony of Robert R. Nathan on behalf of the National Music Publishers' Association, Inc.); *id.* at 479 (testimony of Thurman Arnold, Special Counsel, Record Industry Association of America, Inc.). Under U.S. law, firms that provide public goods such as electricity and gas are frequently permitted to function as natural monopolies but are in turn subject to regulation, including price setting, to prevent the monopoly from exploiting its market power to charge consumers high prices. *See* CHRISTOPHER DECKER, MODERN ECONOMIC REGULATION: AN INTRODUCTION TO THEORY AND PRACTICE 14-15, 18-19, 24 (2015). The "traditional" approach to such rate setting is rate-of-return regulation, which sets prices with the goal of allowing firms to only recoup their costs. *See id.* at 104-08.

150. *See Hearings: Copyright Law Revision 1967*, *supra* note 149, at 468-69 (testimony of Thurman Arnold, Special Counsel, Record Industry Association of America, Inc.).

rate that "divides the rewards for the respective creative contributions of the record producers and the copyright owners of the lead tune equitably between them."[151] Though the music publishers disputed both the analogy and Arnold's proposed standard,[152] Congress eventually determined that mechanical license rate setting would be based on policy criteria similar to those introduced by Arnold.[153]

This rate-setting approach differed dramatically from some of the other compulsory license schemes created in the 1976 Copyright Act, which appear to have been designed to remedy more conventional transaction cost problems and, accordingly, instructed regulators to set rates based on market proxies.[154] In particular, the 1976 Copyright Act's compulsory license for public broadcasting provides the best contrast to the 801(b) approach. Under this license, noncommercial broadcasters (such as NPR and PBS) may use a compulsory license to broadcast copyrighted music and audiovisual works.[155] In establishing this regime, Congress made clear that its primary concern was transaction costs, in particular the "administratively cumbersome and costly 'clearance' problems" encountered by small public broadcasters when seeking to use copyrighted works, rather than any more normative concerns about the importance of public broadcasting.[156] Consistent with a transaction costs approach, the rate-setting standard was market focused,[157] explicitly instructing regulators to set rates that could be based on "rates for comparable circumstances under voluntary license agreements negotiated" between copyright owners and commercial broadcasters.[158]

In contrast, the 801(b) factors correspond in many respects to an approach to compulsory licensing that emphasizes the incentives/access tradeoff, rather than only transaction cost remediation. In particular, the first factor

151. *Id.* at 469.

152. The music publishers' experts disputed the public utility analogy generally and noted that even if the analogy were justified, the proposed "reward" sharing standard was not actually a conventional feature of public utility rate making. *See id.* at 1090-94 (testimony of Robert R. Nathan on behalf of the National Music Publishers' Association, Inc.) ("As far as the . . . so-called accepted standard is concerned, I have never in all my experience encountered this novel concept of dividing rewards for creative contributions as a meaningful and relevant standard of ratemaking.").

153. Copyright Act of 1976 § 801(b)(C), 90 Stat. at 2594-95.

154. *See supra* Part I.A (discussing the link between transaction costs remediation and market proxy-based rate setting).

155. Copyright Act of 1976 § 118(b)(3), 90 Stat. at 2565-66 (codified as amended at 17 U.S.C. § 118(b)(4) (2018)).

156. *See* H.R. REP. NO. 94-1746, at 117 (1976); *see also* Samuelson, *supra* note 8, at 39.

157. *See supra* Part I.A.

158. Copyright Act of 1976 § 118(b)(3), 90 Stat. at 2565-66 (codified as amended at 17 U.S.C. § 118(b)(4)).

emphasizes that the goal of rate-setting regulators should be "[t]o maximize the availability of creative works to the public."[159] As Part I explained, the primary way that copyright maximizes creative content for the public is by providing exclusive rights that allow creators to receive financial rewards for their works, while simultaneously limiting those exclusive rights in order to mitigate social costs. The third 801(b) factor makes this balancing approach even more direct by explicitly asking the rate-setting body to *weigh* the contributions and costs of the copyright owner against the contributions and costs of disseminators in making the copyrighted works available to the public.[160]

The third factor's alleged origins in public utility rate-setting principles also bolster this reading. The analogy between music copyright owners and natural monopolies is imprecise;[161] indeed, as the D.C. Circuit noted in an appeal of an early rate-setting decision, the 801(b) factors are quite different from the "cost of service ratemaking" used for most public utilities.[162] Nonetheless, the emphasis in public utility regulation on using costs as the primary way of calculating an appropriate rate has parallels in what some believe is the price structure that copyright should aspire to: allowing authors to recover "something close to their persuasion costs, defined as the sum necessary to persuade an author to undertake a given work's creation."[163] The recognition that public utility regulation is justified because of a "special privilege" bestowed by the state—the right to privately administer services that might otherwise fall under authority of the state because of their importance to the public interest—also has parallels in copyright law's grant of a special right to exclude so as to encourage the creation of new creative works.[164]

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159. *Id.* § 801(b)(1)(A), 90 Stat. at 2594.

160. *Id.* § 801(b)(1)(C), 90 Stat. at 2595.

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

162. Recording Indus. Ass'n of Am. v. Copyright Royalty Tribunal, 662 F.2d 1, 9 (D.C. Cir. 1981); *see also supra* notes 149-52 and accompanying text.

163. Lunney, *supra* note 80, at 1014-15 (examining the nineteenth-century cost-based focus of copyright); *see also* Lemley, *supra* note 46, at 1054-58 (arguing that intellectual property rights make sense as a way of allowing creators to recoup their fixed costs, but not as a way of allowing creators to internalize all of the positive externalities their works generate).

164. FISHER, *supra* note 100, at 178-79, 181-82 (drawing the link between the special privilege status of public utility owners and intellectual property owners); *cf.* K. Sabeel Rahman, *The New Utilities: Private Power, Social Infrastructure, and the Revival of the Public Utility Concept*, 39 CARDOZO L. REV 1621, 1635 (2018) (arguing that, historically, public utility regulation was applied when "a good was of sufficient social value to be a necessity, and where the provision of this necessity was at risk of subversion or corruption if left to private or market forces").

The first CRT proceeding to set the mechanical royalty rate also supports the conclusion that the 801(b) factors can be read to reflect copyright policy goals. This 1980 proceeding pitted a group of music publishers and songwriters (represented primarily by the National Music Publishers Association) against a group of record labels (represented primarily by the Recording Industry Association of America).[165] The primary dispute was whether the mechanical license was allowing "record companies to buy music at a rate that is unfairly cheap" in light of inflation and the significant increase in record label profits.[166] After a 46-day hearing, the CRT chose to raise the statutory rate, though not to a level as high as the music publishers had sought.[167]

The CRT found, overall, that the 801(b) factors supported raising the statutory rate, but cited the third "relative roles" factor when explaining why it declined to make the rate as high as the publishers and songwriters claimed was appropriate.[168] In analyzing this factor, the CRT noted that while upward adjustment of the statutory rate was important to ensure adequate economic incentives to create, this economic incentive must be weighed against the record labels' role in fostering dissemination.[169] Though songwriters provide the "essential input" in the form of the musical composition, the record labels' role was far greater when it came to the "opening of new markets for creative expression and media for [its] communication," in particular, through "technological innovation, and through development of new types of music."[170]

This discussion of the third factor is notable because it provides an example of the CRT appearing to set a royalty rate through weighing compensation for copyright owners against the prospect of increased public access through innovative forms of dissemination. Even though, in this case, the CRT ultimately chose to raise the royalty rates, its analysis of the third factor provided a blueprint for future rate-setting decisions, as explained further below.[171]

165. *See* Adjustment of Royalty Payable Under Compulsory License for Making and Distributing Phonorecords; Rates and Adjustment of Rates, 46 Fed. Reg. 10,466, 10,466 (Copyright Royalty Tribunal Feb. 3, 1981).

166. *Id.* at 10,467.

167. *Id.* at 10,467, 10,481.

168. *Id.* at 10,480-81.

169. *Id.*

170. *Id.* (quoting Copyright Act of 1976, Pub. L. No. 94-553, § 801(b)(C), 90 Stat. 2541, 2594-95). This "opening of new markets" also occurred "through record clubs, mail order sales and television advertising campaigns" arranged by the labels. *Id.* at 10,481.

171. *See infra* Part III.B.1.

III. The Erosion of Policy-Driven Compulsory Music Licensing

The last Part argued that the first compulsory music license, the mechanical license, was originally conceived of as a tool for readjusting the incentives/access balance in the music marketplace. This Part examines the trends that have placed pressure on this original role, both in the legislative context and in the regulatory rate-setting context. In the legislative context, various changes to the music copyright system have furthered a narrative that compulsory licensing's only role should be to remedy transaction-costs-based market failures. Somewhat consistent with this narrative, policymakers and regulators increasingly maintain that compulsory licensing should attempt to mimic free market rates using market proxies, with no regard for broader copyright policy goals.[172] Most recently, the Music Modernization Act (MMA) has pushed this narrative even further by applying a willing buyer-willing seller standard to all future music-related rate setting.[173]

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

A. Legislative Context

This Subpart examines the legislative changes that have slowly unmoored the compulsory music licensing system from the goals of copyright policy. Particular attention is paid to the rise of digital music dissemination in the late 1990s and early 2000s.

1. The sound recording copyright

As the last Part explored, the mechanical license was created to regulate the use of copyrighted musical compositions by technologies of music dissemination: the player piano, the phonograph, and the record player. For most of the twentieth century, the actual recorded versions of these

172. *See supra* Part I.A (discussing the link between transaction costs remediation and market proxy-based rate setting).

173. Orrin G. Hatch-Bob Goodlatte Music Modernization Act, § 102(a)(1)(B), Pub. L. No. 115-264, 132 Stat. 3676, 3680 (2018) (codified at 17 U.S.C. § 115(c)(1)(F) (2018)).

compositions were not independently copyrightable.[174] That changed in 1971, when Congress provided for limited copyright protection for sound recordings, with the specific goal of preventing "piracy" by companies that were copying recorded music onto records and tapes and selling them to the public.[175] The 1971 Sound Recording Act forbade the copying of a sound recording without permission from the copyright owner.[176] As the next Subparts explore further, the sound recording copyright has played an important role in complicating the goals of music dissemination that the mechanical license was designed to regulate, especially as technologies that involve the digital duplication of previously recorded songs for sale to the public have become more ubiquitous.

Even in 1971, Congress was aware that recognizing copyright in sound recordings could potentially frustrate public access to music. In the lead-up to the 1971 Sound Recording Act, tape manufacturers argued that the mechanical license should be extended to the new sound recording copyright in order to ensure public access.[177] In making this argument, they echoed many of the original arguments for the mechanical license, including that record companies "will be able to dictate extortionate licensing terms and thus increase the cost of taped music to the consumer."[178] They also explicitly invoked the 1909 Copyright Act, claiming that had Congress not imposed a compulsory license in 1909, music publishers would have "demanded exorbitant licensing fees," frustrating development of "the infant record industry."[179] A compulsory license for sound recordings, they argued, would provide "compensation sufficient to encourage" the creation of additional sound recordings, while still allowing the tape reproduction market to

174. *See* Act of Oct. 15, 1971, Pub. L. No. 92-140, 85 Stat. 391 (amended 1976) (establishing copyright in sound recording for the first time).

175. *See id.*

176. *Id.* § 1(a), 85 Stat. at 391.

177. *Prohibiting Piracy of Sound Recordings: Hearings on S. 646 and H.R. 6927 Before the H. Comm. on the Judiciary*, 92d Cong. 73 (1971) [hereinafter *Hearings: Prohibiting Piracy*] (statement of Thomas H. Truitt, Esq., on behalf of G & G Sales, Inc. et al.).

178. *Id.*; *see also id.* at 82 (statement of Arthur Leeds on behalf of G & G Sales, Inc. et al.) (advocating for a compulsory license to prevent "substantial hardship on the purchasing public"); *id.* at 107 (testimony of Arthur Leeds on behalf of G & G Sales, Inc. et al.) (arguing that the record companies have a "monopolistic position" that allows them "to fix prices at an artificially high figure").

179. *Id.* at 73-74 (statement of Thomas H. Truitt, Esq., on behalf of G & G Sales, Inc. et al.); *id.* at 84 (statement of Arthur Leeds on behalf of G & G Sales, Inc. et al.).

flourish.[180] In so doing, consumers would benefit from lower fees, as well as from access to a greater variety of musical works.[181]

Though some members of Congress were sympathetic to these arguments,[182] the record industry effectively painted the tape industry as "pirates" and "parasites" who could not be trusted to abide by the requirements of a compulsory licensing regime.[183] Congress ultimately rejected the compulsory license proposal.[184]

At the same time, Congress did provide an important exception to the sound recording copyright: no public performance right.[185] This meant that uses that did not involve the actual duplication of a recorded song—including radio broadcasts—did not require permission from the sound recording copyright owners.[186] Congress revisited this issue in the 1976 Copyright Act and again declined to extend public performance rights to sound recordings.[187] Thus, AM and FM radio stations were (and for the most part still are) free to broadcast any sound recording without the consent of the sound recording copyright owners, or even payment under a compulsory licensing scheme.[188]

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180. *See id.* at 83-84 (statement of Arthur Leeds on behalf of G & G Sales, Inc. et al.).

181. *See id.* at 118 (statement of Perry S. Patterson on behalf of United States Automatic Phonograph Manufacturers et al.).

182. Senator Philip Hart, for example, called the 1971 Sound Recording Act "sound in purpose," albeit also noting that it was "troublesome in design, and vague in reach." 117 CONG. REC. 12,764 (1971) (statement of Sen. Hart).

183. *See Hearings: Prohibiting Piracy*, *supra* note 177, at 96-97 (statement of Abeles and Clark on behalf of the Harry Fox Agency, Inc.) ("The illicit duplicators have seen fit to ignore applicable legal precedents and have conducted their respective business operations in direct violation thereof. There is no reason to believe they will change their tactics and comply with the pertinent legal requirements of a compulsory licensing system. We believe such a system would only force the legitimate members of the industry to deal with its worst parasites to the substantial detriment of the entire industry.").

184. *See* S. REP. NO. 92-72, at 6 (1971) (rejecting compulsory license proposals). In the years following the 1971 Sound Recording Act, some litigants attempted to invoke the mechanical license to excuse copying sound recordings, but the courts uniformly rejected this argument. *See* Joseph P. Fishman, *The Copy Process*, 91 N.Y.U. L. REV. 855, 877-78 (2016).

185. *See* Act of Oct. 15, 1971, Pub. L. No. 92-140, 85 Stat. 391 (amended 1976) (establishing the sound recording copyright without public performance rights). Recall that the right to perform a copyrighted work is distinct from the rights to duplicate and distribute it. *See supra* text accompanying notes 37-39.

186. *See* Act of Oct. 15, 1971 § 1(a), 85 Stat. at 391 (noting that the sound recording copyright includes the right to "duplicate to the sound recording in a tangible form").

187. Copyright Act of 1976, Pub. L. No. 94-553, § 114, 90 Stat. 2541, 2560 (codified as amended at 17 U.S.C. § 114 (2018)); *see also* García, *supra* note 9, at 1134-35.

188. *See* García, *supra* note 9, at 1134-35.

2. Competing narratives in the § 114 license

In the years following the 1971 Sound Recording Act and the 1976 Copyright Act, the lack of compulsory licensing for sound recording reproduction rights likely had minimal consequences for the public's consumption of musical works. First and foremost, the lack of public performance rights for sound recordings meant that radio stations were free to play music without seeking the consent of the copyright owners or compensating them at all. On the distribution side, record companies continued to be the primary disseminators of recorded music; technologies involving the duplication of the sound recordings embodied in those records had yet to become pervasive.[189] Congress's refusal to extend the mechanical license to sound recordings certainly may have impeded the burgeoning tape-copying industry, but other copyright limitations and exceptions came into play in preventing record companies from exerting disproportionate control over music dissemination. In particular, the 1976 Copyright Act's codification of the "first sale doctrine" established that the public could distribute and resell lawfully made records, tapes, and CDs without first seeking the consent of copyright owners.[190]

The rise of digital music dissemination—in particular, MP3 music files capable of being played or downloaded via the internet—fundamentally altered this landscape. The 1971 Sound Recording Act's creation of sound recording copyright protection for *duplication* meant that digital retailers of MP3 files—such as iTunes—were required to obtain licenses from record labels before selling music (which, as discussed below, takes place through free market transactions because of the lack of a compulsory license[191]). But the complete lack of public performance protection for sound recordings meant that digital forms of radio were not obligated to clear licenses, or even pay royalties to record labels.

The recording industry grew increasingly concerned about the threat that digital radio posed to its traditional revenue streams,[192] and in 1995, Congress

189. *See* FISHER, *supra* note 100, at 83-84 (describing the rise of cheap audio-copying technologies during the mid-1980s).

190. Copyright Act of 1976 § 109(a), 90 Stat. at 2548 (codified as amended at 17 U.S.C. § 109(a)); *see also* 2 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 8.12 (LexisNexis 2019).

191. *See infra* Part III.A.4.

192. *See Digital Performance Right in Sound Recordings Act of 1995: Hearings on H.R. 1506 Before the Subcomm. on Courts & Intellectual Prop. of the H. Comm. on the Judiciary*, 104th Cong. 31-39 (1995) (statement of Jason S. Berman, Chairman and CEO, Recording Industry Association of America) [hereinafter *Hearings: DPRA*] (arguing that "digital delivery would siphon off and eventually eliminate the major source of revenue for investing in future recordings").

passed the Digital Performance Right in Sound Recordings Act (DPRA).[193] The DPRA and follow-on legislation altered the status quo by creating a public performance right in sound recordings performed "by means of a digital audio transmission,"[194] such as those provided by satellite and internet radio. The DPRA, however, coupled this grant with a new compulsory licensing regime requiring licensing of sound recordings to any digital radio service,[195] often referred to as the § 114 license.

In many ways, this process paralleled the original creation of the mechanical license.[196] Congress granted copyright interests where none had previously existed in order to ensure authors would be incentivized to continue to create, and, in fact, the need for financial incentives was a key argument used by the record labels leading up to the DPRA.[197] But Congress tempered this exclusive right with a compulsory license designed to ensure access. Indeed, the § 114 license took an approach to rate setting very similar to that of the mechanical license, at least at first. In passing the DPRA, Congress suggested that a goal of this compulsory licensing regime would be to encourage technologies that increase music dissemination, like internet radio, because "[t]hese new digital transmission technologies may permit consumers to enjoy performances of a broader range of higher-quality recordings than has ever before been possible."[198] Congress sought to balance this priority against the need for "appropriate copyright protection in the digital environment" to incentivize "the creation of new sound recordings and musical works."[199]

Presumably to best facilitate this balance, Congress chose to use the 801(b) factors to govern rate setting for the new § 114 license.[200] As the next Part explores, early rate-setting decisions under the 801(b) factors explicitly accounted for internet and satellite radio's access-expanding effects, as weighed

193. Digital Performance Right in Sound Recordings Act of 1995, Pub. L. No. 104-39, 109 Stat. 336 (codified as amended in scattered sections of 17 U.S.C.).

194. *Id.* § 2, 109 Stat. at 336 (codified as amended at 17 U.S.C. § 106); *see also, e.g.*, Digital Millennium Copyright Act, Pub. L. No. 105-304, § 405(b)(2), 112 Stat. 2860, 2902 (1998) (codified as amended at 17 U.S.C. § 112(e)(8)).

195. Digital Performance Right in Sound Recordings Act of 1995 § 3(3), 109 Stat. at 336-38 (codified as amended at 17 U.S.C. § 114(d)(1)); *see also* U.S. COPYRIGHT OFFICE, *supra* note 1, at 43-44.

196. *See supra* Part II.A.

197. *See Hearings: DPRA*, *supra* note 192, at 39 (statement of Jason S. Berman, Chairman and CEO, Recording Industry Association of America) (warning that "[o]ver time," the lack of public performance protection for sound recordings would "lend to a vast reduction in the production of recorded music").

198. S. REP. NO. 104-128, at 14 (1995).

199. *Id.*; *see also* FISHER, *supra* note 100, at 104.

200. *See* Digital Performance Right in Sound Recordings Act of 1995 § 3(3), 109 Stat. at 341 (codified as amended at 17 U.S.C. § 114(f)(2)).

against the importance of providing economic incentives to sound recording copyright owners.

In 1998, however, Congress altered the § 114 license in the Digital Millennium Copyright Act (DMCA).[201] The DMCA's revisions were ostensibly designed to correct an "oversight" in the DPRA: the fact that *nonsubscription* digital services were grouped together with existing terrestrial radio and thus not required to pay sound recording copyright owners.[202] The DMCA extended the obligation to pay royalties, as well as the ability to use the § 114 compulsory license, to all digital radio stations, regardless of whether they operate using subscription or nonsubscription models.[203] But the DMCA also created a bifurcated rate-setting standard. For any internet radio service established after the passage of the DMCA in 1998, the regulators were tasked with establishing rates "that most clearly represent the rates . . . that would have been negotiated in the marketplace between a willing buyer and a willing seller."[204] However, satellite radio services and internet radio services that "preexist[ed]" passage of the DMCA would have their rates set using the 801(b) policy objectives.[205]

The DMCA's switch to a willing buyer-willing seller standard for any new digital radio service was never explained. The new standard was added shortly before the bill was passed[206]—and may have simply been a product of lobbying by the record labels. But the switch also may have reflected a belief that the § 114 compulsory license should primarily regulate transaction-costs-based market failures and would best do so using the market-mimicking rate-setting approach more frequently used when a compulsory license's sole goal is to address such issues.[207]

201. Digital Millennium Copyright Act, Pub. L. No. 105-304, § 405(a)(1)-(4), 112 Stat. 2860, 2890-97 (1998) (codified as amended at 17 U.S.C. § 114).

202. DiCola & Sag, *supra* note 135, at 223-25.

203. Digital Millennium Copyright Act § 405(a)(1), 112 Stat. at 2890 (codified as amended at 17 U.S.C. § 114(d)(2)).

204. *Id.* § 405(a)(2)(C), 112 Stat. at 2894-96 (codified as amended at 17 U.S.C. § 114(f)(1)).

205. *Id.*; *see also* U.S. COPYRIGHT OFFICE, *supra* note 1, at 13.

206. *Compare* H.R. REP. NO. 105-551, pt. 2 (1998) (failing to mention a willing buyer-willing seller standard), *with* H.R. REP. NO. 105-796, at 86 (1998) (Conf. Rep.) (adding the willing buyer-willing seller standard).

207. *See supra* Part I.A. Though the legislative history of the DMCA is silent on this issue, it may be possible to glean some insight from congressional hearings on contemporaneous copyright-related legislation. On October 30, 1997, Congress held hearings regarding whether to switch the existing cable rebroadcast compulsory license to a "fair market value" rate-setting standard. *See Copyright Licensing Regimes Covering Retransmission of Broadcast Signals: Hearing Before the Subcomm. on Courts and Intellectual Prop. of the H. Comm. on the Judiciary*, 105th Cong. 7-9 (1997) (statement of Marybeth Peters, Register of Copyrights, Copyright Office of the United States) (arguing in favor of a "fair market value" rate-setting standard). Similarly, others

footnote continued on next page

This reading is bolstered by the fact that the § 114 compulsory license, after its creation, increasingly took on a role focused on resolving transaction cost barriers to efficient mass licensing by digital radio stations. To understand this role, additional background is in order. Recall that even though radio stations historically were free to play sound recordings without a license, they were still required to receive permission from the *musical composition* copyright owner before playing a song.[208] The process of clearing licenses for public performance of musical compositions has raised transaction cost concerns since the early history of radio. In particular, the number of licenses, volume of plays, and difficulty of tracking plays made it effectively impossible for radio stations to enter into individual licenses with musical composition copyright owners.[209]

In the early twentieth century, copyright owners began addressing this problem by forming performance rights organizations (PROs). The PROs aggregate copyright interests to make it logistically easier for public performance licensees, such as radio stations, bars and restaurants, and TV stations, to license musical compositions for public performance.[210] The two largest PROs—the American Society of Composers, Authors and Publishers (ASCAP) and Broadcast Music, Inc. (BMI)—together manage the vast majority of these works.[211] These entities frequently provide blanket licenses for a flat fee or percentage of revenue, and then ensure distribution of the royalties to the many copyright owners whose works are implicated, saving all parties significant time and money.[212] While the PROs were originally structured exclusively through contract law, a series of antitrust consent decrees have made them increasingly regulated in a manner similar to a compulsory licensing regime.[213] Most notably, the PROs may only grant nonexclusive licenses and must license to all comers.[214] Additionally, licensees unsatisfied

argued that a compulsory license driven by fair market value—"'the rate a willing buyer would pay [to] a willing seller'"—"may be necessary in the short run [in markets where there are] transaction cost problems." *Id.* at 174-75 (statement submitted by ABC, Inc. et al.) (alteration in original) (quoting H.R. REP. NO. 103-703, at 9 (1994)).

208. *See supra* notes 38, 185-88 and accompanying text.

209. *See* U.S. COPYRIGHT OFFICE, *supra* note 1, at 32-33.

210. *See* Merges, *Contracting into Liability Rules*, *supra* note 8, at 1328-29.

211. *See ASCAP vs BMI vs SESAC: The Big Three, Who's for Me?*, ROYALTY EXCHANGE (July 12, 2017), https://perma.cc/6GVQ-5MHR.

212. *See, e.g.*, Kristelia A. García, *Facilitating Competition by Remedial Regulation*, 31 BERKELEY TECH. L.J. 183, 194 (2016) (describing ASCAP's blanket license offering).

213. *See, e.g.*, Wu, *supra* note 22, at 310-11 (noting the de facto compulsory license established for ASCAP via consent decrees).

214. GLYNN LUNNEY, COPYRIGHT'S EXCESS: MONEY AND MUSIC IN THE US RECORDING INDUSTRY 64-65 (2018); *see also* U.S. COPYRIGHT OFFICE, *supra* note 1, at 36; Wu, *supra* note 22, at 310-11.

with a proposed royalty rate may petition the federal district court for the Southern District of New York for a court-determined rate.[215]

The PROs' rights aggregation—originally created through private ordering but now also overseen by the government via antitrust consent decrees—is the quintessential example of a transaction-cost-saving licensing technique. It appears to have provided an important model for how digital radio stations and copyright owners use the § 114 compulsory licensing regime. Indeed, after passage of the DMCA, the Recording Industry Association of America created an entity known as SoundExchange, which was later spun off into its own nonprofit.[216] SoundExchange essentially functions like a PRO: It facilitates blanket licensing of § 114 licenses and also enables royalty payments to disparate rights holders.[217] In 2002, Congress explicitly incorporated SoundExchange into the architecture of the § 114 licensing scheme,[218] and it is now the sole entity entrusted to collect and distribute § 114 royalties to copyright owners and artists.[219]

The increased use of the § 114 license as a tool for efficient rights aggregation and payment via SoundExchange might similarly account for Congress's decision to replace the 801(b) factors with a willing buyer-willing seller standard in the DMCA.[220] An approach to compulsory licensing solely focused on transaction costs generally strives to approximate rates that would prevail in the market, as discussed above.[221] Reflecting this assumption, some of the Copyright Act's other compulsory licensing regimes, such as the regime for cable television and public broadcasting, have historically used market proxies for rate setting.[222] Similarly, the district courts that engage in rate setting for the PROs "attempt to approximate the 'fair market value' of a license—what a license applicant would pay in an arm's

215. LUNNEY, *supra* note 214, at 64.

216. *See* DiCola & Sag, *supra* note 135, at 230.

217. *See* García, *supra* note 9, at 1119 n.1.

218. Small Webcaster Settlement Act of 2002, Pub. L. No. 107-321, § 3(b), 116 Stat. 2780, 2781 (codified as amended at 17 U.S.C. § 114 (2018)) (incorporating the "receiving agent," defined as SoundExchange, into the § 114 licensing scheme); Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings and Ephemeral Recordings, 67 Fed. Reg. 45,240, 45,267 (Copyright Office July 8, 2002) (defining SoundExchange as the "Receiving Agent").

219. DiCola & Sag, *supra* note 135, at 230.

220. *See supra* text accompanying notes 201-05.

221. *See supra* Part I.A. *But see infra* Part IV.B.2 (discussing the difficulties of setting prices based on market mimicking in regulated markets).

222. *See supra* note 66 (discussing cable); *supra* text accompanying notes 156-58 (discussing public broadcasting).

length transaction."[223] In creating the willing buyer-willing seller standard, Congress may have been trying to more clearly model the § 114 license after these other regimes.

3. Interactive streaming's exclusion from the § 114 license

While the DPRA established that satellite radio and internet radio services (also known as webcasters or noninteractive streaming services) could take advantage of the § 114 compulsory license in order to license sound recording public performance rights from record labels, the DPRA provided an important exception to this regime for one class of digital distributors: "interactive" streaming services.[224] In essence, a noninteractive service (for example, the original version of Pandora) provides a service akin to radio: Consumers can listen to music stations but cannot directly choose a specific song.[225] In contrast, interactive services (for example, the original version of Spotify) provide on-demand music, allowing consumers to choose specific songs to stream.[226]

Interactive streaming technology was not yet in existence when the DPRA was passed, though its emergence was understood to be imminent. Congress appeared to be convinced that the technology would pose such an extreme threat to the traditional markets of record labels, CD sales and the like, and that subjecting it to a compulsory license would unfairly deprive copyright owners of revenue.[227] In contrast, noninteractive streaming was understood to pose only some risks of substitution because consumers could not choose songs on demand,[228] prompting Congress to create the § 114 license.[229]

223. Pandora Media, Inc. v. Am. Soc'y of Composers, Authors, & Publishers, 6 F. Supp. 3d 317, 353 (S.D.N.Y. 2014) (quoting Am. Soc'y of Composers, Authors, & Publishers v. MobiTV, Inc., 681 F.3d 76, 82 (2d Cir. 2012)), *aff'd*, 785 F.3d 73 (2d Cir. 2015); *see also* U.S. COPYRIGHT OFFICE, *supra* note 1, at 41.

224. Digital Performance Right in Sound Recordings Act of 1995, Pub. L. No. 104-39, § 3(3), 109 Stat. 336, 336-39 (codified as amended at 17 U.S.C. § 114(d) (2018)).

225. FISHER, *supra* note 100, at 104; LUNNEY, *supra* note 214, at 66-67.

226. FISHER, *supra* note 100, at 104; LUNNEY, *supra* note 214, at 66-67; *see also* U.S. COPYRIGHT OFFICE, *supra* note 1, at 48; Peter DiCola, *Copyright Equality: Free Speech, Efficiency, and Regulatory Parity in Distribution*, 93 B.U. L. REV. 1837, 1853-54 (2013). Pandora and Spotify each now operate both interactive and noninteractive services. *See* Ryan Waniata & Quentyn Kennemer, *Spotify vs. Pandora: Which Music Streaming Service Is Better for You?*, DIGITAL TRENDS (Feb. 11, 2020), https://perma.cc/3M9D-2WZS.

227. *See* S. REP. NO. 104-128, at 15-16 (1995).

228. *See* FISHER, *supra* note 100, at 104-05. Another explanation offered was that noninteractive streaming could in fact increase record sales by promoting other recording artists to the public. *Id.* This has been a frequent explanation for why terrestrial radio has consistently been excluded from having to pay royalties to sound recording copyright owners. *See id.*

229. As Part IV below explores in more detail, this distinction (and the logic that underlies it) has proven misguided over time.

Because interactive streaming services cannot take advantage of the § 114 sound recording compulsory license, services like Spotify must negotiate free market licenses with sound recording copyright owners.[230] Sound recording copyright owners can also pull their songs from streaming services, as Taylor Swift has famously done on several occasions.[231]

4. The gradual transformation of the mechanical license

While the DPRA and the DMCA made significant changes to the sound recording copyright interest in the aftermath of the digital revolution, other aspects of the music copyright regime received less congressional scrutiny, at least at first. This included the mechanical license, which remained mostly unchanged from the 1976 Copyright Act until very recently.[232] That said, the rise of digital distribution also significantly affected how the mechanical license was used, potentially encouraging a narrative that the mechanical license should only be considered a transaction-cost-remedying tool.

In the aftermath of the rise of digital music file distribution, record labels lost their status as the primary source of music purchases for consumers; instead, third-party digital distribution platforms, like Apple's iTunes, became increasingly important in selling recorded music to consumers in the form of downloadable files.[233] Unlike a radio public performance, the selling of an MP3 file clearly implicated sound recording copyright owners' exclusive rights, and digital distributors were thus required to enter into licensing agreements with record labels permitting the distributor to sell MP3 versions of their sound recordings to the public.[234]

The authority of a record label to license a sound recording copyright was obvious, but it remained somewhat uncertain how the digital sale of a recorded song by a third-party distributor would implicate the musical composition copyright (owned by publishers and/or composers) also embodied in the

230. There is one minor caveat: Under the DPRA, copyright owners may only enter into exclusive licenses with interactive distributors for twelve months at a time. Pub. L. No. 104-39, § 3(3), 109 Stat. 336, 338 (1995) (codified as amended at 17 U.S.C. § 114(d)(3)(A) (2018)). In enacting this requirement, Congress appeared to believe it would be sufficient to prevent copyright owners from frustrating public access. *See* 2 NIMMER & NIMMER, *supra* note 190, § 8.22[E].

231. *See* Kaitlyn Tiffany, *A History of Taylor Swift's Odd, Conflicting Stances on Streaming Services*, VERGE (June 9, 2017, 11:50 AM EDT), https://perma.cc/PZG5-4SBG. In contrast, the compulsory licensing regime does not give recording artists this option when it comes to noninteractive services.

232. *See infra* Part III.A.5 (discussing the Music Modernization Act).

233. Jon Porter, *The Rise and Fall of iTunes, Apple's Most Hated App*, VERGE (June 3, 2019, 4:59 PM EDT), https://perma.cc/7MUD-S3HX.

234. *See* 17 U.S.C. § 115(c)(1)(E)-(F); *see also supra* text accompanying note 107.

recording. Record labels did not necessarily have the authority to grant secondary distributors the authority to use the musical composition copyright even if the label had received a lawful mechanical license to make the recording.

The DPRA addressed this issue by explicitly amending § 115 to establish that the digital reproduction and distribution of a sound recording—otherwise known as a digital phonorecord delivery (DPD)—required the payment of mechanical royalties to the musical composition copyright owner.[235] In making this change, Congress, for the first time, invoked transaction cost justifications when considering the continued importance of the mechanical license. Congress appeared to recognize that requiring digital distributors to negotiate with two sets of copyright owners could be burdensome and explained that expanding the license to DPDs would allow digital distributors who received permission to distribute recordings to bypass direct negotiations with the owners of musical composition copyrights.[236]

At the same time, however, the DPRA did not fundamentally alter the architecture of the mechanical license. The individualized notice requirement for invoking the license remained in place, which impeded the ability of digital distributors to engage in efficient bulk licensing of content.[237] More importantly, the DPRA left the 801(b) factors in place, implicitly suggesting that the policy objectives reflected in those factors remain relevant to rate setting.[238] As explained in Part III.B below, this has created some confusion at the CRB as to what goals should be reflected when applying the mechanical license in the digital music space.

The DPRA also failed to clarify how new forms of music dissemination, such as interactive streaming, would be affected by the mechanical license. As explained above, interactive streaming services, like Spotify, were exempted from the new § 114 license and must therefore negotiate sound recording licenses directly with record labels.[239] But it remained unclear how the use of such sound recordings by interactive services would implicate the musical composition copyrights also embodied in these recordings. In 2008, the Copyright Office determined that because interactive streaming services must

235. Digital Performance Right in Sound Recordings Act of 1995 § 4, 109 Stat. at 344-48 (codified as amended at 17 U.S.C. § 115).

236. *See* S. REP. NO. 104-128, at 37 (1995) ("[T]he changes to section 115 are designed to minimize the [license negotiation] burden on transmission services . . . .").

237. *See* 17 U.S.C. § 115(b)(2)(A) (requiring a potential licensee to serve a notice of intention on the copyright owner before licensing); *infra* Part III.A.5 (explaining recent pressure to eliminate the individualized notice requirement in order to allow blanket licensing).

238. *See* Digital Performance Right in Sound Recordings Act of 1995 § 3(3), 109 Stat. at 341; *see also* 17 U.S.C. § 801(b)(1) (2017); *supra* text accompanying note 200.

239. *See supra* Part III.A.3.

make server copies to stream a song, their operations implicate the copyright reproduction right.[240] Under this interpretation, interactive services must pay mechanical royalties (either via the compulsory license or via direct negotiation) to musical composition copyright owners whenever a song is streamed.[241] Though some streaming services have attempted to dispute that streaming implicates mechanical reproduction,[242] a 2009 CRB-approved settlement established mechanical royalty rates to be paid by streaming services to the owners of musical composition copyrights.[243]

The ways in which streaming services now use the mechanical license has further reinforced a narrative that the regime should be understood as primarily transaction-cost-remediating: They have increasingly used the mechanical license to avoid the costs of having to identify and negotiate with musical composition copyright owners after having cleared sound recording rights in a song.[244] At the same time, the mechanical license's cumbersome individual licensing process proved highly inefficient for this task; without the ability to engage in blanket licensing facilitated by entities like the PROs and SoundExchange, interactive streaming services were still required to individually notify specific copyright owners about their intent to use the compulsory regime.[245] As explained further below, recent changes to the

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240. Compulsory License for Making and Distributing Phonorecords, Including Digital Phonorecord Deliveries, 73 Fed. Reg. 66,173, 66,174, 66,178, 66,181 (Nov. 7, 2008) (codified as amended at 37 C.F.R. § 201.18 (2019)). In the recently passed Music Modernization Act, Congress adopted this interpretation. Pub. L. No. 115-264, § 102(a)(4), 132 Stat. 3676, 3684 (2018) (codified as amended at 17 U.S.C. § 115(d)(1)(A)-(B) (2018)).

241. Compulsory License for Making and Distributing Phonorecords, Including Digital Phonorecord Deliveries, 73 Fed. Reg. at 66,174, 66,178-81; *see also* U.S. COPYRIGHT OFFICE, *supra* note 1, at 28.

242. *See* Robert Levine, *How Spotify's Argument in Copyright Lawsuit Could Upend the Music Industry's Newfound Recovery*, BILLBOARD (Sept. 13, 2017), https://perma.cc/L8LT-VWKQ (reporting that Spotify has argued in other contexts that streaming does not implicate any of copyright's exclusive rights except public performance).

243. *See* U.S. COPYRIGHT OFFICE, *supra* note 1, at 28-30; *see also infra* Part III.B.1. Even more confusingly, because it is widely understood that interactive streaming implicates copyright's public performance rights, services must pay musical composition owners both mechanical royalties and public performance royalties (generally via the PROs) for the same works. *See* U.S. COPYRIGHT OFFICE, *supra* note 1, at 160-61. The CRB, in the most recent streaming rate-setting proceeding, which is further described below, established an "all-in" mechanical rate—that is, a rate that is designed to explicitly encompass whatever performance royalty amount must be paid by a streaming service. Determination of Royalty Rates and Terms for Making and Distributing Phonorecords (Phonorecords III), 84 Fed. Reg. 1918, 2035 (Copyright Royalty Bd. Feb. 5, 2019) (codified at 37 C.F.R. § 385.21 (2019)).

244. *See* Jeong, *supra* note 111.

245. *See* U.S. COPYRIGHT OFFICE, *supra* note 1, at 107-08 (discussing the inefficiencies of the song-by-song licensing and payment scheme); R. Anthony Reese, *Copyright and Internet Music Transmissions: Existing Law, Major Controversies, Possible Solutions*, 55 U. MIAMI L.

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mechanical license seem designed to remedy these inefficiencies but, in doing so, have pushed the mechanical license even further into the transaction cost narrative.

5. Reform and the Music Modernization Act

By the early 2000s, government regulation of the music marketplace had dramatically shifted. For most of the twentieth century, the government's main intervention surrounded the mechanical license, which regulated the relationship between musical composition copyright owners and distributors of recorded music, primarily record labels. But thanks to the dramatic technological changes to music distribution—and partial attempts to address these changes in the DPRA and the DMCA—this regulation became significantly more complex and inconsistent. Most notably, similar forms of dissemination (such as noninteractive and interactive streaming) did not have access to the same compulsory licensing options or were subject to different rate-setting standards—for instance, the 801(b) factors versus a willing buyer-willing seller standard.[246]

As discontent with this convoluted regime grew, the U.S. Copyright Office began to study the problem. In 2015, it released a report that advocated for various changes designed to promote greater fairness, efficiency, consistency, and transparency.[247] In laying out its vision, however, the Copyright Office tacitly rejected the original guiding principles of the mechanical license and § 114 license as tools for balancing copyright's policy objectives.[248] Instead, the report concluded that "compulsory licensing should exist only when clearly needed to address a market failure."[249] While the report questioned whether compulsory music licensing was still necessary at all, it ultimately concluded that transaction costs in the licensing of musical works by digital music distributors made some form of compulsory system necessary.[250] But it

REV. 237, 255-57 (2001) (same). This also spawned a number of lawsuits in which musical composition copyright owners alleged a streaming service failed to abide by the statutory licenses' formalities or failed to pay necessary mechanical royalties. *See* Jeong, *supra* note 111. As failure to abide by the mechanical license regime renders the use of a musical composition an infringement, these lawsuits often seek huge amounts of statutory damages under the Copyright Act's infringement regime. *See id.*

246. *See supra* Parts III.A.2-.4.

247. *See generally* U.S. COPYRIGHT OFFICE, *supra* note 1.

248. *Id.* at 135 ("To the extent our policies require copyright owners to subsidize certain business models through reduced royalties, as copyright owners claim, this is not the result of a present-day judgment that it is a fair way to treat creators, or promotes the values of our copyright system.").

249. *Id.* at 163.

250. *Id.* at 162-64.

proposed several changes seemingly designed to further the regime's transformation into an exclusively transaction-cost-remediating tool. Most notably, the report advocated that the 801(b) factors be replaced across the board with a willing buyer-willing seller standard "designed to achieve to the greatest extent possible the rates that would be negotiated in an unconstrained market."[251] Using the model of the PROs and SoundExchange, the report also suggested that a collective be created to handle blanket licensing of musical composition mechanical rights to streaming services.[252]

Congress implemented many of these suggestions in the recently passed MMA. Among other things, the Act addresses the "inconsistent" rules that govern compulsory music licensing by replacing the 801(b) factors with the willing buyer-willing seller standard,[253] previously only used for internet radio stations created after the DMCA.[254] This means that in future rate-setting proceedings, the rates of both the mechanical license and the § 114 license will be set using an ostensible market-mimicking standard.[255]

The MMA also furthers an exclusively transaction-cost-oriented approach to compulsory licensing by addressing the Copyright Office's concerns about the inefficiencies of the individualized mechanical licensing procedures. Digital distributors—including those that sell individual music files or operate an interactive streaming platform—will soon be able to receive a special blanket compulsory license to use the musical compositions embodied in any sound recording that the service is authorized to distribute.[256] This process, and payment to copyright owners, will be managed by a new "mechanical licensing collective," very similar to SoundExchange.[257] Congress was explicit that this

251. *Id.* at 144.

252. *Id.* at 169-70, 175.

253. Orrin G. Hatch-Bob Goodlatte Music Modernization Act, Pub. L. No. 115-264, § 102(a)(1)(B), 132 Stat. 3676, 3680 (2018) (codified at 17 U.S.C. § 115(c)(1)(F) (2018)); House & Senate Comms. on the Judiciary, 115th Cong., H.R. 1551: The Music Modernization Act 1-3 (2018), https://perma.cc/W4D4-9YPN; *see also supra* Part III.A.2 (discussing the creation of the willing buyer-willing seller standard).

254. *See supra* text accompanying notes 201-05.

255. *See* Orrin G. Hatch-Bob Goodlatte Music Modernization Act § 102(a)(1)(B), 132 Stat. at 3680 (codified at 17 U.S.C. § 115(c)(1)(F)) (establishing a willing buyer-willing seller standard for § 115 licenses); *id.* § 103(a)(1), 132 Stat. at 3723 (codified at 17 U.S.C. § 114(f)(1)(B)) (establishing a willing buyer-willing seller standard for all uses of § 114 licenses).

256. *Id.* § 102(a)(4), 132 Stat. at 3684 (codified at 17 U.S.C. § 115(d)(1)(A)). This provision will take effect beginning in 2021. *Music Modernization: Frequently Asked Questions*, COPYRIGHT OFF., https://perma.cc/44ZY-X4H7 (archived Apr. 4, 2020).

257. Orrin G. Hatch-Bob Goodlatte Music Modernization Act § 102(a)(4), 132 Stat. at 3684 (codified at 17 U.S.C. § 115(d)(1)(A)). Individuals may still receive a compulsory license to make sound recordings of specific musical compositions, which means artists and record labels will still be able to use the license to make cover songs with relative ease. *Id.* § 102(a)(4), 132 Stat. at 3684 (codified at 17 U.S.C. § 115(d)(1)(C)).

new system will decrease the need for "[s]ong-by-song licensing negotiations" and, in so doing, reduce transaction costs.[258]

B. Rate-Setting Context

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

1. The 801(b) factors in the digital era

In the 1980s and 1990s, the mechanical license royalty rates were primarily chosen via industry-wide settlements,[259] which meant that music rate-setting proceedings were relatively infrequent in the decades following the 1976 Copyright Act. This began to change following passage of the DPRA and DMCA in the 1990s; the CRB and its predecessor, the Copyright Arbitration Review Panel (CARP), which had replaced the CRT system,[260] were now confronted with a range of new compulsory licensing regimes related to digital distribution of music. As explained above, these included the § 114 sound

258. House & Senate Comms. on the Judiciary, *supra* note 253, at 3.

259. *See, e.g.*, Mechanical and Digital Phonorecord Delivery Rate Adjustment Proceeding, 63 Fed. Reg. 7288 (Copyright Office Feb. 13, 1998) (formerly codified at 37 C.F.R. § 255.3) (governing the mechanical royalty rate for ten years and providing for automatic adjustment every two years); 1987 Adjustment of the Mechanical Royalty Rate, 52 Fed. Reg. 22,637 (Copyright Royalty Tribunal June 15, 1987) (formerly codified at 37 C.F.R. § 307.3(e)) (same).

260. In 1993, Congress abolished the CRT and replaced it with a system of ad hoc copyright arbitration royalty panels (CARPs). *See* Copyright Royalty Tribunal Reform Act of 1993, Pub. L. No. 103-198, 107 Stat. 2304 (repealed 2004). In 2004, Congress abolished the CARP system and replaced it with the Copyright Royalty Board (CRB). *See* Copyright Royalty and Distribution Reform Act of 2004, Pub. L. No. 108-419, 118 Stat. 2341 (codified as amended in scattered sections of 17 U.S.C.).

recording public performance license for satellite radio and "preexisting" internet radio services (set under the 801(b) factors) and for all other internet radio services (set under a willing buyer-willing seller standard).[261] In addition, the expansion of the mechanical license to digital distribution meant that several new industries (like digital MP3 sellers and streaming services) were now covered by the existing mechanical license, which continued to be set under the 801(b) factors.[262]

During this period, CARP and the CRB relied on a two-step process for setting rates under the 801(b) factors. First, the judges identified a range of potential rates based on marketplace "benchmarks" derived from licensing deals in analogous free market licensing contexts.[263] Second, the judges chose a rate from within this range that would be most conducive to realizing the 801(b) policy goals.[264] This approach is not mandated by the statutory text, which does not require any consideration of analogous market-based rates at all; this point has frequently been reinforced in rate-setting decisions and by the D.C. Circuit, which reviews such decisions.[265] Indeed, CARP noted that a rate set under the 801(b) factors "need not mirror a freely negotiated marketplace rate—and rarely does—because it is a mechanism whereby Congress implements policy considerations which are not normally part of the calculus of a marketplace rate."[266] Nonetheless, CARP and the CRB consistently used this two-part process when setting rates.[267]

261. *See supra* text accompanying notes 204-05.

262. *See supra* Parts III.A.2-.4.

263. *See, e.g.*, Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings, 63 Fed. Reg. 25,394, 25,396 (Copyright Office May 8, 1998). This first stage also often involved choosing a rate structure (such as a per-unit price or a percentage of revenue) in addition to an actual rate. *See, e.g.*, *id.* at 25,395-96.

264. *See, e.g.*, *id.* at 25,396.

265. *See, e.g.*, Recording Indus. Ass'n of Am. v. Librarian of Cong., 176 F.3d 528, 533 (D.C. Cir. 1999) ("Section 801(b)(1) requires only that arbitration panels set 'reasonable copyright royalty rates.' The statute does not use the term 'market rates,' nor does it require that the term 'reasonable rates' be defined as market rates."); Determination of Royalty Rates and Terms for Ephemeral Recording and Webcasting Digital Performance of Sound Recordings (Web IV), 81 Fed. Reg. 26,316, 26,391 (Copyright Royalty Bd. May 2, 2016) [hereinafter *Web IV*] ("[U]nder [the § 801(b)] standard '[t]he Copyright Act permits, but does not require, the Judges to use market rates to help determine reasonable rates.'" (third alteration in original) (quoting Music Choice v. Copyright Royalty Bd., 774 F.3d 1000, 1010 (D.C. Cir. 2014))); Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings, 63 Fed. Reg. at 25,399 ("Unlike a marketplace rate which represents the negotiated price a willing buyer will pay a willing seller, reasonable rates are determined based on policy considerations." (citation omitted)).

266. Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings, 63 Fed. Reg. at 25,409.

267. *See, e.g.*, sources cited *infra* notes 274-76. This approach appears to have emerged from the fact that market benchmarking is a routine feature of regulatory rate setting in

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Despite starting its inquiry with marketplace evidence, CARP and the CRB often found that the 801(b) factors required the selection of rates at the lower end of the range suggested by benchmark evidence in order to further the 801(b) policy objectives. In 1998, in its first rate-setting proceeding applying the 801(b) objectives to the new § 114 compulsory license, CARP explicitly adopted a "low rate favoring the [digital radio] Services" in light of the 801(b) objectives.[268] CARP relied in particular on the third factor (the relative roles of the copyright owner and distributor in making works available to the public), focusing on the services' technological innovations in

> opening a new avenue for transmitting sound recordings to a larger and more diverse audience, including the creation of technology to uplink the signals to satellites and transmit them via cable; technology to identify the name of the sound recording and the artist during the performance; and technology for programming, encryption, and transmission of the sound recording.[269]

While the record label argued that only the "creation of the sound recordings" should be relevant to the third factor's emphasis on making music available to the public,[270] the Register of Copyrights, in reviewing the CARP decision, rejected this argument. She agreed with CARP that the services' work in creating "a new industry that expands the offerings of the types of music beyond that which one receives over the radio, through live performances, and other traditional means of public performance" supported a lower statutory rate that would allow the internet radio services to succeed.[271]

This interpretation of the third factor is consistent with what the previous Parts in this Article identified as the traditional purpose of the compulsory music licensing regime and the 801(b) objectives: to weigh copyright owners' incentives to create new works against disseminators' roles in furthering access.[272] Indeed, in affirming CARP's interpretation of the third factor, the Register of Copyrights noted that the record labels had, in the past, themselves taken advantage of this interpretation in order to receive low mechanical license rates.[273]

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other contexts. *See, e.g.*, 1980 Adjustment of the Royalty Rate for Coin-Operated Phonorecord Players, 46 Fed. Reg. 884, 888-89 (Copyright Royalty Tribunal Jan. 5, 1981).

268. Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings, 63 Fed. Reg. at 25,405-06.

269. *Id.* at 25,407.

270. *Id.* at 25,407-08.

271. *Id.* at 25,408-10. The Register of Copyrights ultimately slightly raised CARP's chosen rate, from 5% to 6.5% of gross revenue, primarily because of disagreements over CARP's interpretation of market benchmark evidence. *Id.* at 25,399, 25,407-10.

272. *See supra* Part II.B.

273. Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings, 63 Fed. Reg. at 25,408. Specifically, the Register of Copyrights noted that

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In the years following the 1998 CARP decision, the CRB, on several other occasions, recognized that the 801(b) factors required lower royalty rates for innovative technologies of dissemination. For example, when setting sound recording performance rates for satellite radio in 2008, the CRB found that the third factor (relative roles) and fourth factor (industry stability) together warranted a rate "that is lower than the upper boundary most strongly indicated by marketplace data" because of satellite radio services' technology-related expenses.[274] When revisiting these rates in 2013, the CRB again found that the third factor counseled in favor of a rate at the lower end of marketplace benchmarks because of the costs to satellite radio services in maintaining their "proprietary music distribution system."[275] The CRB also occasionally cited the third factor when choosing to maintain rates based on an expiring settlement agreement, despite the demands of copyright owners that the rates be raised. For example, the CRB chose to maintain prior rates for the mechanical license in 2009, despite complaints from copyright owners that the rates were too low, concluding that the prior rates reflected the "balance of the contributions made by the parties."[276]

2. *Phonorecords III*

In earlier rate-setting decisions, the CRB appeared to understand its role as policy-driven, concluding that the 801(b) factors, in particular the third factor, required lower rates for music distributors that had facilitated music access for

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

274. Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services, 73 Fed. Reg. 4080, 4096-97 (Copyright Royalty Bd. Jan. 24, 2008).

275. Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services, 78 Fed. Reg. 23,054, 23,069 (Copyright Royalty Bd. Apr. 17, 2013) [hereinafter *SDARS II*].

276. Mechanical and Digital Phonorecord Delivery Rate Determination Proceeding, 74 Fed. Reg. 4510, 4524-25 (Copyright Royalty Bd. Jan. 26, 2009) [hereinafter *Phonorecords I*]. The CRB has also cited the first factor (maximization of availability of music to the public) in justifying the maintenance of prior rates, noting, somewhat tautologically, that in the absence of evidence that copyright owners and services had reduced their offering under the prior rates, it was safe to presume that the availability of music to the public was being maximized. *See, e.g.*, *id.* at 4523-24 (noting that digital distributors "like Apple's iTunes[] provide[] an important avenue for enhancing the public's access to creative works" but finding that the current rates were allowing these services to function appropriately); *see also SDARS II*, *supra* note 275, 78 Fed. Reg. at 23,059 (citing the first factor to support maintaining the prior rate for sound recording performance rights for digital radio on the grounds that neither digital radio services nor record labels had "reduced [their] music offerings or contemplated exiting the business" under the prior rate).

the public through innovative changes to dissemination technology. But in the recent *Phonorecords III* proceeding, which, among other things, set the mechanical royalty rate for interactive streaming, the CRB appeared to abandon this approach. Instead, the CRB privileged analyses ostensibly designed to replicate free-market-driven royalty rates, and treated the 801(b) objectives as an afterthought.

As explained above, the question whether interactive music streaming even implicates the mechanical license has been contested,[277] but the music industry nonetheless entered into two settlements governing mechanical royalty rates for streaming: *Phonorecords I* in 2009,[278] and *Phonorecords II* in 2013.[279] In the *Phonorecords III* proceeding, the CRB was tasked with setting mechanical rates for January 2018 through December 2022.[280] No settlement was reached for interactive streaming,[281] meaning that the CRB was, for the first time, required to identify an appropriate musical composition royalty rate for the entire interactive streaming industry.[282] A 46-day hearing was conducted in 2017, involving the National Music Publishers Association and Nashville Songwriters Association International representing the interests of songwriter and publisher copyright owners, and Amazon, Apple, Google, Pandora, and Spotify representing the interests of interactive streaming services.[283]

The *Phonorecords I* and *Phonorecords II* settlements had set the interactive streaming mechanical royalty amounts using a complicated formula primarily focused on percentages of the services' revenue, with different calculations used depending on the streaming service's business model. For example, different formulas were used for subscription services versus services that provided free access to consumers and only derived revenue from advertising

277. *See supra* text accompanying note 242.

278. *Phonorecords I, supra* note 276.

279. Adjustment of Determination of Compulsory License Rates for Mechanical and Digital Phonorecords, 78 Fed. Reg. 67,938 (Copyright Royalty Bd. Nov. 13, 2013) [hereinafter *Phonorecords II*]. Prior to 2009, earlier settlements had established that digital downloads would be governed by the same rates as physical phonorecords. *See* Mechanical and Digital Phonorecord Delivery Rate Adjustment Proceeding, 64 Fed. Reg. 6221, 6222-23 (Copyright Office Feb. 9, 1999) (formerly codified at 37 C.F.R. § 255.5).

280. Determination of Rates and Terms for Making and Distributing Phonorecords (Phonorecords III), 81 Fed. Reg. 255, 255 (Jan. 5, 2016).

281. Determination of Royalty Rates and Terms for Making and Distributing Phonorecords (Phonorecords III), 82 Fed. Reg. 15,297, 15,299 (Copyright Royalty Bd. Mar. 28, 2017); *see also Phonorecords III, supra* note 27, 84 Fed. Reg. at 1919-20.

282. *See Phonorecords III, supra* note 27, 84 Fed. Reg. at 1918.

283. *Id.* at 1920.

("freemium" platforms).[284] The theory behind this system appears to be that it would allow for greater price discrimination—services operating freemium plans were generally required to pay less than services operating subscription plans—and, accordingly, for more consumers to be reached.[285]

The *Phonorecords III* CRB judges, however, decided to abandon the "Rube-Goldberg-esque complexity" of the settlement-developed system, instead adopting a rate structure applicable to all forms of streaming, with no variation based on business model.[286] This across-the-board rate structure would be calculated by looking both at a service's revenue and its "total content cost" (TCC).[287] TCC is essentially the payments made by streaming services to record companies for *sound recording rights* under their free market licensing deals.[288] In including a TCC calculation, the judges sought to "import[]" the free market structure from the unregulated sound recording licensing market and thus "influence . . . directly" the ratio of sound recording royalties to music composition royalties, which, the judges believed, was not in line with the ratio that would likely prevail if both licensing markets were unregulated.[289]

The actual rates chosen by the judges, expressed as both revenue percentages and TCC percentages (whichever amount ends up being higher controls[290]), were also calculated to parallel the unregulated sound recording licensing market. Utilizing a complicated economic model,[291] coupled with

284. *See id.* at 1922-23; *see also Rate Charts*, HARRY FOX AGENCY, https://perma.cc/9N8U-4CDR (archived Feb. 17, 2020) (describing price structures for different business models).

285. *See Phonorecords III*, *supra* note 27, 84 Fed. Reg. at 1980-82, 1990-92 (Strickler, C.R.J., dissenting).

286. *Id.* at 1935 (majority opinion).

287. *Id.* at 1918; *see also* 37 C.F.R. § 385.21 (2019) (codifying the 2018-2022 all-in royalty rates based on revenue and TCC).

288. *See Phonorecords III*, *supra* note 27, 84 Fed. Reg. at 1923 n.38 (majority opinion). This is essentially a greater-of calculation: A service must pay whichever number is higher based on a calculation of percentage of revenue and percentage of TCC. *Id.* at 1918.

289. *Id.* at 1934-35. The judges noted that a pure percentage of revenue calculation was unsuitable to achieve an accurate picture of rates that would prevail in an unrestrained market because streaming "[s]ervices . . . seek to engage to some extent in revenue deferral in order to promote their long-term growth strategy," meaning their revenue may be artificially low, leading to artificially lower royalty rates for copyright owners. *Id.* The inclusion of the TCC prong was designed to provide an alternative metric that would ensure copyright owners would be compensated if this happened. *See id.*; *see also supra* Part III.A.3 (explaining how interactive services pay sound recording royalties under free market agreements).

290. *Phonorecords III*, *supra* note 27, 84 Fed. Reg. at 1918 (majority opinion).

291. The specific model used by the judges is called the Shapley value. It "models bargaining processes in a free market by considering all the ways each party to a bargain would add value by agreeing to the bargain and then assign[ing] to each party [its] average contribution to the cooperative bargain." *Id.* at 1947 (quoting the trial exhibit's expert

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record label, publisher, and streaming-service financial data, the judges attempted to model the entire market structure that gives rise to music streaming—both the record label/sound recording side and publisher/musical composition sides—based on total revenue, costs for all parties, and their bargaining positions.[292] From this model, the judges arrived at a range of possible mechanical royalty rates.[293]

Having established a range of possible market-derived rates, the judges then turned to the 801(b) factors to assess their options. While prior rate-setting decisions had made clear that market benchmarking is only the "starting point for establishing an appropriate rate" to be followed by assessment in light of the 801(b) goals,[294] the judges, in an unusual step, declined to weigh the factors' policy objectives in an inquiry separate from their free market benchmarking inquiry. They instead declared that the 801(b) objectives simply "provide[] further support for their findings" in their earlier analysis.[295] After making this conclusion, the judges chose rates that will ultimately yield a 44% increase in streaming services' mechanical royalty payments.[296]

Copyright Royalty Judge David Strickler, in a lengthy dissenting opinion, identified some of the problems with the majority's approach.[297] While Judge Strickler did not frame his dissent with explicit reference to the policy-oriented approach to compulsory licensing discussed above, his analysis points

report). A full discussion of this model, and whether the judges applied it accurately, is outside the scope of this Article, but it bears mentioning that the applicability of the model and its utility for drawing conclusions about the musical composition market from data in the sound recording market were significantly contested during the *Phonorecords III* proceeding. *See id.* at 1948-51.

292. *Id.* at 1947-54.

293. *Id.* at 1954.

294. *See, e.g.*, Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings, 63 Fed. Reg. 25,394, 25,404 (Copyright Office May 8, 1998).

295. *Phonorecords III*, *supra* note 27, 84 Fed. Reg. at 1955 (majority opinion). In so doing, the judges explicitly distinguished D.C. Circuit precedent holding that the 801(b) inquiry is distinct from a willing buyer-willing seller inquiry, and the judges concluded that "to the extent market factors may implicitly address any (or all) of the four itemized factors, the reasonable, market-based rates may remain unadjusted." *Id.* For example, even while acknowledging that "Congress included Factors B and C [respectively, fair returns/income and relative roles] in section 801(b)(1) to establish a legal standard for the Judges to use to move their determination of new rates for existing licenses beyond a strictly market-based analysis," the judges nonetheless concluded that these factors could be realized "through" a Shapley value or similar analysis of the sound recording licensing market described above. *Id.* at 1959.

296. *Id.* at 1960.

297. *Id.* at 1963-2031 (Strickler, C.R.J., dissenting).

to many of the reasons why the *Phonorecords III* decision should be considered a dramatic departure from the traditional approach.

Most importantly, the dissent noted that the majority's rate structure has the effect of "tying" the mechanical royalty rate to the unregulated sound recording licensing market, which means that "whenever the record companies demand and obtain a higher sound recording royalty rate, under the majority's rate structure, the services' section 115 mechanical royalty rate must increase as well."[298] By simply "pegging the *regulated* mechanical royalty rate to the *unregulated* sound recording royalty rate," the judges had failed to perform their rate-setting responsibilities under § 801(b).[299]

Instead, Judge Strickler engaged in his own independent rate-setting analysis and concluded that the record and the 801(b) objectives counseled in favor of maintaining the statutory rate structure and rates established in the *Phonorecords I* and *Phonorecords II* settlements.[300] Judge Strickler's alternative analysis took a remarkably different approach from the majority in considering the CRB's role in regulating the music marketplace. Rather than treating market proxies as the be-all and end-all of the rate-setting inquiry, the dissent considered the unique realities of the music marketplace through the lens of the goals of the copyright system. In particular, Judge Strickler recognized that copyright aims to find the right "balance between access and incentives."[301] He noted that

> [a]t the theoretical extremes are two unacceptable approaches to rate-setting: (1) setting price equal to the marginal physical cost of copying, which is zero; and (2) setting price on a per unit basis that exceeds marginal physical cost. In the chasm between these two inadequate approaches exist many alternative rate structures with varying rates for various segments of the market. In general terms, these alternative rate-setting structures are forms of "price discrimination" . . . .[302]

While acknowledging that perfect price discrimination is not possible, Judge Strickler gravitated towards the existing settlement rate structure

298. *Id.* at 1964 & n.169 (emphasis omitted). As discussed further below, this approach is particularly inconsistent with copyright policy goals because it allows the mechanical royalty rate to reflect the market power imbalances in the unregulated sound recording licensing market. *See id.* at 1964-65; *see also infra* Part IV.A.2.

299. *See Phonorecords III*, *supra* note 27, 84 Fed. Reg. at 1967, 1974 (Strickler, C.R.J., dissenting).

300. *Id.* at 1968-2014.

301. *Id.* at 1977-78 (quoting David W. Barnes, *The Incentives/Access Tradeoff*, 9 NW. J. TECH. & INTELL. PROP. 96, 96 (2010)). More specifically, Judge Strickler discussed how copyright has aspects of a public good and how copyright owners' ability to price above marginal cost yields a deadweight loss that must be weighed against the need for incentivizing authors to create. *See id.*

302. *Id.* at 1980.

because its approach enables a form of price discrimination—in particular, by allowing services to operate freemium plans—that allows a greater number of consumers to be reached.[303] The settlement structure enabled services to "segregat[e] listeners according to [willingness to pay]—allowing them to 'experience' interactive streaming, while, second, still providing royalties to Copyright Owners."[304] Of all of the options on the table, it provided the best way of ensuring balance between incentives and access.[305]

* * *

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

In more concrete terms, the majority's approach will likely prove problematic for streaming services. Looking only at the percentage-of-revenue component of the new rate structure, the mechanical royalty rates paid by services are expected to increase 44% over the next few years.[306] The overall higher rates—and the costs they impose on distributors—will likely be borne by consumers.[307] For example, the new rates may make it unfeasible for services to operate free, ad-supported plans; may require services to charge

303. *See id.* at 1985-2001. Copyright scholars have noted that price discrimination, where feasible, can sometimes be an effective tool in facilitating maximum access to copyrighted works without compromising copyright owners' ability to monetize those works. *See, e.g.*, FISHER, *supra* note 100, at 166-68.

304. *Phonorecords III*, *supra* note 27, 84 Fed. Reg. at 1988 (Strickler, C.R.J., dissenting) (emphasis omitted).

305. It is important to note that Judge Strickler framed this conclusion as emerging from a market-based inquiry, while also noting that the 801(b) factors "provide[] further support" for the conclusion. *See id.* at 2015. As discussed below, this framing has important implications for future rate-setting proceedings. *See infra* Part IV.B.

306. *See Phonorecords III*, *supra* note 27, 84 Fed. Reg. at 1960 (majority opinion); *Major Victory for Songwriters as US Streaming Royalty Rates Rise 44%*, MUSIC BUS. WORLDWIDE (Jan. 27, 2018), https://perma.cc/8BW8-GTJX.

307. *See* DiCola, *supra* note 226, at 1874-75 (explaining generally why "an increase in [music] royalty costs will increase prices and reduce quantity sold [by music distributors] to some extent").

more for subscription plans; and may increase barriers to entry for new streaming services.[308]

In this respect, *Phonorecords III* clarifies the stakes of a copyright policy-sensitive approach to compulsory licensing as compared to one focused exclusively on transaction costs and market-mimicking. To be clear, however, this Article does not argue that minimization of transaction costs cannot or should not also be a primary consideration in the architecture of the Copyright Act's compulsory licensing regimes. Digital services and copyright owners both benefit from the ability to blanket license entire catalogues of music, and this reduction in transaction costs certainly allows for more works to reach the public. However, an *exclusive* focus on transaction costs and market proxies prevents the regime from also serving the policy goals at the heart of American copyright law. The next Part explores in more detail how streaming implicates these policy goals, particularly the incentives/access tradeoff, and why compulsory licensing remains an important tool for ensuring these goals are not compromised.

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

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

This Part argues that this shift is problematic and seeks to make a normative case for copyright policy-centered compulsory licensing regimes. To make this case, I focus on the newest form of innovative music dissemination: music streaming. Part IV.A outlines the arguments in favor of consistently applying compulsory licensing to all new forms of music

308. *See, e.g.*, Rhett Jones, *Bigger Streaming Royalties Sound Like Trouble for Spotify*, GIZMODO (Jan. 29, 2018, 5:40 PM), https://perma.cc/ZH7Z-YLYV; *see also Phonorecords III*, *supra* note 27, 84 Fed. Reg. at 1980 (Strickler, C.R.J., dissenting) (discussing how the prior rate structure reflected different royalty rates for ad-supported services than for subscription services).

dissemination, including interactive streaming. Part IV.B argues that rate setting should once again attempt to actively further copyright policy goals, rather than only seeking to identify ostensibly free market proxies. Part IV.C highlights some ways that the CRB could do so, even under the willing buyer-willing seller rate-setting standard now used throughout the existing compulsory music licensing regime.

A. Why Compulsory Licensing?

As Part III explored, compulsory licensing is now applied inconsistently in the music marketplace. While noninteractive services can take advantage of the § 114 compulsory license for sound recordings, interactive services are only partially covered: They must negotiate free market rates for sound recording copyrights but can utilize the mechanical compulsory license for musical composition copyrights. Despite its efforts to create greater consistency in the music licensing landscape, the MMA did not alter this status quo. This Subpart argues that a compulsory licensing regime for all forms of streaming would be most consistent with the historic approach to compulsory licensing and would best facilitate substantive copyright policy aims. To make this case, I focus on two issues in particular: the innovative nature of interactive and noninteractive streaming in facilitating unprecedented access to music for the public and the evidence that pathologies in the music marketplace allow copyright owners to extract unduly high licensing fees, potentially frustrating streaming services' ability to reach consumers. While free market licensing is unlikely to account for these issues, a policy-sensitive compulsory licensing regime could ensure that copyright owners receive sufficient financial incentives, while also ensuring that the streaming industry can continue to expand public access to music.

1. Access-enhancing innovation

The advent of music streaming is likely the most important technological innovation for facilitating dissemination of music since the invention of recording technology. Streaming services provide users with instantaneous access to vast amounts of recorded music, with the potential to someday deliver every single recorded song ever commercially released.[309] As William Fisher presciently argued in 2004, streaming has the unique potential to "satisfy

309. In this respect, streaming represents the arrival of the "celestial jukebox" that copyright scholars and policymakers have discussed for decades. *See, e.g.*, GOLDSTEIN, *supra* note 79, at 187.

consumers' desires more fully, rapidly, and precisely" than any other form of music dissemination ever created.[310]

In addition to providing access, both interactive and noninteractive streaming services also enhance consumers' experience of music. Many interactive services employ sophisticated algorithms designed to recommend new songs to consumers based on a variety of data, as well as features that allow users to curate detailed compilations and share them across social media communities.[311] Similarly, noninteractive services provide innovative music discovery tools, which make these services far more customizable than traditional radio.[312] Together, these technologies have dramatically changed the ways consumers engage with music in their day-to-day lives, with more changes likely to come.[313]

Recent trends in fair use case law can help clarify why streaming's ability to expand consumers' access to and experience of music is socially valuable and thus important from the perspective of copyright policy. Much of fair use case law—in particular "transformative" use cases—deals with the use of existing copyrighted material in follow-on expressive works.[314] But recent cases have increasingly applied the doctrine in situations "where the defendant's use does not add any new insights to the work, but rather presents it in a new technological or functional context."[315] The Ninth Circuit, for example, has repeatedly held that the creation of thumbnail images of copyrighted content

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310. *See* FISHER, *supra* note 100, at 25; *see also* Written Direct Testimony of Will Page at 9-19, *Phonorecords III*, *supra* note 27 (Copyright Royalty Bd. Oct. 31, 2016) (discussing the ways that Spotify has expanded music access); Reese, *supra* note 245, at 238-39 (discussing how on-demand music services expand access).

311. *See* ALAN B. KRUEGER, ROCKONOMICS: A BACKSTAGE TOUR OF WHAT THE MUSIC INDUSTRY CAN TEACH US ABOUT ECONOMICS AND LIFE 183-84, 192-93 (2019); *see also* Testimony of David Dorn at 17-21, *Phonorecords III*, *supra* note 27 (Copyright Royalty Bd. Nov. 1, 2016) (discussing Apple Music services); Written Direct Testimony of Paul Joyce at 5, *Phonorecords III*, *supra* note 27 (Copyright Royalty Bd. Oct. 31, 2016) (discussing Google Play services); Written Direct Testimony of Will Page, *supra* note 310, at 28-40 (discussing Spotify services).

312. *See* Xiyin Tang, Defining the Relevant Market in Fair Use Determinations 41-42 (2018), https://perma.cc/2ATK-WXWE (discussing Pandora's Music Genome Project and arguing that these tools could even be transformative enough to warrant a fair use finding).

313. John Seabrook, *Revenue Streams*, NEW YORKER (Nov. 17, 2014), https://perma.cc/3R2Q-CM5L (discussing Spotify's technological ambitions).

314. *See* Jacqueline D. Lipton & John Tehranian, *Derivative Works 2.0: Reconsidering Transformative Use in the Age of Crowdsourced Creation*, 109 NW. U. L. REV. 383, 412-13 (2015).

315. *Id.* at 413; *see also* Tang, *supra* note 312, at 18-19, 19 n.84 (discussing the line of "functionally transformative" cases).

for search engine purposes is fair use.[316] In *Authors Guild v. Google, Inc.*, the Second Circuit found that Google's mass digitization of millions of copyrighted books was fair use when this archive was provided to the public for certain search purposes.[317] Recently, a Second Circuit opinion by Judge Pierre Leval reflected on this line of cases and noted that they all involved uses that "'expand[ed the] utility'" of the original work, including by "deliver[ing] . . . content in more convenient and usable form[s]."[318]

Consistent with the limitations of the fair use doctrine—in particular, the market harm factor—many of these decisions took care to note that the secondary user had not "merely retransmitted [the works] in a different medium," but had transposed the works into a context where they could be used for a different *function* (in many of these cases, search-related).[319] But the cases still underscore that a nonexpressive secondary use of preexisting works that expands their "utility" for the consuming public can implicate basic questions of copyright's ideal balance, even if, as in *Authors Guild*, the secondary use essentially involves an entire industry's worth of content.[320]

Streaming's ability to enhance users' basic relationship to music consumption is similar to these kinds of utility-expanding innovative uses. Indeed, the social-cost-reduction justifications for fair use discussed in Part I also help clarify why streaming is an important technological development. In particular, the understanding of access to copyrighted works as generative of spillovers (positive externalities)—and fair use as preventing copyright owners from overly internalizing the value of such spillovers—can provide some insight into why the increased access, discovery tools, and customizability options offered by music streaming are worth fostering.[321] In particular, these features increase the public's enjoyment of musical works, as well as enable later musicians and songwriters to encounter existing works and draw on them in new expression.[322] Also as discussed in Part I, we might understand

316. *See* Perfect 10, Inc. v. Amazon.com, Inc., 508 F.3d 1146, 1164-68 (9th Cir. 2007); Kelly v. Arriba Soft Corp., 336 F.3d 811, 817-22 (9th Cir. 2003).

317. 804 F.3d 202, 214-25 (2d Cir. 2015).

318. Capitol Records, LLC v. ReDigi Inc., 910 F.3d 649, 661 (2d Cir. 2018) (quoting *Authors Guild*, 804 F.3d at 214).

319. *See Kelly*, 336 F.3d at 819.

320. *See Authors Guild*, 804 F.3d at 214; *see also supra* note 84-91 and accompanying text (discussing the alternative reading of *Sony Corp. of America v. Universal City Studios, Inc.*, 464 U.S. 417 (1984), that sees the case as grappling with the tension between author incentives and the public's interest in access to content).

321. *See supra* text accompanying notes 88-91.

322. Frischmann & Lemley, *supra* note 48, at 285-86 (describing enhanced enjoyment and follow-on creation as examples of positive externalities related to copyrighted works); *see also* KRUEGER, *supra* note 311, at 42-43 (discussing music spillovers).

compulsory licensing as operating in the space outside the limits of fair use, where the market harm to copyright owners is great enough that a zero-price license is inappropriate, but where the social value of the use still supports a compulsory license at a royalty rate calculated to promote the new use.[323]

Seen through this lens, the original creation of the mechanical license provides an important parallel to understanding why a policy-sensitive compulsory license regime is important for the burgeoning streaming industry. As Part II explained, the mechanical license was originally created to prevent copyright owners who had previously relied on a specific form of dissemination—sheet music publishing—from frustrating the development of new, spillover-generating forms of dissemination: the player piano and record player.[324] The streaming industry's conflict with publishers and record labels has much in common with this early story, except now *two* separate copyright owner stakeholders—the publishers and record labels—are threatened by the risk that streaming will "cannibalize" their CD sales and other traditional revenue streams.[325] Congress created the mechanical license to ensure that copyright owners, when faced with such risk, could not use their exclusive rights to frustrate the development of new dissemination forms by refusing to license or by charging disproportionate royalties.[326] In setting a low fixed rate, later replaced by the 801(b) factors' policy-sensitive adjustable rate, the original mechanical license facilitated access to musical works by bolstering the developing industries.[327] But by using a compulsory licensing scheme—rather than simply declaring that music composition copyright owners had no interest in mechanical reproductions of their work at all, as the Supreme Court had done—Congress ensured that copyright owners would still receive compensation sufficient to incentivize the creation of new works.[328]

Though the 1995 DPRA rejected applying the § 114 compulsory license to the (then-hypothetical) interactive streaming industry because of concerns over its threats to recording industry revenue (and by implication, copyright's incentive function),[329] this decision is difficult to justify in light of the historical role that compulsory licensing has played. The streaming industry may indeed pose a threat to copyright owners' entrenched revenue sources—

323. *See supra* Part I.C.

324. *See supra* Part II.A.

325. *See Phonorecords III*, *supra* note 27, 84 Fed. Reg. at 1992 (Strickler, C.R.J., dissenting) (discussing the streaming cannibalization argument); *see also* DiCola, *supra* note 226, at 1880-81 (critiquing cannibalization arguments generally).

326. *See supra* Part II.A.

327. *See supra* Part II.

328. *See supra* Part II.

329. *See supra* Part III.A.3.

just as the player piano once did—but compulsory licensing has, in the past, been able to effectively moderate this conflict.[330]

Indeed, some have speculated the decision to require interactive services to engage in market-based licensing slowed the growth of the burgeoning industry by enabling record labels to attempt to block the emergence of the technology by withholding licensing or demanding high royalties.[331] Today, streaming services still pay nearly 70% of their revenue in royalty payments to copyright owners,[332] which has created impediments to new market entrants.[333]

Creating a compulsory license for the use of sound recording copyrights by interactive services would put interactive streaming on the same footing as other innovative forms of music dissemination, ensuring that streaming is able to continue expanding music access for the public, while still ensuring that copyright owners receive compensation.

2. The distorting effects of market power

As copyright law strives to find balance in the incentives/access tradeoff, streaming's access-expanding effects must also be considered alongside the

330. *See supra* Parts II, III.A.2.

331. *See* FISHER, *supra* note 100, at 105 & 287 n.50; DiCola, *supra* note 226, at 1839; *see also, e.g.*, Maura Johnston, *Spotify's U.S. Launch Delayed Again*, ROLLING STONE (Dec. 8, 2010, 5:23 PM ET), https://perma.cc/N4YR-GGVB (discussing how Spotify's attempts to enter the U.S. market were delayed by record labels' licensing demands); Andrew Nusca, *Spotify Saved the Music Industry. Now What?*, FORTUNE (Oct. 21, 2019), https://perma.cc/5H86-GZZN (same).

332. *See* KRUEGER, *supra* note 311, at 181; *see also* Nusca, *supra* note 331 (noting an argument made by an industry observer that "[d]espite its impressive continued growth in terms of users and revenue, Spotify's margins are 'at the mercy of the record labels'" (quoting Ben Thompson, *Lessons from Spotify*, STRATECHERY (Mar. 5, 2018), https://perma.cc/B7S2-SHGM)). Record labels also often require in their licensing deals that services undertake promotional efforts for specific artists, a practice that complicates services' ability to offer unobstructed music access to consumers. *See* KRUEGER, *supra* note 311, at 183.

333. Larger services, like Spotify, have more leverage in bargaining with record labels, and can handle higher royalty rates. *See* KRUEGER, *supra* note 311, at 184. But labels' licensing demands frequently pose a barrier to new market entrants. The end result has been a reduction in competition among services. *See id.* (explaining that scale is often a prerequisite to being able to meet labels' licensing demands); Nusca, *supra* note 331 (discussing the difficulties encountered by newer streaming services, like Tidal). This likely impedes the development of innovation benefitting consumers since a major way that services differentiate themselves from one another in the marketplace is by investing in new access-enhancing features, like playlist curation and voice interaction. *See* KRUEGER, *supra* note 311, at 183-84.

financial incentives provided by market-based licensing.[334] As this Subpart explains, aspects of the music copyright system—in particular, market power imbalances between copyright owners and streaming services, as well as the potential that music's dual copyrights will allow music publishers to engage in holdup strategies—support the conclusion that market-based licensing may not adequately balance between incentives and access. Subjecting music copyright owners to a policy-sensitive form of compulsory licensing has the potential to account for these problems and restore the balance.

The music licensing marketplace—both on the musical composition side and the sound recording side—is characterized by market power imbalances. Only four publishers control almost three-fourths of the most important musical composition copyrights,[335] and only three record labels have most of the market share for sound recording copyrights.[336] As consumers expect a streaming service to provide access to nearly all commercially available recorded music, a streaming service must license all of the major publishers' catalogues and all of the major record labels' catalogues in order to remain competitive. Thus, both of these licensing markets can be described as complementary oligopolies: "[L]arge publishing houses [and] major record labels control large swaths of the market, and their products are 'must haves'" for the services.[337] This complementary oligopoly power allows publishers

334. In the past several years, some scholars have questioned whether copyright is truly necessary in order to encourage authors to produce new creative works. *See, e.g.*, Julie E. Cohen, Essay, *Copyright as Property in the Post-Industrial Economy: A Research Agenda*, 2011 WIS. L. REV. 141, 143 ("[T]he incentives-for-authors story is wrong as a descriptive matter. Everything we know about creativity and creative processes suggests that copyright plays very little role in motivating creative work."). In recent work, Glynn Lunney has applied this lens to the music industry and demonstrated that increases in music industry revenue have had little correlation with the production of new, high-quality musical works, suggesting that copyright's incentive function may be overstated. LUNNEY, *supra* note 214, at 122-56. While these analyses may provide additional support to the argument that compulsory licensing should be applied to the music industry, they are generally outside the scope of this Article, which, consistent with the incentives/access paradigm described above, takes for granted that copyright is necessary to provide some financial incentive to creators. *See supra* Part I.

335. *Phonorecords III*, *supra* note 27, 84 Fed. Reg. at 1922 (majority opinion) ("The four largest publishers—Sony/ATV, Warner/Chappell, Universal Music Publishing Group, and Kobalt Music Publishing—collectively accounted for just over 73 percent of the top 100 radio songs tracked by Billboard as of the second quarter in 2016." (footnote omitted)); Ed Christman, *Publishers Quarterly: Big Lead for Sony/ATV at No. 1*, BILLBOARD (May 4, 2018), https://perma.cc/2QKU-7K3J.

336. *Phonorecords III*, *supra* note 27, 84 Fed. Reg. at 1978 n.230 (Strickler, C.R.J., dissenting); *see also* U.S. COPYRIGHT OFFICE, *supra* note 1, at 22-23; Mark Mulligan, *2018 Global Label Market Share: Stream Engine*, MIDIA (Mar. 13, 2019), https://perma.cc/J5H7-ZBJ8.

337. *See Phonorecords III*, *supra* note 27, 84 Fed. Reg. at 1979 n.232 (Strickler, C.R.J., dissenting); *see also id.* at 1940 (majority opinion); *Web IV*, *supra* note 265, 81 Fed. Reg. at 26,348.

and labels to extract high licensing rates in open markets.[338] There is evidence that this occurs regularly in the unregulated sound-recording-licensing market for interactive streaming.[339]

While the market power of the labels and publishers is clear, how and why this market power should give rise to government intervention is more complex. Indeed, this issue raises difficult questions about the intersection of antitrust and intellectual property, a full discussion of which is outside the scope of this Article. Suffice it to say that most scholars agree that the exclusive grant provided by intellectual property rights does not inherently give those owners market power that would sound in antitrust law.[340] Rather, antitrust law is primarily concerned with "anticompetitive *conduct* designed to achieve market power."[341] Ownership of an intellectual property interest (or, more likely, a group of them) may give rise to an antitrust violation under certain circumstances, but this assessment requires additional evidence regarding the antitrust defendant's use of its market position.[342] In the music industry's case, antitrust law may be inapposite in understanding whether the relationship between digital services and publishers or record labels should be regulated. As Kristelia García has additionally noted, even if the aggregation of music copyrights by labels and publishers creates market power that could be problematic from the perspective of antitrust law, it is still unlikely that the actions of copyright owners are sufficiently grave to warrant application of the usual tools of antitrust enforcement.[343]

But even if the market power imbalances in the music licensing market are of unclear consequence from the perspective of antitrust law, they are still

338. *See Phonorecords III*, *supra* note 27, 84 Fed. Reg. at 1979 & n. 232 (Strickler, C.R.J., dissenting).

339. *See id.* at 1953 (majority opinion); *id.* at 1964 (Strickler, C.R.J., dissenting).

340. *See* HOVENKAMP ET AL., *supra* note 66, §§ 1.03[A], 4.02; Michael A. Carrier, *Unraveling the Patent-Antitrust Paradox*, 150 U. PA. L. REV. 761, 791 (2002) ("[P]atents typically do not demonstrate market power, and the set of technological substitutes that cannot be practiced because of the patent grant often has little overlap with the set of products that consumers view as economic substitutes.").

341. HOVENKAMP ET AL., *supra* note 66, § 1.03; *see also* U.S. DEP'T OF JUSTICE & FTC, ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY 4-5 (2017), https://www.perma.cc/XA4R-49BM ("As with any other asset that enables its owner to obtain significant supracompetitive profits, market power (or even a monopoly) that is solely 'a consequence of a superior product, business acumen, or historic accident' does not violate the antitrust laws." (quoting United States v. Grinnell Corp., 384 U.S. 563, 570-71 (1966))).

342. HOVENKAMP ET AL., *supra* note 66, § 4.02[B]-[C].

343. García, *supra* note 212, at 230-42 ("Most individual copyrights (for example, a copyright to a single song) are not viewed as conferring market power on individual owners, but in the aggregate they may—for example, a music publisher with rights to millions of songs.").

significant from the perspective of copyright law.[344] Neil Netanel has explained that copyright law should account for "copyright industries' market structure" because situations in which "a small number of firms holding vast inventories of copyrighted works enjoy oligopolist and oligopsonistic dominance of their sectors" can lead to practices that "exacerbate[]" the ways that copyright already limits dissemination.[345] Judge Strickler, in his copyright-policy-sensitive dissent from the rate-setting decision described above, evoked similar reasoning to argue that adjusting market benchmarks to correct for market power imbalances would be consistent with the compulsory licensing regime's policy goals because such an adjustment would ensure that copyright owners do not earn royalties that far exceed their costs in producing new works.[346]

Seen through this lens, the publishers' and labels' complementary oligopoly power is problematic because it creates an imbalance in the incentives/access tradeoff by allowing copyright owners to extract licensing fees that likely exceed the level necessary to incentivize authorship, while simultaneously imposing costs on services that prevent them from facilitating access to works.[347]

While both the record labels and music publishers possess problematic, complementary oligopoly power, the musical composition copyright owners also possess a different strategic tool for extracting outsized royalties from streaming services in open markets. As Judge Strickler noted in his *Phonorecords III* dissent, the unusual (and possibly unique) dual nature of music copyright—that a single stream, music file, CD, or record embodies

344. Indeed, as one treatise notes, market power is often assessed through the lens of copyright policy goals, rather than antitrust, in other contexts like copyright misuse. *See* HOVENKAMP ET AL., *supra* note 66, § 3.04[B].

345. Netanel, *supra* note 100, at 24-27; *see also* FISHER, *supra* note 100, at 181-82 (discussing how entertainment copyright owners' market power, in warranting regulation, relates to the copyright policy); *cf.* Depoorter & Parisi, *supra* note 75, at 460-64 (exploring how control over prices by many independent copyright holders leads to deadweight loss in copyright markets and advocating for the use of fair use to remedy this problem).

346. *Phonorecords III*, *supra* note 27, 84 Fed. Reg. at 2023-24 (Strickler, C.R.J., dissenting); *see also id.* at 1978-79 (discussing the interplay between market power and copyright policy goals in more general terms). Indeed, market structure has been interwoven with the copyright policy goals at issue in music dissemination since the creation of the mechanical license in 1909; recall that the potential for monopoly in the burgeoning player piano roll industry was used as a way of framing justifications for the mechanical license. *See supra* Part II.A.

347. Moreover, to the extent their traditional revenue streams rely on forms of technology threatened by streaming, like CDs, copyright owners have the incentive to use their market power to frustrate the growth of streaming services. *See* Mark A. Lemley, *IP in a World Without Scarcity*, 90 N.Y.U. L. REV. 460, 497-99 (2015) ("It may well be rational for record companies and movie studios to fight the digital transition . . . .").

independent copyrights in both the underlying musical composition and the sound recording[348]—means that music licensing is potentially vulnerable to holdup problems.[349] Holdup problems, frequently discussed in the patent context, occur when, for example, a patent holder waits for a licensor to implement a technology that utilizes its patent and then uses this fact as leverage to demand a disproportionate share of royalties.[350] The patent holder "holds up" the licensor and thus extracts a royalty payment based more on the timing of the demand—and the money the licensor has already invested—than the actual value of the patent.[351] Somewhat analogously, once a musical composition "has been incorporated into a recording . . . it has become essential," and "its uniqueness allows the owner of the input [i.e., music publishers] to demand a disproportionate share of the revenue in royalties" from streaming services.[352] Compulsory licensing remedies this risk by removing musical composition rights holders' ability to deny or withdraw permission to use their copyrights.

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The conclusion that copyright owners should receive less revenue than what they can demand in open markets might seem surprising in light of the frequent allegation that many recording artists and composers receive paltry royalty revenue.[353] Many argue that compulsory licensing is exclusively to blame for this alleged undercompensation,[354] but there is little empirical support for that claim.[355] Indeed, recording artists raise the same undercompensation allegations with respect to sound recording royalties,[356] even though sound recording royalties are unregulated for digital downloads and interactive streaming.[357]

348. *See* García, *supra* note 212, at 192.

349. *See Phonorecords III*, *supra* note 27, 84 Fed. Reg. at 2026 (Strickler, C.R.J., dissenting).

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

351. *See id.*; Terrell McSweeny, Holding the Line on Patent Holdup: Why Antitrust Enforcement Matters 2-3 (2018), https://perma.cc/LMH7-EBRF.

352. *Phonorecords III*, *supra* note 27, 84 Fed. Reg. at 2026 (Strickler, C.R.J., dissenting).

353. *See, e.g.*, Seabrook, *supra* note 4.

354. *See* U.S. COPYRIGHT OFFICE, *supra* note 1, at 73-76.

355. It also bears mentioning that both record label and publisher revenue have gone up consistently over the last four years. *See* Tim Ingham, *How Much Money Is the US Music Publishing Industry Making? A Billion Dollars More than It Was 4 Years Ago*, MUSIC BUS. WORLDWIDE (June 16, 2019), https://perma.cc/SC7V-PH9A; *see also* KRUEGER, *supra* note 311, at 185.

356. *See* Amy X. Wang, *The Median U.S. Musician Is Still Making Under $25,000 a Year*, ROLLING STONE (June 27, 2018, 1:47 PM ET), https://perma.cc/PWH6-U9S5.

357. *See supra* Part III.A.3.

A more likely culprit for artists' financial state is the basic structure of the music industry and the ways in which royalties are allocated therein. Record labels—which were among the original music disseminators that the mechanical license helped foster—have always claimed the largest share of music industry revenue.[358] At a time when the barriers to entry for new artists were high, this made sense; record labels could front the large costs associated with music distribution. But digitization has eliminated the need for the "brick-and-mortar world of paper, plastic, trucks, and warehouses."[359] Since the creation of another digital copy is essentially costless, now the main costs are only those associated with the creation and marketing of the work itself, which for music, unlike film and television, are relatively low.[360] Although record labels play a valuable role in promoting and marketing new works, their revenue-allocation arrangements with recording artists (and the fact that they usually own the entire sound recording copyright) may still reflect the pre-digital-distribution reality.[361] Thus, many believe that the financial troubles of artists have less to do with underpayment by digital distributors and far more to do with the music industry's outdated royalty-distribution practices.[362]

Indeed, a well-structured compulsory licensing regime could actually increase payments to artists. For example, the § 114 compulsory license for digital radio allocates a percentage of royalty revenue to the recording artists regardless of whether the artist or a record label owns the sound recording

358. *See* FISHER, *supra* note 100, at 19-20, 55-56.

359. Ku, *supra* note 100, at 300-01, 305-06; *see also* Lemley, *supra* note 347, at 469-70.

360. *See* Ku, *supra* note 100, at 300-01, 305-06.

361. *See* U.S. COPYRIGHT OFFICE, *supra* note 1, at 76-78 (discussing the lack of transparency in royalty-sharing arrangements); Ku, *supra* note 100, at 305-07 (criticizing record label royalty sharing); Ben Sisario, *A New Spotify Initiative Makes the Big Record Labels Nervous*, N.Y. TIMES (Sept. 6, 2018), https://perma.cc/LLR9-3942; *see also* Michael A. Carrier, *Copyright and Innovation: The Untold Story*, 2012 WIS. L. REV. 891, 922-23 (discussing numerous stakeholders' ownership of rights in any given piece of music).

362. *See* U.S. COPYRIGHT OFFICE, *supra* note 1, at 76-77; *see also, e.g.*, Litman, *supra* note 100, at 32-38; Josh Constine, *The Truth About Streaming: It Pays Labels a Lot, They Don't Pay Musicians*, TECHCRUNCH (Sept. 23, 2015, 4:24 PM PDT), https://perma.cc/G4M4-6X95; Ian Morris, *Technology Is Destroying the Music Industry, Which Is Great for the Next Taylor Swift*, FORBES (Nov. 17, 2014, 3:41 PM), https://perma.cc/3KDE-7N7G; Daniel Sanchez, *The Music Industry Generated $43 Billion in Sales Last Year. Artists Only Received 12% of That*, DIGITAL MUSIC NEWS (Aug. 7, 2018), https://perma.cc/42KG-BZ44; Amy X. Wang, *How Musicians Make Money—or Don't at All—in 2018*, ROLLING STONE (Aug. 8, 2018, 10:21 AM ET), https://perma.cc/UQ8F-3GPK; *see also* David Nelson, Note, *Free the Music: Rethinking the Role of Copyright in an Age of Digital Distribution*, 78 S. CAL. L. REV. 559, 568-69 (2005) (discussing the role of copyright and record labels in the age of digital distribution).

copyright.[363] Expanding this arrangement to a music-industry-wide compulsory licensing regime—covering both musical composition and sound recordings and all forms of streaming—could ensure that songwriters and recording artists receive sufficient royalty payments irrespective of the ownership of the copyrights in their creations.[364]

B. Why Policy-Driven Rate Setting?

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

As Part III explored, both Congress and the CRB have departed from the 801(b) policy-oriented approach to rate setting and now assume that a compulsory license should only attempt to approximate ostensible free market rates. This Subpart argues against this trend for two reasons. First, rate setting that weighs public access against copyright's incentive function is more consistent with the historical purpose of compulsory licensing, and remains necessary to ensure that the compulsory licensing regime can allow access-expanding technologies of dissemination to succeed. Second, from a more practical standpoint, attempts by rate-setting entities to find free market rates in regulated licensing markets are plagued by ambiguity. When regulators fail to use policy criteria to guide their analyses, instead privileging market mimicking for its own sake, they leave these proceedings potentially vulnerable to strategic manipulation by the parties.

1. Rate setting and the incentives/access tradeoff

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

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363. 17 U.S.C. § 114(g)(2) (2018); *see also* U.S. COPYRIGHT OFFICE, *supra* note 1, at 47. The PROs often arrange for similar direct-to-songwriter payments in their licensing deals. *See* U.S. COPYRIGHT OFFICE, *supra* note 1, at 152-53.

364. For such a system to work effectively, however, the statute would need to require parties circumventing the compulsory license through private licensing deals to abide by the same distribution scheme. *See* García, *supra* note 9, at 1151-52 (proposing this type of amendment to the § 114 compulsory license).

As Part II explained, the 801(b) policy objectives were crafted based on the assumption that market mimicking alone would not necessarily facilitate an ideal balance between public access and copyright owners' financial incentives, especially when a new dissemination technology is in its infancy. Accordingly, the factors encouraged regulators to depart downward from market benchmarks through explicit consideration of the interests of those external to the specific licensing deal between rights holders and disseminators: the consuming public.[365]

In contrast, rate setting for internet radio sound recording royalties following the DMCA—which established a willing buyer-willing seller rate-setting standard in lieu of the 801(b) criteria for the majority of internet radio services—set high royalty rates for services.[366] These rates were in fact so high that Congress chose to intervene on several occasions, suspending the rates and creating mechanisms to facilitate negotiated settlements.[367] As explained further below, these high rates were not inevitable (and were partially the result of gamesmanship by copyright owners), but Matthew Sag and Peter DiCola have argued that they emerged because the CRB failed to consider the economic reality faced by burgeoning internet radio services.[368] The result was a slowdown in the growth of internet radio services.[369] Had these proceedings been governed by the 801(b) factors, the outcome might have been different.

That said, the CRB also eventually began setting rates in 801(b)-governed proceedings that were ill-equipped to ensure that new technologies of dissemination could facilitate access to copyrighted works. As discussed above,

365. The early 801(b) rate-setting decisions pointed to the importance of compensating music disseminators for their work in innovating new forms of music access, even if this required a reduction in royalties to copyright owners. The first mechanical license rate-setting proceeding noted that record labels were "opening . . . new markets" through technological innovation. Adjustment of Royalty Payable Under Compulsory License for Making and Distributing Phonorecords; Rates and Adjustment of Rates, 46 Fed. Reg. 10,466, 10,466 (Copyright Royalty Tribunal Feb. 3, 1981). A later CARP proceeding explicitly used royalty rates at the lower of end of those suggested by free market proxies because innovations by internet radio providers had "expand[ed] the offerings of the types of music beyond that which one receives over the radio." Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings, 63 Fed. Reg. 25,394, 25,408-10 (Copyright Office May 8, 1998).

366. DiCola & Sag, *supra* note 135, at 226-29, 232-34 (discussing *Webcasting I* and *Webcasting II*, two proceedings in which a rate-setting entity set the royalty rates for webcasting).

367. *Id.* at 229-31, 234-37 (discussing the passage of the Small Webcaster Settlement Act of 2002, the Webcaster Settlement Act of 2008, and the Webcaster Settlement Act of 2009).

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

369. *See id.*; *see also* DiCola, *supra* note 226, at 1877 (noting that some have argued that venture capital has avoided investing in internet radio because of high royalty costs).

the *Phonorecords III* decision tethered mechanical royalty rates to unregulated sectors of the music licensing market and failed to meaningfully grapple with the 801(b) objectives, thus leading to a dramatic increase in royalty rates for services.[370]

These examples suggest that compulsory-license rate setting for streaming must remain policy-oriented in order to effectively allow access-expanding technologies to flourish. That being said, this Article's argument is not that streaming services should always receive a "discount" simply because they facilitate access.[371] As Part III.B explained, compulsory-license regulators rely predominantly on complex economic models and financial data in order to arrive at appropriate rate structures and rates.[372] The ideal rate structure and rate for streaming would require economic analyses that are beyond the scope of this Article. Rather, the argument here is that rate-setters should *consider* this access-encouraging role, as weighed against the need for financial incentives when setting rates. It is of course possible that a rate that factors in these policy goals would be no different from an exclusively market-proxy-derived rate. But any such determination requires a policy-focused inquiry of

370. *See supra* Part III.B.2. Had the CRB considered the importance of consumer access, it might have—as Judge Strickler's dissent in *Phonorecords III* suggested—maintained the prior settlement rates, which provided lower royalty rates generally, and different rates for services offering free ad-supported streaming to consumers. *See Phonorecords III*, *supra* note 27, 84 Fed. Reg. at 1985-88 (Strickler, C.R.J., dissenting).

371. Copyright owners have sometimes argued that streaming services are seeking a discounted rate even though they are "highly profitable." *See, e.g.*, Witness Statement of David Israelite at 36-39, *Phonorecords III*, *supra* note 27 (Copyright Royalty Bd. Oct. 28, 2016). Whether the music streaming market is profitable is disputed to begin with. *See Phonorecords III*, *supra* note 27, 84 Fed. Reg. at 1921 (majority opinion); *id.* at 1971 (Strickler, C.R.J., dissenting) (citing the "conflicting evidence about whether the market for streaming services is faring poorly financially or performing about the same as other emerging industries"). But profitability should not necessarily be the most important (and certainly not the only) question from the perspective of copyright law and policy. The real issue, as many of the early 801(b) rate-setting decisions recognized, is to "weigh[] the contributions of the [services] in creating and expanding the market" against the contribution of copyright owners in supplying the copyright good to the public, and allocate surplus accordingly. *See* Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings, 63 Fed. Reg. 25,394, 25,408-09 (Copyright Office May 8, 1998); *cf.* Pandora Media, Inc. v. Am. Soc'y of Composers, Authors, & Publishers, 6 F. Supp. 3d 317, 369 (S.D.N.Y. 2014) (declining to factor in Pandora's alleged commercial success when setting musical composition performance rates pursuant to the ASCAP consent decree), *aff'd*, 785 F.3d 73 (2d Cir. 2015). This analysis is independent of the question whether the services can profit when their innovations prove successful. Indeed, fair use case law has moved soundly past the idea that a defendant's secondary use of a copyrighted good cannot be fair use simply because the defendant is able to profit when its use is successful. *See* Authors Guild v. Google, Inc., 804 F.3d 202, 219 (2d Cir. 2015).

372. *See supra* notes 291-94 and accompanying text.

the kind the CRB has appeared unwilling to undertake in recent decisions like *Phonorecords III*.

2. The malleability of market-mimicking rate setting in regulated licensing markets

A policy-oriented approach to rate setting would also be able to more clearly identify the assumptions that will inevitably define any attempt to identify ostensible free market rates for compulsory licenses. Several scholars have noted that attempting to find free market rates in markets that have always been regulated, like mechanical royalties or sound recording performance royalties, is something of a contradiction in terms.[373] As explained above, rate-setting entities like the CRB must use market benchmarks from other contexts in order to arrive at rates that might prevail in an ostensibly free market. But this benchmarking approach is subjective; the CRB must choose from a range of different benchmarks offered by the parties from similar, though not identical, licensing contexts and then use them to construct a hypothetical rate for the regulated market.[374] The benchmarks offered by the parties often dictate sharply different royalty rates.[375]

The subjectivity of this process has made it susceptible to manipulation. For example, in *Webcasters I*, the first proceeding for post-DMCA digital radio sound recording royalties set under the newly created willing buyer-willing seller standard, CARP found evidence that record labels had entered into inflated licensing deals in other sectors of the music market in order to influence the benchmarking inquiry.[376] While CARP ultimately found one

373. *See, e.g.*, DiCola & Sag, *supra* note 135, at 245 ("[A] decision rule premised on discovering the price that would be set by a hypothetical willing buyer-willing seller market is likely to generate arbitrary results. Given the non-existent market for permissions in orphan works, a willing buyer-willing seller determination would be entirely speculative in this context."); García, *supra* note 9, at 1141-45; Lemley & Weiser, *supra* note 8, at 833-34; *cf.* Michael Risch, *(Un)Reasonable Royalties*, 98 B.U. L. REV. 187, 218-19 (2018) (raising similar concerns about the use of a willing buyer-willing seller standard in calculating reasonable royalties during a patent damages inquiry).

374. *See, e.g.*, *Web IV*, *supra* note 265, 81 Fed. Reg. at 26,334-92 (considering various licensing deals between record labels and interactive streaming services, and record labels and noninteractive streaming services).

375. *See, e.g.*, *id.* at 26,334 (noting the "wide disparity" between different rates suggested by the different parties).

376. Beethoven.com LLC. v. Librarian of Cong., 394 F.3d 939, 943 (D.C. Cir. 2005) ("The CARP determined that the [copyright owners'] strategy was targeted at supra-competitive licensing fees to conform with its view of the 'sweet spot' for the royalty rates. [The copyright owners] then would only close deals that hit its 'sweet spot' to create a favorable record . . . ." (quoting a CARP report)); *see also* DiCola & Sag, *supra* note 135, at 226-28. This issue has emerged recently in rate setting under the PROs' consent decrees. *See* U.S. COPYRIGHT OFFICE, *supra* note 1, at 154; García, *supra* note 212,
footnote continued on next page

benchmark to be untainted,[377] this benchmark still yielded royalty rates too high for internet radio stations to be able to function.[378] Congress chose to intervene, suspending the established rates and allowing SoundExchange, the sound recording rights management entity, to negotiate new rates.[379]

Even in the absence of explicit manipulation by the parties, the benchmarking process may also be affected by pathologies in the markets from which the benchmarks are drawn, in particular market power imbalances. As discussed above, the music licensing landscape is characterized by market power imbalances stemming from the small number of record labels and music publishers.[380] As the licensing deals used in benchmark analysis may themselves be the product of market power, simply importing them into the compulsory regime, without any additional analysis, only serves to recreate the imbalance in the regulated market.[381]

This issue emerged in *Web IV*, the most recent CRB proceeding setting sound recording performance royalties for internet radio services.[382] In that decision, the CRB determined that the use of free market licensing agreements would not be sufficient when setting rates under the willing buyer-willing seller standard; rather, the judges had to "determine whether the proffered rates reflect a sufficiently competitive market, *i.e.*, an 'effectively competitive' market."[383] The judges found that a freely negotiated licensing agreement from the interactive streaming market was suspect because of the market power imbalances in that market (namely, the complementary oligopoly problem described above).[384] Thus, the rate derived from that benchmark required

at 215-16. It has also emerged in the patent damages context. *See* William F. Lee & A. Douglas Melamed, *Breaking the Vicious Cycle of Patent Damages*, 101 CORNELL L. REV. 385, 418 (2016).

377. *Beethoven.com*, 394 F.3d at 943-44.

378. *See* DiCola & Sag, *supra* note 135, at 228-30; Lemley & Weiser, *supra* note 8, at 833-34.

379. *See* U.S. COPYRIGHT OFFICE, *supra* note 1, at 51-52, 142-44 (discussing the Webcaster settlement legislation); DiCola & Sag, *supra* note 135, at 230-31; *see also supra* text accompanying notes 366-67.

380. *See supra* Part IV.A.2.

381. *See supra* Part III.B.2 (describing why and how *Phonorecords III* failed to account for this problem); *cf.* Risch, *supra* note 373, at 218-19 (discussing similar problems in calculating reasonable patent royalties).

382. *Web IV*, *supra* note 265, 81 Fed. Reg. 26,316.

383. *Id.* at 26,332.

384. *Id.* at 26,343-44, 26,353. As explained above, effective competition (or lack thereof) can have direct consequences on copyright policy goals, including the incentives/access tradeoff. *See supra* Part IV.A.2. Indeed, Judge Strickler has noted that determining how to model perfect or effective competition in intellectual property markets will inevitably implicate the "classic IP pricing conundrum" of balancing incentives and access. *See* David R. Strickler, *Royalty Rate Setting for Sound Recordings by the United*

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adjustment "to render it . . . usable as an 'effectively competitive' rate in . . . the noninteractive subscription market."[385]

Copyright owners challenged this determination on appeal, arguing that the willing buyer-willing seller standard "compels the Board to adopt rates that would be negotiated in the *actual* market, without any adjustment to account for how the rates might vary if the market were effectively competitive."[386] The D.C. Circuit disagreed and affirmed the CRB's determination.[387] The court concluded that the "willing buyer and willing seller" language was ambiguous and that the CRB's choice to read an effective competition requirement into the statutory language was reasonable.[388] Importantly, the court rejected the copyright owners' argument that effective competition cannot be considered under the willing buyer-willing seller standard because it is a "policy objective[]."[389] The court essentially held that the willing buyer-willing seller standard's subjectivity means that normative economic considerations will invariably be factored into its application.[390]

The D.C. Circuit's decision provides support for the continued relevance of policy-oriented rate setting in compulsory licensing regimes. If determining a "willing buyer and willing seller" in a regulated licensing market will always require some normative inquiry, it makes sense to continue ensuring that this inquiry reflects the policy aims of copyright. The now-abolished 801(b) objectives certainly provided a helpful push in this direction. But as *Phonorecords III* made clear, these factors were never alone sufficient to ensure rates consistent with copyright policy objectives.[391]

Legislation that restored these factors, or provided other focused guidance to the CRB, makes it more likely that future rate-setting decisions would achieve reasonable rates. But even in the absence of such guidance, the D.C. Circuit's decision that the willing buyer-willing seller standard is ambiguous

States Copyright Royalty Board: The Judicial Need for Independent Scholarly Economic Analysis, 12 REV. ECON. RES. ON COPYRIGHT ISSUES 1, 7 & n.5 (2015).

385. *Web IV*, *supra* note 265, 81 Fed. Reg. at 26,343-44, 26,404-05. In applying this analysis, the CRB ultimately *lowered* the rates paid by subscription webcasters. *See* Glenn Peoples, *D.C. Sets New Webcasting Rates: Free Streams Up, Paid Streams Down (With an Asterisk)*, BILLBOARD (Dec. 16, 2015), https://perma.cc/WKW2-XCX8.

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

387. *Id.* at 56-57, 62.

388. *Id.* at 56-57.

389. *Id.* at 56.

390. *See id.* at 56-57 (rejecting the argument that the CRB cannot consider economics-related "policy objectives" in willing buyer-willing seller proceedings).

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

potentially opens the door for regulators to consider copyright policy goals even within the existing statutory framework, as the next Subpart explores.

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

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

As an initial matter, it is important to note that the willing buyer-willing seller standard articulated in the MMA (and in earlier legislation like the DMCA) is not entirely a free market standard, at least on its face. Rather, in the case of the mechanical license, the CRB is instructed to "establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller," but also to consider "the relative roles of the copyright owner and the compulsory licensee in the copyrighted work and the service made available to the public with respect to the relative creative contribution, technological contribution, capital investment, cost, and risk."[392] The statute's reference to the "relative roles" of the copyright owners and licensees uses language very similar to the third 801(b) factor.[393] As explained above, the CRB has in the past interpreted this factor as requiring rates that allow new technologies of dissemination, like internet and satellite radio, to reach a broad range of consumers.[394] This suggests that prior decisions applying the third 801(b) factor could potentially inform rate setting even under the willing buyer-willing seller standard.

That being said, past CRB decisions interpreting the willing buyer-willing seller standard have not taken this approach (or even mentioned the 801(b) "relative roles" subfactor at all).[395] The conventional wisdom is that the willing

392. *See* Orrin G. Hatch-Bob Goodlatte Music Modernization Act, Pub. L. No. 115-264, § 102(a)(1)(B), 132 Stat. 3676, 3680 (2018) (codified at 17 U.S.C. § 115(c)(1)(F) (2018)).

393. *See* Copyright Act of 1976, Pub. L. No. 94-553, § 801(b)(1)(C), 90 Stat. 2541, 2594-95 ("To reflect the relative roles of the copyright owner and the copyright user in the product made available to the public . . . .").

394. *See supra* Parts II.B, III.B.1.

395. *See, e.g., Web IV, supra* note 265; Digital Performance Right in Sound Recordings and Ephemeral Recordings, 76 Fed. Reg. 13,026 (Copyright Royalty Bd. Mar. 9, 2011).

buyer-willing seller standard yields rates that are higher than the rates produced under the 801(b) factors.[396] Indeed, some of the earlier willing buyer-willing seller proceedings set unworkably high rates for sound recording public performance licenses for internet radio.[397]

But these high rates were not necessarily mandated by the statutory text of the willing buyer-willing seller standard. As discussed above, the lack of an objective metric for free market rates in markets that have always been regulated also means that application of the willing buyer-willing seller standard will always require the CRB to consider how copyright licensing markets *should* operate and use these assumptions to guide its benchmarking inquiry, just as the 801(b) objectives explicitly required.[398] As the D.C. Circuit noted in the *Web IV* appeal, the "'inherent ambiguity in the statute's mandate'" means that the CRB maintains discretion to "identify the relevant characteristics of competitiveness on which to base its determination of the statutory royalty rates."[399]

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

Pandora Media, Inc. v. American Society of Composers, Authors, & Publishers: A copyright-policy-sensitive approach has begun to inform the rate-setting proceedings in the Southern District of New York under the consent decrees that govern the performance rights organization ASCAP.[400] Like the CRB, the rate court must set a rate reflecting "the price that a willing buyer and a willing seller would agree to in an arm's length transaction."[401] In recent rate-setting

396. *See* García, *supra* note 9, at 1140-42.

397. *See* DiCola & Sag, *supra* note 135, at 228-30.

398. *See supra* Part IV.B.2. Interestingly, both digital services and the record labels agreed, in comments to the Copyright Office, that decisions under the 801(b) standard "do[] not result in rates lower than fair market value." U.S. COPYRIGHT OFFICE, *supra* note 1, at 106.

399. SoundExchange, Inc. v. Copyright Royalty Bd., 904 F.3d, 41, 56-57 (D.C. Cir. 2018) (quoting Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd., 574 F.3d 748, 757 (D.C. Cir. 2009) (per curiam)).

400. For a discussion of ASCAP's role, see Part III.A.2 above.

401. *See* United States v. Broad. Music, Inc., 316 F.3d 189, 194 (2d Cir. 2003) (quoting Am. Soc'y of Composers, Authors & Publishers v. Showtime/The Movie Channel, Inc., 912 F.2d 563, 569 (2d Cir. 1990)).

decisions, however, Judge Denise Cote (who, until recently,[402] had sole jurisdiction over ASCAP rate-setting proceedings) recognized that this inquiry implicates basic questions of incentives/access balancing:

> The task at hand is to determine the fair market value of a blanket license for the public performance of music. The challenges of that task include discerning a rate that will give composers an economic incentive to keep enriching our lives with music, that avoids compensating composers for contributions made by others either to the creative work or to the delivery of that work to the public . . . .[403]

In practical terms, Judge Cote has been willing to set rates favorable to disseminators, especially when presented with evidence that copyright owners have attempted to extract more than their reasonable share of royalties. For example, in a recent proceeding setting a musical composition performance royalty rate, Judge Cote set a rate favorable to Pandora.[404] Among other things, the court rejected ASCAP's proffered benchmark licensing agreements on the grounds that, in those agreements, publishers had used "their considerable market power to extract supra-competitive prices" inconsistent with the balanced approach that copyright strives for.[405]

Judge Cote also rejected ASCAP's argument that Pandora's alleged success entitles copyright owners to a higher royalty fee, concluding that Pandora's success is "attributable not just to the music it plays . . . but also to its creation of the [Music Genome Project, a database and algorithms designed to predict users' musical interests,] and its considerable investment in the development and maintenance of that innovation."[406] As with the fair use case law discussed above, a subtext of this conclusion is that copyright owners are not entitled to the value generated by innovations designed to enhance the public's access to existing copyrighted works. Under Judge Cote's reasoning, even a free-market-mimicking rate-setting inquiry can support this finding.

Phonorecords III Dissent: An important example of a copyright-sensitive approach to a free market benchmark inquiry can also be found in Judge Strickler's dissent in *Phonorecords III*. Although *Phonorecords III* was governed by

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402. *See* Orrin G. Hatch-Bob Goodlatte Music Modernization Act, Pub. L. No. 115-264, § 104, 132 Stat. 3676, 3726 (2018) (codified at 28 U.S.C. § 137 (2018)).

403. MobiTV, Inc. v. Am. Soc'y of Composers, Authors, & Publishers, 712 F. Supp. 2d 206, 209 (S.D.N.Y. 2010), *aff'd*, 681 F.3d 76 (2d Cir. 2012); *see also* Pandora Media, Inc. v. Am. Soc'y of Composers, Authors, & Publishers, 6 F. Supp. 3d 317, 320-21 (S.D.N.Y. 2014) (rearticulating this point), *aff'd*, 785 F.3d 73 (2d Cir. 2015).

404. *See Pandora Media*, 6 F. Supp. 3d at 320. ASCAP alone appealed Judge Cote's decision, but the Second Circuit ultimately affirmed it. *See Pandora Media*, 785 F.3d at 75 (per curiam).

405. *Pandora Media*, 6 F. Supp. 3d at 357. In recent work, Xiyin Tang has argued that this decision sounds in fair use principles and that, in the absence of the consent decrees, Pandora could have potentially employed the fair use defense. Tang, *supra* note 312, at 40-44.

406. *Pandora Media*, 6 F. Supp. 3d at 368-69.

the 801(b) objectives, both the majority opinion and Judge Strickler's dissent engaged in independent free market benchmark inquiries, as was typical even in 801(b) rate-setting proceedings.[407] These benchmark inquiries were essentially no different than the kind of inquiry that occurs under the willing buyer-willing seller standard.[408] When Judge Strickler arrived at the conclusion that the previous rates for streaming should be maintained, he did so *exclusively* through this benchmark inquiry, without relying on the 801(b) factors.[409] What is particularly interesting about *Phonorecords III*, then, is that both the majority and the dissent purported to rely on a free market benchmark inquiry in deriving their rate structures and rate. And yet, as explained above, the majority's approach of tethering the rate to the unregulated sound recording licensing market yielded significantly higher rates for streaming than did Judge Strickler's approach of relying on the prior settlement rates.[410]

Judge Strickler's dissent implicitly points to some of the disagreements about the nature of copyright markets that underlie this divergence. In contrast to the majority, Judge Strickler grounded his analysis in the particular "market at issue in this proceeding," recognizing the need to balance "'between the competing goals of ensuring access to intellectual property at a price equal to marginal cost and providing incentives for the production of information.'"[411] Implicit in the dissent is that a free market benchmark inquiry sensitive to these considerations counseled in favor of adopting a rate structure that would allow streaming services to operate tiers catered to

407. *Phonorecords III*, *supra* note 27, 84 Fed. Reg. at 1936-47 (majority opinion); *id.* at 2001-15 (Strickler, C.R.J., dissenting).

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

409. As he explained, "to the extent that market factors may implicitly address any (or all) of the four itemized factors, the reasonable, market-based rates may remain unadjusted," and, in this case, the factors merely provided "further support" to the conclusions drawn from the free market benchmark inquiry. *Phonorecords III*, *supra* note 27, 84 Fed. Reg. at 2015 (Strickler, C.R.J., dissenting).

410. *See supra* Part III.B.2.

411. *Phonorecords III*, *supra* note 27, at 84 Fed. Reg. at 1977-78 (Strickler, C.R.J., dissenting) (quoting Barnes, *supra* note 301, at 96); *see also* Strickler, *supra* note 384, at 4 (bemoaning that "economists who testify [at the CRB] do not necessarily emphasize the economic nuances of copyright issues"). Judge Strickler also noted that, in the streaming market, the difficulty of achieving this balance is magnified by the "additional complexity" of the publishers' market power. *See Phonorecords III*, *supra* note 27, at 1978-79 (Strickler, C.R.J., dissenting).

consumers' willingness to pay (including a free ad-supported tier),[412] as well as rates significantly lower than those adopted by the majority.[413] Thus, by treating questions of incentives and access as endogenous to the CRB's market-mimicking inquiry, Judge Strickler's dissent potentially points to ways that these considerations could play a role in future proceedings, even under a willing buyer-willing seller rate-setting standard.

Conclusion

Many see the Copyright Act's unusual and complex compulsory music licensing regime as outdated. It is either nothing more than a historical relic, developed in response to long-forgotten concerns about player piano monopolies, or a limited solution to transaction-cost-related market failures. On these accounts, the gradual erosion of this regime makes sense. Declining to extend compulsory licensing to new forms of music dissemination (like Congress's decision not to create a sound recording compulsory license for interactive streaming services) or pushing the existing licenses' rates closer to free market proxies (like the CRB's recent *Phonorecords III* determination and the MMA's elimination of the 801(b) factors) ensures that compulsory licensing will remain a limited exception to copyright's otherwise market-oriented approach. Indeed, on these accounts, the logical culmination of these trends would be the complete dismantling of the compulsory music licensing regime, especially if private-ordering-based solutions could be found to address any remaining transaction cost problems. As this Article has argued, these claims miss the main justification for compulsory copyright licensing, both descriptively and normatively. Rather than being seen exclusively as a solution to transaction costs, the compulsory music licensing regime should be considered alongside copyright's particular social, cultural, and economic policy goals. Seen through this lens, compulsory licensing can be understood as ensuring that copyright's market-based approach to providing creators with

412. *See supra* notes 300-05 and accompanying text (discussing Judge Strickler's belief that having multiple rate structures is conducive to beneficial price discrimination). It is important to note that in *Web IV*, the CRB, applying the willing buyer-willing seller standard, also established different rates for subscription, nonsubscription (ad-supported), and educational webcasters, presumably to allow greater price discrimination. *Web IV*, *supra* note 265, 81 Fed. Reg. at 26,404-06; *see also* SoundExchange, Inc. v. Copyright Royalty Bd., 904 F.3d 41, 58 (D.C. Cir. 2018) (affirming the CRB's authority to set different rates for different business models). This shows that a rate structure that differs with respect to different streaming services' business model is compatible with the willing buyer-willing seller standard.

413. *See* Part III.B.2. *Compare Phonorecords III*, *supra* note 27, 84 Fed. Reg. at 1960 (majority opinion) (setting new rates that increase 44% from the previous rates), *with id.* at 2001 (Strickler, C.R.J., dissenting) (finding the previous rate structure "to be the appropriate benchmark for the rate structure in the forthcoming period").

adequate financial incentives does not overwhelm the value of access to expressive works. Like other copyright-specific limitations—fair use, the first-sale doctrine, term limits, and the idea-expression dichotomy, to name a few—compulsory licensing should be understood as an important tool for ensuring balance within the copyright system.

In this respect, the approach historically taken by the music compulsory licensing regime could serve as a model for addressing innovative technologies that enhance access to existing copyrighted works, especially as these new forms of dissemination come into tension with the entrenched interests of copyright owners. This notion, however, points to a question looming in the background of this Article: What, if anything, makes music different? Why has music been subject to such an intricate regime of compulsory licensing while few other copyright industries are similarly regulated? Certainly, as discussed above, music is unique due to its double-layered copyrights and the imbalances this can create.[414] But another answer is that music has experienced periodic industry-wide changes in methods of dissemination more frequently than most other creative industries.[415] From the player piano to digital radio, new technologies that enhance access to existing copyrighted works have emerged in the music sector regularly over the last century, galvanizing Congress to create an industry-specific compulsory licensing regime capable of facilitating balance.

In contrast, the methods for disseminating other copyright goods have remained relatively constant. That, of course, has changed with the rise of digital forms of dissemination, which have impacted nearly all copyright industries. As future work will explore more fully, the many new fair use cases involving a new technology that is making use of existing copyrighted content—from television news aggregators to massive book digitization projects—perhaps show that music merely had a head start in addressing the problems that emerge when conventional licensing markets are expected to allow a new access-enhancing technology to flourish.[416] Moreover, the copyright limitations and exceptions that have traditionally been used to further access-related goals in other copyright markets, such as the first-sale doctrine and fair use, increasingly appear to be ill-equipped to ensure that digital dissemination technologies are able to thrive.[417] Copyright law's long-

414. *See supra* notes 335-52 and accompanying text.

415. *Cf.* KRUEGER, *supra* note 311, at 6 ("From the gramophone and phonograph to on-demand streaming, disruption caused by technological change typically occurs first in music. The music business serves as the canary in the coal mine for innovations.").

416. *See* Jacob Victor, *Utility-Expanding Fair Use*, 105 MINN. L. REV. (forthcoming 2021).

417. *See, e.g.*, Capitol Records, LLC v. ReDigi Inc., 910 F.3d 649, 655-64 (2d Cir. 2018) (finding that the first-sale doctrine is not applicable to digital goods and declining to find fair use).

running experiment with compulsory music licensing could thus serve as an important model for dealing with other industries, as well as a cautionary tale about how such regimes should be managed.