THE TAYLOR SWIFT PARADOX: SUPERSTARDOM, EXCESSIVE ADVERTISING AND BLANKET LICENSES

IVAN REIDEL*

I. INTRODUCTION ........................................... 732
II. THE TAYLOR SWIFT PARADOX .......................... 737
III. THE PRESENT STATE OF ECONOMIC ANALYSIS .... 741
   A. The Economics of Two-Sided Media Markets
      Revisited ........................................... 745
   B. The Economics of Music Superstars Revisited:
      Why Artists’ Revenues Are Skewed in a Welfare
      Decreasing Way ....................................... 759
   C. Economic Analysis of Copyright Collectives ...... 765
IV. THE BLANKET LICENSE AS AN UNREASONABLE
    RESTRAINT OF TRADE ................................. 765
   A. Claimed Procompetitive Effects ..................... 768
      1. Alleged Procompetitive Justification I: The
         “New Product” That Radically Lowers
         Transaction Costs .................................. 770
      2. Alleged Procompetitive Justification II:
         Blanket Licenses Optimally Increase Output
         (In a Way Which Is Superior to à-la-Carte
         Pricing) .............................................. 775
   B. Anticompetitive Harms ............................... 796
      1. Price ............................................... 796
      2. Output .............................................. 800
      3. Quality ............................................. 801
      4. Further Harms ..................................... 802
   C. The Need for a Proper Rule of Reason Analysis .. 804
V. PROPOSED MARKET DESIGN: MUSIC LICENSING
   MARKETS 3.0 ........................................... 805
VI. CONCLUSION ............................................. 808

---

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

The average American watches about 35 hours of TV\(^1\) and listens to 19 hours of radio each week.\(^2\) Paradoxically, much of this time is spent consuming ads, which most of us enjoy less than songs or other broadcasted content.\(^3\)

Besides reducing the quality of perhaps the most important pastime of millions of Americans (and billions of viewers and listeners elsewhere), ads take up a large portion of the scarce airtime and leisure time available, displacing content which audiences value more. The livelihoods of countless artists supplying such content are in turn profoundly affected by the ratio of advertising to content in commercial broadcasting, from which they derive a substantial part of their income. For hundreds of thousands of songwriters in the U.S., for instance, royalties collected from commercial broadcasting licenses are often the same as those they receive from all other income sources including record sales and song downloads.

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

---


3. Modeling ads as imposing nuisance costs on audiences is a common assumption in the literature and it provides an intuitive framework to explain the phenomena analyzed here. The proposal that this article puts forward, however, circumvents the issue of whether ads increase or reduce utility by advancing an alternative market design that allows markets to simply price annoyance costs more efficiently in all inputs used by broadcasters, be they ads or songs. For a survey on the literature on advertising and annoyance costs, see, for example, Anthony Dukes & Esther Gal-Or, Negotiations and Exclusivity Contracts for Advertising, 22 Marketing Sci. 222 (2003). See also Gary S. Becker & Kevin M. Murphy, A Simple Theory of Advertising as a Good or Bad, 108 Q.J. Econ. 941, 961 (1993); Gary S. Becker, Accounting for Tastes 223 (1996).
squander limited resources on costly and counterproductive policies.

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

Focusing first on this long line of legal and economic inquiries, the analysis below begins the task of exposing their analytical shortcomings by eliciting novel answers from three traditional questions these literatures have repeatedly pursued: Why do we watch and listen to so many ads on radio and television when we would rather not? Why are most songwriters unable to make a living out of their creative efforts, but the few that can are often rewarded more than all others combined? Are these superstars the result of an efficient market?

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

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

While labor economists have focused on the talent and popularity of music superstars, they have neglected to examine the prices of songs. And nearly every outlet that plays songs—from supermarkets to broadcasters, in every corner of the world—purchases songs through blanket licenses, which price fame no differently than obscurity.

Economists and lawyers dissecting the law and economics of copyright collectives have long suggested that the use of
blanket licenses\(^4\)—just like pricing songs at marginal cost—results in an optimal output of songs, but they have misunderstood how high blanket license prices, by making advertising more attractive to broadcasters (i.e. suboptimally cheap) reduce the available airtime to songwriters (i.e. the output of songs) in ways that neither competition between songwriters or between collectives, nor rate courts have been able to correct. Indeed, they also missed that, regardless of the advertising market, marginal cost pricing is not necessarily output enhancing when negative prices can increase the profits of songwriters who sell not only songs, but bundles of products, such as concerts, song downloads, and t-shirts.

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

Without better guidance from these strands of legal and economic analysis or the aid of a general theory of these markets, agencies have been unable to assess the full and unfortunate consequences of their actions. The DOJ has, on the one hand, enabled Performing Rights Organizations (PROs) to suppress price competition between songwriters (through their offerings of all-you-can-eat blanket licenses) and, on the other, prosecuted associations of broadcasters trying to limit the amount of advertising that high song prices invite. The FCC has been concerned about the amount of advertising on commercial broadcasting, and also about the livelihoods of independent songwriters trying to break into new media markets, but it has undermined its own goals by enforcing anti-payola\(^5\) regulations which put most songwriters—implicitly overpricing their songs as a consequence of blanket licenses—

---

\(^4\) A blanket license grants a music user the right to play any and all songs in the repertory of a Performing Rights Organization. Such licenses are commonly offered for a flat fee that remains fixed regardless of whether the user, for example a radio station, plays many songs or none at all.

\(^5\) Payola is the practice of making undisclosed payments in exchange for airtime. Under FCC rules, payola is punishable by a fine not to exceed $10,000 or imprisonment for up to one year or both. On the other hand
at a disadvantage vis-à-vis advertisers and vis-à-vis few competing and implicitly better-priced songwriters—superstars. Additionally, courts, which with aid of better theories should have constrained the actions of both the agencies and the firms these agencies seek to regulate, are instead helping to perpetuate the status quo.

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

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

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

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

(d) online transactional platforms can allow markets to vastly outperform blanket licenses—quantitatively and qualitatively—by allowing different songwriters to employ several pricing strategies simultaneously (e.g. auctions or any arbitrarily set price). Payola, when properly examined in this context, is merely the tip of a much larger market that remains almost entirely submersed because it lacks the necessary transactional platforms that would make it viable. Because modern online platforms can accommodate simultaneously both negative and positive auction values (think of negative reservation values), for the first time in history, songwriters could also have access to a competitive advertising market for songs (i.e. a truly competitive payola market). Under such a system, the price of particular songs could be determined through auctions as either

when authors make direct payments to stations in exchange for airplay, the practice is commonly called pay-for-play and it is legal if adequately disclosed.
negative or positive, solely on the basis of competition between radio stations offering airtime (advertising spots) and songwriters offering songs—which are simultaneously an input for broadcasters and a promotional tool for songwriters wishing to stimulate the sale of CDs, song downloads, concerts, and the like. In other words, this is a problem of market design for which we now possess suitable technological solutions.

The analysis below proceeds as follows:

Section 2 examines the economic structure of broadcasting, advertising and music licensing markets and makes four principal contributions to economic analysis. First, it extends a recent strand of research examining commercial broadcasting as a two-sided market and corrects a fundamental shortcoming in the economic modeling of the market—the misunderstood significance of a cartelized side (songwriters) which is not presently modeled. This correction shows for the first time how music licensing practices increase the quantity of advertising in equilibrium in commercial broadcasting in a welfare decreasing way. Second, this section challenges the premature and misguided application of mainstream economic theories of superstardom to the music industry by advancing two novel alternative theories that explain skewed revenue distributions in songwriter markets as partly attributable to decreased competition between songwriters and advertisers and decreased competition among songwriters, both caused by a blanket license pricing system that coalesces with uniform pricing systems also prevalent in record sales and downloaded music. Third, the section extends the economic analysis of payola by examining the practice in the framework of a multi-sided market and by exposing previously ignored positive externalities (information spillovers) associated with the practice that tend to raise the utility of audiences. Fourth, it extends the economic analysis of copyright collectives by assessing the performance of these institutions in conjunction with commercial broadcasting—by far their largest customers—and introducing a novel theory of competitive harms, which includes increased advertising levels, artificially skewed income distributions and reduced creative incentives. This analysis of the licensing behavior of collectives further examines why price and output effects related to songs remain misunderstood by the economic literature, and why quality effects on songs have
Section 4 examines the legal determinants of the pricing anomalies uncovered in Section 2 and challenges mainstream analysis (both legal and economic) of the harms and pro-competitive benefits of blanket licenses and anti-payola regulations. The analysis of blanket licenses is structured as a rule of reason inquiry under U.S. antitrust law in order to show not only that mainstream legal analysis has failed to properly assess the welfare consequences of the use of blanket licenses, but indeed to suggest that proper judicial scrutiny presently compels a declaration of blanket licenses as illegal restraints of trade, and consequently that enforcement practices by the DOJ are in urgent need of reform. Section 4 further describes available remedies and examines alternative market design choices. The section then advocates for ELEGANCE in the market, that is, a novel market design where transactions take place within a network of Electronic Licensing Engines Giving Authors a Non-Collusive Environment. ELEGANCE, by pricing songs through auctions—although most individual pricing mechanisms are feasible—is able to eliminate pricing (and licensing) intermediaries such as PROs and the harms that they inflict through the collective pricing of songs. This system of competition between licensing engines or platforms—unconcerned with pricing songs—is shown to outperform current licensing practices. In particular, by allowing negative price auctions and by allowing for the first time an efficient trading of exclusive rights in public performance licenses, ELEGANCE can curb overuse and underuse of songs by commercial broadcasters.

Section 6 offers concluding remarks.

II. The Taylor Swift Paradox

Fame and fortune are no strangers to songwriter and singer Taylor Swift. In the first week of August of 2009, her song “You Belong with Me” claimed the top spot in radio airplay and commanded, according to Mediaguide, 19,361 spins.\(^6\)

these four strands of economic research, when pieced together, provide the framework not only to solve problems that each in isolation has failed to address, but crucially, it allows us to perceive for the first time what many of those problems are.

The first insight that emerges from integrating these inquiries is that they are focused on different aspects of common media market and price system. The second is that the price system is currently malfunctioning. Because neither songs nor ads are adequately priced in these markets media platforms currently consume these inputs in the wrong quantities. The way in which we license music is to blame for this.

Since 1897, U.S. copyright laws have conferred upon proprietors of copyrighted musical compositions the exclusive right to perform such works publicly and for profit. Similar laws secure these rights for copyright owners in most countries. In the U.S., authors rely upon any of three PROs to license these rights, monitor their use, collect the royalties derived from such use, and distribute these royalties among the authors. ASCAP is the largest of the three PROs, BMI the second largest and close in size to ASCAP, and SESAC is by far the smallest of the three. Most songs publicly performed in commercial venues by music users such as commercial broadcast-


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

ers, restaurants, and internet radio\textsuperscript{28} in the U.S. are licensed by these PROs.\textsuperscript{29} Almost all U.S. music authors (including composers, lyricists and music publishers) have granted either to ASCAP, BMI, or SESAC the non-exclusive right\textsuperscript{30} to license users to perform their compositions.

Put differently, the licensing practices examined in this article currently affect the livelihood of more than 700,000 lyricists, composers and publishers in the U.S. (hereinafter authors), and hundreds of thousands of authors\textsuperscript{31} worldwide, influencing the distribution of income among creators, limiting their ability to break into new markets and compromising their participation in the fabric of our culture.

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

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

\begin{itemize}
\item \textsuperscript{28} In addition to securing licenses from PROs, webcasters need to secure mechanical rights from the Harry Fox agency.
\item \textsuperscript{29} U.S. PROs also have reciprocal agreements with foreign PROs to distribute the revenues perceived by foreign authors in the U.S. and U.S. composers abroad.
\item \textsuperscript{30} Non-exclusive means, in this context, that authors retain the ability to license music users directly through what are known as \textit{source licenses} or \textit{direct licenses}.
\item \textsuperscript{31} In Europe and the U.S. alone there are more than a million authors who are members of PROs. GESAC groups 34 authors’ societies in the European Union, Norway and Switzerland and has nearly 500,000 members. See \textit{Introduction}, GESAC, http://www.gesac.org/ (last visited Feb. 6, 2010). ASCAP, BMI and SESAC’s membership numbers more than 700,000.
\end{itemize}
of each additional song. The cost of music licensing is, therefore, a sunk, fixed and indivisible cost for most music users.

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

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

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

Of the many distortions created by PROs and their use of blanket licenses, those in broadcasting, and in particular in commercial radio, carry especially serious consequences. Royalties paid by domestic radio and television stations alone represent nearly 80% of the total revenues of the two largest PROs in the U.S., ASCAP and BMI, which in turn account for approximately 93% of all performance rights income in the U.S. The relationship between copyright collectives and

broadcasting has therefore not only remained one of life and death for broadcasters, but presently shapes the nature of the rewards that are conveyed by markets to PROs and from PROs to songwriters. To a large extent, therefore, the way in which commercial, advertised-based broadcasting values songs will determine most of the opportunities that songwriters will have to flourish and the types of songs, genres and styles they will be incentivized to produce under such a particular business model.

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

A. The Economics of Two-Sided Media Markets Revisited

The leading analysis of media markets in economics portrays radio broadcasting as a two-sided market\(^\text{34}\) where commercial radio stations act as platforms catering to two sides: listeners that consume the broadcasted programs and advertisers who try to reach those listeners with commercial messages.\(^\text{35}\) Because radio stations cannot decide who listens to their broadcasts, but only what content to air, radio broadcasts are in this sense non-rival and non-excludable\(^\text{36}\) in their consumption by listeners—stations maximize revenue by extracting it from only one of the sides: advertisers—the group they can easily exclude.\(^\text{37}\)

Before being able to use the radio spectrum to broadcast their programs however, radio stations need to secure from the FCC one of a limited number of licenses available to

---


35. See Anderson & Gabszewicz, supra note 23.


37. See Anderson & Coate, supra note 17, at 949-50.
under the light of a superstar theory attentive to talent, past consumption and “commercial appeal.” Section 5 proposing a new market structure based on auctions (which contemplates the trading of exclusive rights) on the other hand, augurs difficult times ahead for those trying to predict future income distributions based on superstar dynamics.

C. Economic Analysis of Copyright Collectives

Commercial radio plays a crucial role in the sale of CDs and music downloads, and yet, even though economists have often examined the symbiosis between radio and CD sales, and also the pricing of songs through blanket licenses, they have yet to provide a common analytical framework that integrates these interdependent markets. The most troublesome complication that such isolated analysis has produced resides in praising the use of blanket licenses as efficient pricing mechanisms by collectives (better indeed than à-la-carte pricing), while simultaneously lamenting how excessive use of songs by the radio industry actually cannibalizes CD sales, all without linking the pricing of songs in broadcasting with song usage and ultimately substitution.

Unfortunately, the economic analysis of copyright collectives as isolated market institutions remains influential within modern antitrust analysis and the very legality of PROs and their pricing practices continue to be evaluated under a fragmented analytical framework which is incapable of detecting the serious harms caused by blanket licenses. In the next section I argue that a more careful examination of the harms caused by blanket licenses should compel courts and antitrust enforcers to challenge the practice.

IV. The Blanket License as an Unreasonable Restraint of Trade

The legal analysis and policing of broadcasting, advertising, and music licensing markets is presently burdened with both unsystematic and self-defeating efforts which result in large and unnecessary welfare losses. U.S. Courts, the DOJ and the FCC regularly pursue policies which not only undermine the efforts of one another, but that are in fact internally inconsistent with their stated goals.
At the heart of the enforcement anomalies in these markets lies the legal status of PROs and their licensing practices, which initiate the cycle of pricing distortions that we examined in the previous section, collectively referred to in this article as “the price of fame anomaly.” The price of fame anomaly has as much a legal life as it has an economic one, with effects that, while pervasive, still elude the legal analysis and regulation of broadcasting, advertising and music licensing markets.

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

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

To untangle this largely Sisyphean regulatory enterprise, the price of fame anomaly needs to be corrected both by improving markets and their licensing platforms, and also by modifying the laws, agency policies and misguided judicial analysis that help generate the anomaly. Proper legal analysis, I argue, compels a declaration of current licensing practices as

---

77. For example, anti-payola regulations.
illegal under U.S. antitrust laws and opens the way to several remedial alternatives—notably among them the deployment of modern transactional platforms—which can obviate the need for rate courts and government oversight by turning markets competitive for the first time in nearly a century.

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

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

Antitrust analysis provides, in this sense, an elegant structure to assess not only the legality of the practice, but indeed its welfare effects.

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


Under the rule of reason, courts consider on a case by case basis whether the agreement has a plausible procompetitive justification. If it does, then the plaintiff must prove an anticompetitive effect either through direct proof or by showing market power that can be used to infer the anticompetitive effect. If the anticompetitive effect is shown, the defendant must prove the procompetitive justification empirically and that the challenged restraint is the least restrictive means of accomplishing that procompetitive virtue. If that is proven, the court must determine whether the anticompetitive effects outweigh the procompetitive effects.\textsuperscript{81}

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

I will examine the first claim in the paragraphs immediately below and introduce modern transactional platforms as a less restrictive alternative in Section 5.

\textbf{A. Claimed Procompetitive Effects}

Consider first why blanket licenses have been legally allowed at all. The Supreme Court examined the legality of the blanket license in 1979 when deciding \textit{Broadcast Music, Inc. v.}

\footnote{81. See Einer Elhauge, \textit{United States Antitrust Law and Economics} 50 (2008).}
While lyricists, composers and publishers appeared to be subjecting their entire collective output of songs to a common price under a blanket license, the Supreme Court suggested that the practice, rather than constituting a \textit{per se} violation of the antitrust laws, should be subject to a rule of reason analysis by the lower courts and remanded the case with such instructions. The core of this ruling rested strongly on the understanding that courts had not had enough experience dealing with such novel licensing regimes so as to be able to rely on their experience in previous cases and automatically deem blanket licenses illegal.\footnote{\textit{Id.} at 9-10.}

On remand, in a truly surprising turn, the Court of Appeals, plainly discarded both the analysis in the majority opinion and the insightful analysis of Justice Stevens and ruled that blanket licenses were not even a restraint on competition. That is, while Justice White writing for the majority suggested that the blanket license was a restraint and Justice Stevens in his dissent that such restraint was indeed unreasonable, the appellate court took the curious analytical route of finding no restraint at all. The court found that blanket licenses had indeed many procompetitive effects and that countervailing sources of market power—namely competition from direct licenses—were likely to keep the price of the blanket license at competitive levels.\footnote{Columbia Broad. Sys., Inc. v. Am. Soc’y of Composers, Authors and Publishers, 620 F.2d 930 (2d Cir. 1980).}

Since then, much has been written in support of PROs and their blanket licenses and the U.S. example has deeply influenced how competition agencies and courts evaluate the welfare effects of this type of licensing in most parts of the world. Unfortunately, this influential analysis had many and substantial flaws when produced and became simply inapplicable by the mid 1990’s, perhaps earlier—a fact that the last decade of scholarly commentary has simply missed. Let us examine first the alleged procompetitive justifications for blanket licenses and their shortcomings.
1. **Alleged Procompetitive Justification I: The “New Product” that Radically Lowers Transaction Costs**

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

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

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

With minor variations, the transaction cost justification for blanket licenses is indeed consistently formulated in terms
that resemble the preceding example both by leading legal scholars and economists.\textsuperscript{92}

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

\textit{Myopic Balancing: The Unexamined Costs of Blanket Licenses}

While blanket licenses may have delivered transactional efficiencies, they undoubtedly created novel and costly inefficiencies which were never properly examined or accounted for in the early days of the blanket license and, puzzlingly, are still not analyzed and balanced today. As Justice Stevens acknowledged at the time in his dissent in \textit{Broadcast Music, Inc. v. Columbia Broadcasting Systems},\textsuperscript{93} even if the costs of individual transactions were high, (a) given that song usage was still reported by each station on a per song basis under the blanket license system for purposes of royalty distributions, it is unclear that prices would not have been able to be set also individually on a per song basis at no higher transaction costs (even a system of uniform prices such as the one presently imposed by statutory fees would have conferred substantial advantages over the all-or-nothing, take-it-or-leave-it blanket license system which imposed larger indivisible costs on radio stations)\textsuperscript{94} and (b) even if this had not been possible, replacing the market price system with a blanket price entails its own set of additional costs, which were not balanced against the alleged cost reductions from the blanket license. Indeed from a social welfare perspective, it is not enough that some costs are saved by songwriters or even broadcasters if the new pricing system simply shifts the burden of those costs by imposing larger oversight costs, requiring rate courts and posing greater anticompetitive threats. Furthermore, as we will see below, there is every reason to think that the new structure of blanket

\begin{footnotesize}
\begin{enumerate}
\item See, e.g., Connolly & Krueger, \textit{supra} note 54, at 39.
\item \textit{Id.} at 33.
\end{enumerate}
\end{footnotesize}
licenses indeed dramatically increased the costs—of transactions and beyond—of music licensing, and entirely excluded many songwriters from the market.

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

Commentators, systematically fail to account for these costs of having blanket licenses, which were likely higher than their efficiencies to begin with and are absurdly higher than their alternatives today. Indeed, while declarations of drastic cost savings abound in support of the implementation of blanket licenses, no single study to date has undertaken the necessary step of balancing the hypothetical efficiency gains of blankets (and we shall see how profoundly hypothetical these are) against the actual enforcement and regulatory costs imposed by reason of concentrating so much market power in so few hands, as required by this type of licenses. Insofar as proponents of blanket licenses make the case for cost savings, it is

upon them to prove that the procompetitive metaphor of transaction costs savings, results in net societal savings, and it is upon courts to require such proof before reaching any conclusion as to actual rather than simply “claimed” savings or efficiencies.

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

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

Markets have come a long way since 1941 when the ASCAP and BMI consent decrees were first put in place, but the last 15 years have been particularly eventful in terms of transactional platforms. While the ASCAP and BMI consent decrees have been updated several times96—most recently in 2001—these changes have largely represented modest patches in an outdated regulatory structure. Online automated licensing and transactional platforms with massive reach have been a fact of life for more than a decade, and yet the modest—by today’s standards—licensing hurdles that beset the industry

decades ago, continue to play a dominant role in governmental and academic debate today. Regulators, economists and legal scholars, it seems, need to reassess what markets are and are not capable of achieving and question whether the lesser evil hypothesis of blanket licenses still accurately describes current market conditions.

If each radio or television station had to send a handwritten letter requesting a price quote to each songwriter, await an answer and later agree on a price, all before being able to air a particular song, then clearly the transaction cost savings of the blanket licenses would be astonishingly high. The problem with this example, and with modern commentary, is that this painful way of doing business does not exist today. Whether these insurmountable transactional hurdles existed at all, it seems unclear, especially in light of Justice Stevens’ analysis noted above. But the only relevant question now is whether these hurdles exist today, and the answer to that question seems to be a decisive “no.”

Transactional platforms such as eBay—operating since 1995—which provide an online marketplace for the sale of goods and services, and generate revenues several times larger than all U.S. PROs combined have no influence on the individual pricing decisions of those who use their platform. By 2005 eBay enabled its more than 180 million users to perform more than 4.4 million daily transactions amounting to more than 40 billion dollars in annual gross merchandise volume without interfering with the determination of prices—which were either set independently by each seller or determined through auctions as a result of competition between potential buyers. In this context, the rhetoric of insurmountable transaction costs should seem rather weak for music licensing.

For an even closer example, let us examine advertising markets today.

In 2007, Google deployed an automated system allowing television advertisers to bid for advertising spots, selecting the day, time and channel in which they wanted their ads aired, and also whether they wanted national or regional coverage. The system was indeed open to advertisers of any size\textsuperscript{101} so in light of potentially massive submissions, Google warned: “[t]he review process can take up to two business days.”\textsuperscript{102} Under the analysis provided in the previous section, songs can be understood simply as a particular form of ad, only varying with regard to the products the ad sells and how much audiences actually like the ad. Ad-selling platforms need only be customized to account for particular features that would improve the selling of songs as a type of ad. In other words, the complexity of this task is not much different than what advanced ad-selling platforms, such as “Google TV ADS,” do today.

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

2. Alleged Procompetitive Justification II: Blanket Licenses
   Optimal Increase Output (In a Way Which Is Superior to "a-la-Carte Pricing")

Beyond transaction cost savings, subsequent economic analysis including recent scholarship has postulated additional advantages derived from the use of blanket licenses. Added support for blanket license is garnered under these theories first, from the fact that blanket licenses increase output efficiently,\textsuperscript{103} as a byproduct of pricing songs at marginal cost.

\textsuperscript{103} See Herbert Hovenkamp, Mark D. Janis & Mark A. Lemley, IP AND ANTITRUST: AN ANALYSIS OF ANTITRUST PRINCIPLES APPLIED TO INTELLECTUAL PROPERTY LAW 3-8 (2001) (“But even though [the blanket license] may have
and second, from the fact that because songs are thought to be public goods non-rival in consumption, buyers of the blanket license are efficiently encouraged not to economize on their use of music, a result that only blanket licenses—and not à-la-carte pricing—are capable of achieving.

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

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

In a similar vein, Professor Picker writes that “[t]he blanket license separates use decisions from price, a virtue given the public-good nature of music compositions. . .” These scholars—representing the dominant view on output effects—suggest therefore, not only that blankets result in vast

---


106. See Randal C. Picker, *Unbundling Scope-of-Permission Goods: When Should We Invest in Reducing Entry Barriers?*, 72 U. CHI. L. REV. 189, 196 (2005). See also Einhorn, *supra* note 104 (“blanket licenses . . . efficiently price each additional performance unit at zero, which is the immediate marginal cost of provision.”).

107. Posner, *Transaction Costs and Antitrust Concerns, supra* note 79, at 333 (“An additional economic virtue of the blanket licenses for performing mu-
cost savings, but indeed that (a) blanket licenses increase output; (b) they stimulate consumption optimally; and (c) that despite their collusive appearance—this last point made by Landes—blanket licenses are subject to inner competition from individual songwriters that would abandon collective licenses should the price of the blanket become excessive.

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

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

Because songwriters sell bundles of goods—of which public performance licenses are simply one—and because public performances serve as a type of advertising for the other products in the bundle, it is not only possible, but indeed likely, that the price of a vast number of songs, and even a blanket license of a subgroup of songs, could be negative or zero rather than have a positive value. In other words, it seems likely that some songwriters for at least some time would be willing to pay radio stations to air their songs, rather than collect royalties from them. This has happened many times. Consider, for example, the case of recent payola litigation\(^{108}\) (amounting to millions of dollars, channeled to circumvent the uniform pricing system imposed by the blanket) and indeed the early history of BMI.

In 1939 broadcasters angered by what they perceived to be extremely high prices being charged by ASCAP, decided to create BMI and with it their own blanket license. The novel

\(^{108}\) See Krasilovsky et al., supra note 33, at 380.
enterprise struggled at first, especially given that ASCAP did not allow many of its members to leave the organization109 (depriving BMI of critical mass), but even though BMI had to compete in a market where most songwriters were already members of ASCAP, jazz musicians who had been either excluded from radio airplay or not adequately represented by ASCAP, decided to offer BMI their music for free in order to get airplay and in this way promote their records and concerts.110

The proposition that using broadcasting as simply one element in a profit maximizing strategy aimed at maximizing the value of a bundle of products can be successful, appears to have enjoyed its own natural experiment at the time BMI was created. Once BMI acquired a sufficient number of compositions, broadcasters decided to boycott ASCAP music in 1941 and stopped playing songs from ASCAP’s repertory on radio. In the chart below, Ryan usefully compiled data on music sheet sales (an important commercial part of the bundle then) and radio plugs (or spins) to examine the competitive impact of BMI’s entry. The data however, is also useful as a proxy for the effect of air-time or spins on music sheet sales:111

### Table 6
Billboard’s “Sheet Music Leaders” 1940–1944 by Licensing Organization (Percent)

<table>
<thead>
<tr>
<th>Year</th>
<th>N</th>
<th>ASCAP</th>
<th>BMI</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>1940</td>
<td>(15)</td>
<td>100</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>1941</td>
<td>(15)</td>
<td>6</td>
<td>94</td>
<td>0</td>
</tr>
<tr>
<td>1942</td>
<td>(15)</td>
<td>80</td>
<td>6</td>
<td>13</td>
</tr>
<tr>
<td>1943</td>
<td>(15)</td>
<td>80</td>
<td>20</td>
<td>0</td>
</tr>
<tr>
<td>1944</td>
<td>(15)</td>
<td>87</td>
<td>13</td>
<td>0</td>
</tr>
</tbody>
</table>


110. See Anderson, supra note 61, at 44; see also Ryan, supra note 109, at 115.

111. See Ryan, supra note 109, at 174-75.
Data for 1940 shows that when ASCAP’s songs were played on radio, ASCAP sheet music sold the most, however, when broadcasters boycotted ASCAP and started playing BMI music on radio (1941), sheet music by BMI songwriters sold the most.

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

The present day analysis of record sales is unfortunately not as easy, and some authors do indeed argue that radio stations are not only effective advertisers of music, but that in fact, they also react to popular trends, and hence it is unclear how much record sales are affected by radio. Some airplay may be the result of a feedback relationship.

Montgomery and Moe, for example, suggest:

We find that it could potentially be very profitable if music labels could pay to increase radio airplay. For the thirteen albums studied in this paper we found that 2 million additional GRPs [Gross Rating Points] could increase the average album by 4,135 units (see Table 3). If each album has a gross profit margin of

<table>
<thead>
<tr>
<th>Year</th>
<th>N</th>
<th>ASCAP</th>
<th>BMI</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>1940</td>
<td>(29)</td>
<td>97</td>
<td>0</td>
<td>3</td>
</tr>
<tr>
<td>1941</td>
<td>(20)</td>
<td>0</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>1942</td>
<td>(30)</td>
<td>80</td>
<td>16.6</td>
<td>3.3</td>
</tr>
<tr>
<td>1943</td>
<td>(30)</td>
<td>73.3</td>
<td>20</td>
<td>3.3</td>
</tr>
<tr>
<td>1944</td>
<td>(29)</td>
<td>86.2</td>
<td>13.7</td>
<td>0</td>
</tr>
</tbody>
</table>

112. Id.
$8 and 2 million GRPs sell for $8,800 then these incremental sales could increase profits by $315,700 (=$24,300 average profit per album x 13 albums), which would be a handsome return. At the same time we understand that radio airplay is a limited resource. Increasing airplay for one album will necessarily decrease the airplay that is available for other albums.\textsuperscript{114}

This story seems consistent with the direction of causality implied by a 2001 survey in which “55\% of respondents said hearing a song on the radio was the most influential factor in purchasing music.”\textsuperscript{115}

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

Framing the analysis in the context of a multi-sided market where songs compete for airtime with all other types of advertising, the point of impairing competition between authors \textit{vis-à-vis} other types of advertisers illustrates even more clearly how the blanket license necessarily has output \textit{reducing} effects. Authors competing against themselves and against other kinds of advertisers would necessarily bring the price of public performance licenses down, shifting the station’s ratio of ads to songs to a new profit maximizing equilibrium where there would be either more songs aired or, for the same

\textsuperscript{114} Id. at 27.
amount of airtime, advertisers would be forced to offer higher bids. These effects would depend in part on whether stations would be more likely to exercise market power over listeners than over advertisers.

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

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

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

Naturally, because transaction costs are likely to be substantially lower through the use of modern transactional platforms, collective licensing is, all else equal, also reducing output by increasing costs and pricing out demand that modern

platforms could actually satisfy. Imagine the incredible gains that not having to spend decades negotiating with ASCAP or litigating them in rate courts would represent for most radio and television stations in the country.

The point is even clearer when enforcement costs (mandatorily charged to songwriters for songs that could be priced at zero or a negative price) are factored in. Even if transaction costs were the same for blanket licenses (which require reporting from radio stations, and imply a tacit market-power surcharge) than for modern platforms (which automatically perform usage “reporting” as licenses are obtained in real-time), à la-carte pricing would still outperform blankets because pricing songs competitively and according to the value radio stations place on them (or the lower price that songwriters may be willing to charge under competition) means that those songs carrying zero or negative prices would necessarily incur lower enforcement costs (even holding monitoring costs equal), as not litigating unnecessary infringement cases lowers costs absolutely.

**Consumption of Songs by Radio and Television Stations Is Often Rival**

The proposition that public performances are non-rival, as espoused by Liebowitz above, and others—recently relied upon by the Dutch Competition Authority to leave undisturbed the pricing practices of its national PRO—faces two main objections. On the one hand advertising profits de-

---

117. See Liebowitz & Margolis, supra note 79, at 25.
118. See Randal C. Picker, Unbundling Scope-of-Permission Goods: When Should We Invest in Reducing Entry Barriers?, 72 U. Chi. L. Rev. 189, 196 (2005). See also Michael A. Einhorn, supra note 104, at 350 (stating “blanket licenses . . . . efficiently price each additional performance unit at zero, which is the immediate marginal cost of provision.”).
120. See NEDERLANDSE MEDITERINGSAUTORITEIT, supra note 118. See also RBB ECONOMICS, supra note 118.
epend on the particular demographics at which ads are targeted. Because audiences are attracted to specific content (songs), replicating the same content on competing radio stations necessarily divides audiences,\footnote{121. This point is often noted in the literature and it was made long ago in the seminal work by Peter O. Steiner, \textit{Program Patterns and Preferences, and the Workability of Competition in Radio Broadcasting}, 66 \textit{Q.J. Econ.} 194 (1952).} reduces advertising profits and consequently affects the profitability of the station. There is, in this sense, a tragedy of the commons in the exploitation of copyrighted songs given that overuse cannot be curbed by the current pricing system. Songwriters cannot currently use the pricing system to encourage use of their songs by particular radio stations only at particular times through, for example, congestion pricing. Hence, it is easy to see that this can lead, for example, to saturating listeners with excessive exposure to a particular song over a short period of time and result in a less profitable—for both songwriters and stations—and shorter broadcasting life for a song than what congestion pricing would have allowed.

The other objection builds, surprisingly, on earlier work by Professor Liebowitz himself, which in examining the economics of the record industry argued that airing songs on the radio reduces record sales industry-wide.\footnote{122. Stan J. Liebowitz, \textit{Don’t Play it Again Sam: Radio Play, Record Sales, and Property Rights} (Jan. 5, 2007) (unpublished manuscript), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=956527.} According to Liebowitz, the results of his research “indicate that radio play does not have the positive impact on record sales normally attributed to it and instead appears to have an economically important negative impact, implying that overall radio listening is more of a substitute for the purchase of sound recordings than it is a complement.”\footnote{123. \textit{Id.} preceding p. 1.} Insofar as this statement suggests that there are negative effects from the station’s use of copyrighted songs, it seems that Liebowitz’s claim that radio harms record sales (and therefore creative incentives) is inconsistent with his other claim that the blanket license is optimal because “there are no social benefits to excluding users from using particular songs or in having them economize on the use of already created music.”\footnote{124. See Liebowitz & Margolis, \textit{supra} note 79, at 25.}
The reasons why radio airplay reduces record sales have not been thoroughly examined or exhaustively tested empirically, but three main mechanisms appear to be good candidates and would seem to suggest that usage of songs by radio stations is rival and in need of a better pricing and licensing system than blanket licenses: satiation, substitution, and melioration.

First, most people appear to experience “satiation.” Empirically, work by Kahneman & Snell showed that repeated exposure to a song selected by the participants of an experiment resulted in a decline in the liking of the chosen song by most participants.125 In this sense, a recent poll asking radio listeners about the listening habits seems consistent with the experimental results. When 73% of polled radio listeners said they listened to more than one radio station, pollsters asked these listeners why they switched stations they obtained the following answers:

### Table 5-2: Listening to More Than One Station, by Age 126

<table>
<thead>
<tr>
<th></th>
<th>Age</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
</tr>
<tr>
<td>I like variety</td>
<td>43%</td>
</tr>
<tr>
<td>Different stations serve different functions for me</td>
<td>24</td>
</tr>
<tr>
<td>To avoid commercials</td>
<td>22</td>
</tr>
<tr>
<td>To avoid repetition in music</td>
<td>8</td>
</tr>
<tr>
<td>Other/Don’t know</td>
<td>3</td>
</tr>
</tbody>
</table>


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

Second, radio airplay appears to act as a substitute to recorded music on at least some occasions for some consumers, so one could expect that such consumers would be disinclined to purchase a CD if said CD were constantly being played on the radio.127 Think for example about the economics of free-samples: as Liebowitz’s own work suggests, airplay is especially likely to benefit creators if consumers are unfamiliar with their work. Given that the aired song is a type of free sample of the product itself, if free-samples are pervasively available, airplay can substitute more effectively the on-demand nature of records (or downloads).

Third, music consumption appears to be potentially subject to melioration and other utility maximizing strategies inconsistent with the profit maximizing strategies that drive song selection by broadcasters. Kahn, Ratner and Kahneman explain the phenomenon as follows:128

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

---


128. See Barbara E. Kahn et al., Patterns of Hedonic Consumption over Time, 8:1 MARKETING LETTERS 85, 85-86 (1997).
lioration. Melioration occurs when an individual overconsumes the favorite until its enjoyment level is decreased to that of an initially inferior option.129

Regardless of the direction of preferences, however, underuse or overuse of songs by broadcasters becomes a form of externality (either positive or negative) that can’t be controlled or harnessed by authors because they lack the ability to set optimal prices: they can’t lower their prices even if additional airplay will increase overall profits (for example if they would gain more by selling CDs than what they would lose in public performance royalties) and they can’t increase prices if radio airplay is lowering CD profits by more than what it increases public performance royalties. Importantly, only songwriters have the capacity to optimize the value of their product bundles because broadcasters ignore how the value of such bundles correlates with their song choices (partly, indeed, because anti-payola regulations force some of this detachment).

The social costs of pricing songs at zero therefore contradict the non-rivalry hypothesis advanced by Liebowitz. Because radio airplay clearly alters how audiences consume music and is indeed likely to be able to satiate or saturate audiences altering their general desire to listen to songs, radio airplay could be either excessive or insufficient and therefore socially undesirable in at least two respects: first, whenever it cannibalizes on record sales (or downloads, etc.), reducing the value of one of the products in the songwriters bundle130 it may potentially reduce the value of the entire bundle as a whole, reducing in turn dynamic incentives to produce further songs, or the ability to recoup costs of the songs already produced; second, the fact that all radio stations can play the same song at no extra cost, as mentioned in point one, not only may lead to suboptimal airplay in the sense of reducing songwriters’ profits and radio stations’ profits, but given that blankets necessarily offer non-exclusive rights to radio stations, radio stations may

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

130. See Pareles, supra note 51 (for example, CD sales or song downloads).
be discouraged from continuing to play or even from beginning to play a particular song if many other radio stations played the same song or were likely to play the same song. This in turn could naturally lead to sub-optimally low airplay for a particular song. Excessive and insufficient airplay, on the other hand, could be curbed in well-functioning markets by two strategies that are currently suppressed by blanket licenses: (a) congestion pricing and (b) exclusivity. I examine how modern transactional platforms can be modified to incorporate both strategies in music licensing and offer additional pricing improvements in Section 5.

Songwriters Are Not Able to Compete Effectively Against the Blanket License

It is extremely unlikely that direct competition from authors within the PRO constrains blanket license prices in any significant way. This issue bears not only on whether the cartelized authors are capable of raising the price of the blanket license above competitive levels, but relates to one of the core arguments used by courts to assess whether blanket licenses are legal at all. That authors do not engage in direct licensing in any significant number appears to be today an undisputed fact and yet, courts and, many scholars continue to suggest that direct licenses do constrain the prices of blanket licenses.

As mentioned earlier, when Broadcast Music, Inc. v. Columbia Broadcasting Systems was re-examined on remand, the Court of Appeals found that one key aspect of ASCAP’s licensing practices shielded the blanket license from illegality: direct licensing. The court stated:

If the opportunity to purchase performing rights to individual songs is fully available, then it is customer

---

131. See Dep’t of Justice, Memorandum of the United States in Response to Public Comments on the Joint Motion to Enter Second Amended Final Judgment, available at http://www.usdoj.gov/atr/cases/b200/8224.htm (last visited Feb. 6, 2010) (“under a traditional blanket license, a music user has little incentive to substitute non-ASCAP music or to direct-license because the music user will pay the same fee to ASCAP regardless of how many ASCAP songs are used or how many performances are direct licensed.”); see also Katz, supra note 75, at 573.

preference for the blanket license, and not the license itself, that causes the lack of price competition among songs. . . a practice that is not a per se violation, and this blanket license has authoritatively been found not to be such, does not restrain trade when the complaining customer elects to use it in preference to realistically available marketing alternatives.\textsuperscript{133}

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

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

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

As discussed in Section 2, authors, on the other hand, don’t share nicely. Under the blanket license, PROs channel the market power of all authors into a single blanket license price, but distribute the earnings of that license according to

\textsuperscript{133} Id. at 935.
what songs actually get played. So even though all authors contribute a quantum of market power to the PRO, they all enter a lottery for a share of the inflated royalties in which only a few of them can win.\textsuperscript{134} Since most authors lose most of the time, some of them should be attempting to compete against the blanket license in terms of price, given that quality alone does not seem to be getting most of them any royalty earnings. So why aren’t they?

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

In previous work,\textsuperscript{135} I began answering this question by challenging the aptitude of the \textit{natural monopoly} hypothesis to account for current market structure and subsequent literature has taken a similar path.\textsuperscript{136} My argument then was to suggest that the exercise of market power resulting from the presence of strong network effects in the licensing of music was more likely to account for the enduring dominance of few PROs (or one in most countries) than the natural monopoly hypothesis. As both songwriters and music users are naturally interested in belonging to the largest PRO—music users because they want access to the largest repertoire and songwriters because administration costs are spread over a large number of songwriters and also because users prefer the larger repertoires—PROs in the early years tried to exploit these network effects in what could be called early platform wars.

An example of these platform wars happened when, having reached a critical mass long before BMI, ASCAP attempted to get rid of the competition both by depriving it of the necessary critical mass of domestic songwriters\textsuperscript{137}—offering its members take-it-or-leave-it agreements that made it difficult to

\textsuperscript{134} See supra text accompanying notes 4-76 (discussing distribution or royalties).


\textsuperscript{137} See Ryan, supra note 109, at 115.
switch to another PRO later—and by rapidly deploying exclusivity agreements with PROs in foreign markets.¹³⁸

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

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

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

On the other hand, the single maverick author (or song), faces alone the transaction costs imposed by direct licensing and offers minimal value to the users that need to keep the blanket license anyway. A massive exodus of authors from the blanket license may overcome this particular problem, but collective action problems, along with Obstacle 2, make this result unlikely. Hence, while for example digital transactional platforms (such as Google’s terrestrial radio ad platform)¹³⁹ require high but relatively modest development and implemen-

¹³⁸ See Joseph Farrell & Paul Klemperer, *Coordination and Lock-In: Competition with Switching Costs and Network Effects*, in *Industrial Organization Handbook* 3 (Mark Armstrong & Robert Porter eds., 2007) (discussing how artificial switching costs like contractual restrictions can be leveraged to deter entry in industries with network effects).

¹³⁹ Google’s terrestrial radio ad platform is already used for the allotment of radio advertising space.
Obstacle 2: The Blanket Penalty and the Music Users’ Prisoners Dilemma

Beyond the blanket license, a radio station can either try to obtain direct licenses from authors that do not belong to PROs or try to persuade those authors that are members of the PRO to circumvent the blanket license and deal directly with the radio station (I will call both types of authors that attempt to compete against the blanket license *mavericks*). However, regardless of whether they use some or all songs within the PRO repertory, radio stations are obligated under the terms of the licensing agreements to pay the same price for the blanket license, which they therefore need to assess as fixed cost upon

---


which to add the variable cost incurred by playing maverick songs.

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

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

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

\[ V_m - C_m > V_r \]

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

---


143. Id.

144. In a market where a radio station were licensing songs for the first time we would also add \( C_r \) the cost of dealing with the PRO, itself composed by the price of the blanket license \( P_b \) and the cost of transacting with the PRO \( t_b \), such that \( C_r = P_b + t_b \). The costs of dealing with the PRO, \( C_r \), are however not considered in the choice above, because I assume in a way consistent with PROs being the first movers, that the PRO has already recruited most authors in the market and that the radio station has already accepted an all-or-nothing offer for the entire repertory of the PRO and hence has already paid \( P_b \). Additionally, \( t_b \) is also excluded because once the licensing and re-
As the radio station increases the proportion of maverick songs, it foregoes use of songs contained in the PRO repertory for which it has already paid, and instead needs to increasingly incur incremental cost. 

\[ \sum C_{n1} + C_{n2} + C_{n3} \]

But what about per-program licenses, one may ask. Don’t per-program licenses represent a lower cost alternative to the blanket license that reduces the penalty imposed on mavericks? As it turns out, it is a rather thorny endeavor to reap the benefits of the per-program option. A typical radio station plays approximately 12 songs per hour. According to the terms agreed upon by most radio stations and PROs, radio stations seeking to avail themselves of per-program licenses must at least be able to secure two thirds of the total programming from direct licenses. The use of any song (or part of it) within the PRO repertory, for however brief a period, within a 15 minutes program computes the entire program as using the PRO repertory. More precisely, out of a total of 273 weighted programming periods available per week, usage of PRO songs in more than 90 periods (even if only one PRO song is used per period) automatically requires stations to obtain a blanket license and precludes the option of a per-program license. In other words, any radio station wishing to deal directly with authors, would be forced to pay a “penalty price” and incur the extra expense of direct licensing until capable of securing more than two thirds of its weighted programming periods from maverick authors without interrupting a single time any of those periods with a song from the PRO. Furthermore, under the current Radio Music License Committee (RMLC) agreement, radio stations can only request per-program licenses once every 6 month period, implying that the stations would


have to secure at least 66% of their weighted programming periods from direct licensing for those entire 6 months (having to give 60 days advanced warning to the PROs and wait for approval before changing the licensing scheme).  

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

Considering that high earning authors have less incentives than low earning authors to compete against the cartel that helps them secure supra-competitive profits, and that only authors with low earnings are the ones most likely to make use of direct licensing, the effects of Obstacle 1 and Obstacle 2 seem particularly troubling and suggest that direct licensing is not likely to expose PROs to any significant competitive pressures.

An additional and interesting implication of this penalty effect is that it exacerbates the undesirable effects of anti-

147. See Radio Music License Committee, Methodology for ASCAP Industry-Wide License Fee Allocation for the Period January 1, 2004 through December 31, 2009, 6, http://www.ascap.com/licensing/radio/FeeMethodology.pdf (last visited Jul. 25, 2010) [hereinafter ASCAP Industry-Wide Fee]. For BMI, see Radio Music License Committee, Methodology For Industry-Wide License Fee Allocation for the Period January 1, 2001 through December 31, 2009, 5, http://www.radiomlc.com/RMLC%20Allocation07.pdf (last visited Feb. 6, 2010). The industry-wide license agreement negotiated between ASCAP and the RMLC for the period January 1, 2001, to December 31, 2009, has expired. On its website ASCAP notes that “[s]tations that are represented by the RMLC for the period commencing January 1, 2010, will be licensed on an interim basis as of that date. Stations currently licensed by ASCAP under the 2001 - 2009 agreement are being offered an extension of that agreement, pending the outcome of negotiations with the RMLC or any decisions on this matter from the Rate Court.” See Radio Licenses, ASCAP, http://www.ascap.com/licensing/radio/ (last visited Feb. 6, 2010). The current BMI Agreement has expired and according to disclosure in the extension agreement, BMI and RMLC have been unable to agree on the terms of the licensing agreement for 2010. According to BMI’s website, “BMI and the Radio Music License Committee have been meeting to discuss the terms of a new license agreement for the radio industry which will commence as of January 1, 2010.” See 2010 Radio License Extension, RADIO, http://www.bmi.com/radio/?link=navbar (last visited Feb. 6, 2010).
payola regulations. I suggested earlier that anti-payola regulations increase the cost of advertising for authors. This increase in the cost of advertising for authors reduces the demand for radio spots by authors which in turn necessarily reduces the value of advertising time for radio stations. If the total value of advertising time is lower for a radio station, that means in turn that the value of songs as an input is also lower, as they are capable of generating lower profits for radio stations. In other words, the value of songs, from both mavericks and repertory authors, will be lower with anti-payola regulations in place than without them. As the value of each song decreases, the transaction costs (which are independent of the value of a song) increase relative to song value.

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

The radio stations’ prisoners’ dilemma in this scenario is the following: all radio stations would like to pay lower prices for songs, their basic input. One station alone, trying to maximize profits inter-temporally may realize that exiting the blanket license would likely be a worthwhile endeavor, even if it meant incurring the blanket penalty for a limited number of periods, given that in the long run stimulating a competitive market for songs would render returns in the form of lower licensing costs. While such radio station, however, would have to incur all the costs of nurturing a competitive market for songs, all other competing radio stations would be able to reap the benefits of such competitive market without incurring any costs. Depending on how long it would take the radio station, the first mover, to develop a competitive market for songs, the station would have to endure extended periods of higher costs than all of its competitors, earning lower profits or in competitive markets even becoming unprofitable.

Such reduced profits would in turn hamper the ability of the radio station to remain viable.
The logic of collective inaction, in this scenario, suggests that radio stations may be trapped in a suboptimal equilibrium where they could all benefit from lower licensing costs in the future, but no station would like to be the first one to invest alone in the enterprise.148

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

B. Anticompetitive Harms

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

1. Price

There are three main reasons why the blanket license price is high: (a) direct licensing does not constrain the blanket’s price;149 (b) rate courts are incapable of constraining supracompetitive pricing;150 and (c) price discrimination, which has actually ceased to exist, never assured a modest relation to actual competitive prices.

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

149. See Landes, supra note 105 (arguing that direct licenses constrain the price of the blanket license).
creases output by suppressing a pricing system where many songs would otherwise carry negative prices. A price of zero or above will be too high for many songs. Second, regardless of whether songs, absent a pricing system, are played too little or too much (given rivalry between radio stations and substitution between broadcasts, CDs and downloads), the value of songwriters’ bundles will necessarily decrease if radio usage departs from the optimal (as it must whenever songs are priced uniformly) and the creation of songs will be lower than with an à-la-carte system.

As discussed earlier, the argument of competition keeping prices in check espoused by Landes and many others does not survive thorough scrutiny. But there are, however, two additional lines of defense meant to appease concerns about supra-competitive price levels. One, most recently espoused by Professor Crane, suggests that rate courts151 are capable of doing a decent job at pricing blanket licenses.152 The second one, espoused by Professor Liebowitz, suggests that price discrimination, by tying the price of blanket licenses to industry revenues, loosely maintains a linkage to actual value.

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

When an antitrust court intervenes to set a rate for music licensed by ASCAP or BMI . . . , the court effectively acts as a rate regulator, allowing BMI, ASCAP, and the artists they represent a price that reflects the exclusivity rights granted by Congress but not any incremental market power from the aggregation of multiple copyrights.153

This is an important claim, not only because it remains influential in modern antitrust analysis—as Professor Crane exemplifies—but because the idea that rate courts can actually perform an adequate job lends support to the claim that the

151. As Michael A. Einhorn, supra note 104, at 356 explains, “[a] fee setting Rate Court was established in the U.S. District Court for the Southern District of New York for hearing license disputes, with the burden of proof upon ASCAP to show reasonableness (section IX). The Justice Department and BMI modified their respective Decree in a similar fashion in 1966 and instituted a Rate Court provision in 1994.”
152. See Crane, supra note 148, at 716.
153. Id.
consent decrees currently in place, actually work as intended and provide sensible mechanisms to prevent abuses of market power.

Since 1941, most transactions related to public performance rights for radio stations and television stations—and most other places where music is publicly performed—have taken place in the shadow of rate courts, resulting in one of the most enduring rate setting activities by any court in U.S. history. The claim therefore that rate courts can set prices that do not reflect “any incremental market power from the aggregation of multiple copyrights”\(^154\) is highly consequential and if believed, should provide a good quantum of peace of mind to courts and regulators concerned with cartel prices.

Unfortunately, this claim is misguided in important respects. Indeed, judges involved in rate-setting proceedings appear rather skeptical about their ability to determine the “reasonable” rates they are asked to elucidate. In Judge Dolinger’s terms:

As noted on a prior occasion, a “‘reasonableness’ inquiry does not lend itself to the application of a clear and simple formulation and ultimately involves some conceded arbitrariness on the part of the rate setter.” Indeed, the testimony...in this proceeding confirms the absence of any readily available formula dictated by generally recognized economic principles. It is to be assumed that, in the absence of more precise standards in the Decree, the court will be left principally with a range of prior agreements by these or other parties, which are to be invoked as concededly imprecise analogies...\(^155\)

Regrettably, while seeking refuge in past negotiations may at first seem a more reliable alternative, in view of the lack of clear guidance from economics, the effort is bound to be equally unsuccessful given that the “prior agreements” meant to be used as guidance were also reached in conditions where PROs were already exercising market power. As a result, not only can rate-setting courts determine prices that bear no possible resemblance with how markets would likely price li-

\(^154\) Id.
\(^155\) See United States v. ASCAP, 1993 WL 60687, at *40 (internal citations omitted).
licenses, but these proceedings impose transactional inefficiencies hardly matched by any other industry anywhere in the world; for example, radio and television stations and copyright collectives have been unable to agree on the price of blanket licenses for decades at a time. In 2004, the RMLC and ASCAP reached an agreement to set the prices of the blanket licenses retroactively. In 1993, the rate court set fees for 963 television stations determining the value of fees which had been disputed since 1978.

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

One major saving grace of most performing rights tariffs is that they are linked to the overall size of the market. The performing rights tariff rate for radio, for example, is a percentage of advertising revenues. Therefore, the royalty payments will change as the industry grows or declines. This assures some modest linkage between them and is likely to keep the royalty payments from getting too far out of line.

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

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

If corn-starch producers had their way, for example, they would probably charge top restaurants a percentage of the re-

156. See ASCAP Industry-Wide Fee, supra note 145.
157. See United States v. ASCAP, 1993 WL 60687 at *2; see also Einhorn, supra note 104, at 358-59.
158. See Stan Liebowitz, MP3’s and Copyright Collectives, in DEVELOPMENTS IN THE ECONOMICS OF COPYRIGHT: RESEARCH AND ANALYSIS 37, 50 (Lisa Takeyama, Wendy J. Gordon & Ruth Towse eds., 2005).
taurants’ profits. No doubt, a successful corn-starch cartel would see its revenues increase with those of the restaurant industry. However, it would be a mistake to think that these price levels would therefore be reasonable or “not out of line.” The adequate benchmark for determining prices in these industries is the competitive but-for-world rather than the successfully cartelized market.

2. **Output**

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

(a) As mentioned above, both higher prices for songs and higher prices for blanket licenses are likely to have an impact on output. When songs that would have carried a negative price are priced above zero, they inefficiently reduce demand of songs by a radio station (and simultaneously the content output of that station.) Holding the price of ads constant, a supra-competitive price for songs will mean that more ads will be played and song output reduced. Given that the traditional advertising market seems competitive, it therefore seems likely that more advertisements are currently replacing songs than what it would be the case in a competitive market.

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

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

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

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

While a transactional platform allowing the trading of exclusive rights in this way has, to my knowledge, not been developed, in Section 5 I will discuss how modest improvements over the state of the art in transactional platforms appear to be able to enable a type of auction market that can indeed go even beyond this first step, allowing bids for exclusive rights over groups of songs and combinations of territories simultaneously.

3. **Quality**

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

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

(b) second, as to the content of the program itself, there is actually no reason to believe that the quality of songs will remain the same. The quality of songs—defined as the capacity of a song to elicit utility in audiences—created and broadcasted is actually likely to increase if blanket licenses are eliminated and songs are priced competitively. After all, audiences are only likely to purchase CDs, t-shirts or music online if they actually like the free sample of the song they hear on the radio. Because sales of the songwriter’s product bundle are an efficient way to convey information as to listening preferences as well as information about the intensity of such preferences (magnitude of utility measured in willingness and ability to pay, for instance, for higher CD prices), the willingness of songwriters to adjust the prices (negative or positive) of songs guarantees an efficient (indeed, probably the most efficient) way to convey to broadcasters information about how to improve their programs to maximize audience utility (something they cannot do as accurately with the information they get from most other product sales, say, for instance, of detergent).

4. Further Harms

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

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

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

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

Enforcement costs (e.g. 60 years of DOJ oversight and consent decree drafting), transaction costs (e.g. several decades of industry-wide stalemates on royalty prices), as well as unnecessary litigation burdening music users, songwriters and the court system (e.g. the uninterrupted operation of rate courts since 1950) are also vast under the current system. Furthermore, enforcement costs not only arise out of the many governmental efforts and expenditures—that would not be necessary but for the abuses of market power arising out of the existence of blanket licenses—but also emerge out of the vast unnecessary enforcement of copyrighted works which would have been priced at zero or at negative prices but for the blanket license, and which under the current system are nevertheless enforced at a cost to songwriters.

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

C. The Need for a Proper Rule of Reason Analysis

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

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

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

earlier, the welfare consequences of the blanket license regime are both grave and pervasive.

V. PROPOSED MARKET DESIGN: MUSIC LICENSING MARKETS 3.0

Using online auctions for music licensing requires little else than applying the licensing technology already in use by widespread global platforms such as Google or eBay to performance rights licensing. As noted earlier, Google has recently deployed an auction system allowing for the automated sale and allocation of advertising space in offline radio broadcasting.\textsuperscript{161} If, as suggested in this article, authors were to be allowed the same transactional freedoms as regular radio advertisers, then application of advertising through online platforms would be straightforward.

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

This system, which entirely displaces PROs from pricing songs, has the advantage of creating an environment where different platforms, such as eBay, iTunes, and Google simultaneously compete for serving buyers and sellers of music, which are nevertheless able to price their products individually. Also, minimal interoperability standards could be used to induce competing platforms to adopt uniform standards in order to allow the free flow of songwriters and users between competing platforms preventing the proliferation of the lock-in effects.

that have beset PRO members since these organizations began operating.

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

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

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

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

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

These externalities, as we examined earlier, have in all likelihood a profound impact on the livelihood of authors. Under the blanket license system any or all radio stations may decide to play a particular song for as long as they wish, owing PROs exactly the same fee for their public performance licenses. Those programming decisions—which authors are unable to influence through pricing variations—represent a type of externality that has potentially both positive and negative effects on authors.
For example, some amount of airplay is likely to stimulate CD sales by the featured author, while excessive airplay may actually hurt CD sales as radio performances substitute for the need of CDs. Overuse of songs by radio stations may create in this sense a tragedy of the commons scenario harming both stations and authors with decreased advertising revenues, and potentially harming authors through decreased sales of complementary goods such as CDs. As an extreme example, if the song “Across the Universe” by the Beatles were the only song continuously played by all radio stations during the entire day, people would probably be less inclined to purchase that song on iTunes or buy the corresponding Beatles CD, and radio stations would likely experience a decrease in advertising revenue.\footnote{162}

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

VI. CONCLUSION

If, as suggested earlier, blanket licenses are likely to fail a rule of reason analysis, it seems that there are a few ways to correct under-enforcement by courts and government agencies. Perhaps a natural start would be to modify the consent decrees that preserve the current pricing system and rely upon rate setting proceedings before New York courts. There are three possible ways in which consent decrees can be modified.\footnote{163}

The first option, which is also the easiest and least costly, would be for the DOJ to compel the necessary modifications in the consent decrees. Convincing the DOJ to alter its enforcement strategy (replacing the current pricing system along the lines of the auction system I describe above) has, as I have sug-

\footnote{162. See substitution and satiation discussion, supra Section 4.1.2.}  
gested earlier, the additional benefit of providing reliable signals to courts, which do take the expertise of talented DOJ analysts into account when examining the market of PROs. A second option would be direct legislative action, which seems uncertain but not necessarily unlikely given the existence of reasonably well matched interest groups with antagonistic positions. The third option, private litigation, seeking to declare blankets illegal, seems the more likely candidate but it is also more expensive for any given music user, given that the plaintiff, if not collectively representing users, is likely to absorb litigation costs on its own and share the benefits of the competitive licensing system with all other users.

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

Fortunately, the arguments supporting anti-payola regulations—mainly related to song quality—are so perfectly misguided, that the best (and least expensive) effort to achieve anything in the vicinity of the policy goals intended by these regulations is to simply repeal all anti-payola enforcement wherever it exists. Surprisingly, this is a good and low-cost start

---

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

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


167. *Id.*
that leads to better performing markets regardless of whether one shares the goals of anti-payola regulations or not.

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