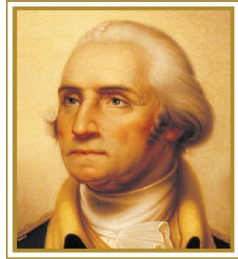


IN



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CREATIVE & INNOVATIVE ECONOMY CENTER

**CREATIVE INDUSTRIES IN TRANSITION:  
NEW DIRECTIONS FOR THE DIGITAL ERA**

*The Songwriters' Performing Rights Organization Imperative  
and Copyright Law for the Electronic Music Marketplace*

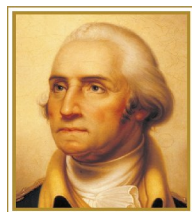
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Former U.S. Register of Copyrights, 1985-1993

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## CREATIVE AND INNOVATIVE ECONOMY CENTER

### CREATIVE INDUSTRIES IN TRANSITION: NEW DIRECTIONS FOR THE DIGITAL ERA

#### *The Songwriters' Performing Rights Organization Imperative and Copyright Law for the Music Electronic Marketplace*

Ralph Oman, JD, Pravel Professorial Lecturer and GWU CIEC Fellow  
Former U.S. Register of Copyrights, 1985-1993

Michael P. Ryan, PhD, Director, GWU CIEC

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#### *Summary*

- The Internet has posed important challenges to copyright law.
- The emerging music electronic marketplace—online downloads, wireless deliveries, and new services still on the drawing boards—has prompted Congress to reevaluate U.S. copyright law regarding the licensing of music.
- We apply an analytic framework drawn from managerial economics to explain the historical emergence of and evolving role of PROs as representatives of the collective interests of songwriters, composers, and music publishers.
- PROs demonstrate organizational capacities and core competencies to license and monitor usage of the songs and compositions owned by their clients and to collect from users and pay to copyright owners the royalties they are owed.
- Congress should allow the future evolution of the music electronic marketplace to determine the future meaning of reproduction and performance rights.
- Congress should insure the continued existence of competing PROs that provide digital music distribution monitoring, royalty-collecting, and other services on behalf of songwriters, composers, music publishers, and their small businesses.
- Congress and marketplace participants should evaluate how the core competencies, technology-organization systems, and business practices developed by the PROs can be applied to new systems for copyright licensing and management to help facilitate electronic commerce in intellectual property.

Since the invention of the printing press, changes in technology have driven changes in copyright law.<sup>1</sup> Legislators are challenged by the marketplace uncertainties fomented by technology changes. The Internet has posed important challenges to copyright law. In its early years, the Internet provided inexpensive and helpful communication means for academics, public researchers, and defense industry engineers before the computer network expanded by design in the 1990s to include millions of consumers and businesses. The Internet thereby enabled an electronic marketplace for the distribution of digitized works of informational, cultural, and entertainment creative expression. “At least in theory, every computer user can become his or her own publisher, and every terminal can become a library, bookstore, or audio and video jukebox.”<sup>2</sup> The nature of Internet technology led some scholars to argue that copyright law would wither in importance because digitized creative expression could no longer be controlled,<sup>3</sup> while others argued that digital rights management would reinforce copyright law and traditional notions of ownership.<sup>4</sup> The revolution in music distribution—online downloads, wireless deliveries, and new services still on the drawing boards—has prompted Congress to reevaluate the provisions of the U.S. copyright law that now govern the licensing of music and other copyrighted entertainment programming and information services. Several policy proposals are under consideration, some more radical than others. In this paper we challenge these copyright law reform proposals that may seek to limit the role of performing rights organizations and suggest, to the contrary, that the role of the PRO and the business processes and systems they

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<sup>1</sup> Jessica Litman, “Copyright Legislation and Technological Change,” *Oregon Law Review* 68(1989)275.

<sup>2</sup> Jane C. Ginsburg, “Putting Cars on the Information Superhighway: Authors, Exploiters, and Copyrights in Cyberspace,” *Columbia Law Review* 95(1995)1466.

<sup>3</sup> Eric Schlacter, “The Intellectual Property Renaissance in Cyberspace: Why Copyright Law Could Be Unimportant on the Internet,” *Berkeley Technology Law Journal* 12(1997)15.

<sup>4</sup> Mark Stefik, “Shifting the Possible: How Trusted Systems and Digital Property Rights Challenge Us to Rethink Digital Publishing,” *Berkeley Technology Law Journal* 12(1997)137.

have developed could be expanded to the benefit of the owners and users of the copyright in the marketplace.

We place the PRO into the context of the digital technology-enabled music electronic marketplace. We apply an analytic framework, drawn from the theory of the firm as the term is understood in managerial economics, in order to explain the historical emergence of and evolving role of PROs as representatives of the collective interests of songwriters, composers, and music publishers during a previous music distribution technology revolution—radio. We highlight how the PROs are a prime example of the efficiencies of a competitive music marketplace. PROs demonstrate organizational capacities and core competencies to value, license and monitor usage of the songs and compositions owned by their clients and to collect from users and pay to copyright owners the royalties they are owed. We suggest that these core competencies may be applicable to the management of other forms of copyright expressions and digital content. We compare our analysis to the legal scholarship and commentary regarding copyright law and the music electronic marketplace. We agree that these marketplace transactions are not costless in a digital environment and that institutions are needed to process these transactions.<sup>5</sup>

We argue that PROs have built special organizational capacities that have demonstrated marketplace success for their clients. We conclude that Congress should insure the continued existence of competitive PROs that provide digital music distribution monitoring, royalty-collecting, talent-fostering, and other services on behalf of songwriters, composer, music publishers, and their small businesses.

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<sup>5</sup> Robert P. Merges, “The Continuing Vitality of Music Performance Rights Organizations,” *Creative Industries in Transition: New Directions for the Digital Era Symposium Series*, The George Washington University Law School, 18 June 2008; Merges, “Contracting into Liability Rules: Intellectual Property Rights and Collective Rights Organizations,” *California Law Review* 84(1996)1293.

Nevertheless, despite our argument regarding the vital role of PROs as the collective managers of the copyrights of songwriters, composers, and music publishers, we contend that the music electronic marketplace still needs some copyright law refinement. There has long been a copyright law separation between music performance rights and music reproduction rights. Digital transmissions create conceptual uncertainties: what happens when a song is transmitted digitally to a listener via the Internet? Is it a performance or a reproduction? Or is it both? The answer will have a big impact on the business of music. We argue that Congress should allow the music electronic marketplace to evolve naturally in response to market forces and new technologies, and in that way conform the law to ever-evolving technology, rather than shoehorn the technology into an ill-suited law. After that natural evolution, Congress can then sort out the significance of the distinction between the future meaning of reproduction and performance rights. Throughout the paper we will refer to “songwriters, composers, music publishers, and their small businesses” by the short-hand “songwriters.”

#### *Performing Rights Organizations as Songwriter Collective Actions*

In 1831 Congress first gave composers a copyright in their musical compositions, which at that stage of technology meant copyright protection for sheet music. In 1897 Congress, readying U.S. copyright law for what it thought would be the early entry of the United States into the Berne Convention, gave to songwriters in all genres of popular music the exclusive right to perform their music publicly. At the outset, the new performance right was more theoretical than real. Songwriters found that they could not enforce their right. They had no way to know when and where their music was being performed in the tens of thousands of venues across the United States that used their music. At the same time, the problem also existed in reverse: the

performers and the business people who wanted to use the music had no workable mechanism available to locate the copyright owners with whom to negotiate licenses.

The songwriters banded together to solve the problem by forming a performing rights organization. The American Society of Composers, Authors, and Publishers (ASCAP) was established in 1914. Individual songwriters and music publishers, who either hired a stable of in-house songwriters, or acquired the rights to the music of freelance songwriters, or both, assigned their performance rights to ASCAP, the organization that collectively managed these rights on their behalf. ASCAP set up shop around Tin Pan Alley in New York, in the heart of the biggest concentration of songwriters and music publishers in the United States. The valuable services offered by ASCAP made songwriters and music publishers quick to seek them out. ASCAP licensed and monitored the live public performances of music by orchestras, vocalists, and instrumentalists in concert halls, hotels, dance halls, passenger ships and ferry boats, sporting events, restaurants, taverns, theaters, and amusement parks. Early in the last century motion picture technology was invented, so ASCAP licensed songs for movie house performances.

Historically, ASCAP was, by organizational definition, a society and, as a society, it had membership rules. To gain admission to ASCAP a writer had to have published five *hit* songs. This requirement restricted membership to a relatively small number of successful songwriters and prevented new writers from joining the society and sharing the licensing revenues. The ASCAP admission rules favored established music publishers; twenty years after its founding, 15 ASCAP members controlled 90% of the most-played songs on network radio. In the late 1930s, ASCAP represented only 1100 songwriters and 140 music publishers.<sup>6</sup>

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<sup>6</sup> Russell Sanjek with David Sanjek, *Pennies from Heaven: The American Popular Music Business in the Twentieth Century* (New York: Da Capo Press, 1996), 187.

Many music publishing companies during this era were controlled by the motion picture studios, which wanted access to music for their films. The motion picture studios and a few of the major music publishers controlled decision-making at ASCAP through their board membership. However, many songwriters were working in American musical genres of interest neither to the film studios nor to ASCAP. Blues, ragtime, jazz, and country music were grassroots American genres that were locally popular in parts of the United States. But the songwriters of these genres were not invited to join ASCAP. The elite ASCAP stable counted as members the likes of Irving Berlin and George Gershwin.

Radio broadcast technology came into use in the 1920s. By the end of the 1930s radio dominated family entertainment: 85% of homes had a radio receiver in 1939. Radio technology fomented an upheaval in the economics of the music industry. In the 1920s, when many middle class homes had a piano and many people played the piano, a hit song would sell 500,000 to a million copies of sheet music. By 1931, with the Depression, a 200,000 copy seller was a huge hit. The retailer Woolworth closed its sheet music departments; piano players were laid off; bandleaders hired buses and singers and musicians headed for small towns to play for small audiences with little purchasing power in Depression Era America. The music publishers and ASCAP saw their revenues drop precipitously; in 1933 ASCAP could not afford to host its annual dinner.<sup>7</sup>

Three radio networks, the National Broadcasting Company (NBC), Columbia Broadcasting System (CBS), and the Mutual Broadcasting System, controlled the radio airwaves. In 1932 ASCAP negotiated an agreement with the radio networks that established fees based on a percentage of advertising time sales. A few years later ASCAP negotiated a five-year agreement with the radio broadcasters that they would receive 5% of annual advertising revenues

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<sup>7</sup> Sanjek, *Pennies from Heaven*, 184-185, 193.

as compensation for use of their music. Wary of the marketplace dominance of ASCAP and the bargaining power that came with it, the radio broadcasters sought legislation from Congress and filed an antitrust law suit against ASCAP, but neither tactic succeeded. As a result they created a new PRO as a competitor to ASCAP. Broadcast Music Incorporated was founded by NBC, CBS, and some other radio networks with a \$400,000 investment in 1940. Most of the radio industry let its contracts with ASCAP expire and BMI got a jump-start of new business. Some music publishers left ASCAP and joined BMI. At its inception, BMI initiated its signature business practice of being open to any and all songwriters.<sup>8</sup> Nonetheless, ASCAP would survive and, indeed, would again thrive.

FM radio and broadcast television emerged in the 1950s. Cable television emerged in the 1970s. Satellite television emerged in the 1980s. The copyright law principle remained intact with the emergence of each new music distribution technology: under the terms of their assignments of rights to the PROs, the songwriters, composers, and music publishers owned the copyrights to their songs and received payment for the public performances of their music from their PROs.

The Society for European Songwriters, Artists, and Composers (SESAC), founded in London in 1930, initially entered the U.S. market to protect the rights of European songwriters but has become a competitor to ASCAP and BMI by welcoming U.S. national songwriters. SESAC revenues, as we report below, are, however, a small fraction of those of ASCAP and BMI. Thus, three PROs organized themselves to provide services to their client songwriters and music publishers. PROs aggressively market their repertoires to users of music; they vigorously compete with each other to generate revenue for their clients. They negotiate fees and grant

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<sup>8</sup> Sanjek, *Pennies from Heaven*, 174-211. We have greatly simplified a convoluted story of competition, cooperation, and acrimony.

performance right licenses to users, they monitor uses, and they enforce the rights of songwriters when businesses refuse to take licenses. They collect the performance royalty on behalf of their affiliated songwriters wherever their music is played publicly—in hotels, dance clubs, college football games, restaurants, retail stores; when music is performed at live concerts; when music is sung or played, recorded or live, on radio, television, satellite services, and, now, web-casting.

The managerial economist, when told this story, identifies marketplace failure as the source of the problem and organizational capacity as the solution. Songwriters, composers, and music publishers are small businesses; they lack the organizational capacities to market their products and enforce their copyrights through the varied means of music distribution and many venues of performance that exist. The modest scale of each songwriter's business, and even the relatively modest scale of each music publisher's business, discourages any one of them from building the internal organizational capacity to license and monitor billions of performances every quarter, collect a royalty payment for each performance, and equitably distribute these royalties to the creators and owners of the copyrights. It is the "theory of the club"<sup>9</sup> at work: they act collectively through representatives that build the organizational capacities to do what not one among them can do individually. They don't "free-ride" on the others, as economists explain to be a key problem of collective action,<sup>10</sup> because in this instance they cannot derive benefit (money) by staying outside the club.

From a managerial economic perspective, a performing rights organization is the rational, collective, organizational response of songwriters to solve their problem of small business strategy. The PROs and collective blanket licensing solutions they offer are an efficient market-driven solution. The history of the 1930s music distribution technology change era from sheet

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<sup>9</sup> James M. Buchanan, "An Economic Theory of Clubs," *Economica* 32(1965)1.

<sup>10</sup> Mancur Olson, *The Logic of Collective Action* (Cambridge, MA: Harvard University Press, 1965).

music to radio shows that ASCAP adapted to the technology change by changing its business strategy to focus on the how to generate revenue from radio, the emerging music distribution technology. The history also shows that they performed this strategy change sufficiently well by leveraging their near-monopoly over the most popular music of day to stimulate a confrontational strategic response from the radio networks. When legislation and lawsuit didn't work, the radio networks banded together to create BMI as a competitor to ASCAP. It is a textbook strategic response from the perspective of managerial economics: "Buyers pose a credible threat of backward integration."<sup>11</sup> Put another way, ASCAP overplayed its hand, market forces prevailed, and competition entered the market.

#### *PRO Capacities for the Traditional Music Marketplace*

A managerial economist would explain that the kind of economic transactions that are described in the story of the development of the songwriters' PROs require substantial organizational capacities and that is exactly the market circumstance that leads to the establishment of organizations and to their survival over time. Economists theorize that the existence of the business enterprise or, more generally, of any organization of the non-public sector, owes to its superior information-processing capabilities.<sup>12</sup> Business enterprises exist to organize economic transactions through the expert management of knowledge and know-how and they find that there are marketplace advantages to doing it better than their competitors.<sup>13</sup> Knowledge is the essential resource of the firm that explains marketplace competitive

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<sup>11</sup> Michael Porter, *Competitive Strategy: Techniques for Analyzing Industries and Competitors* (New York: Free Press, 1980), 25.

<sup>12</sup> Harold Demsetz, "The Theory of the Firm Revisited," *Journal of Law, Economics and Organization* 4(1988)141.

<sup>13</sup> Robert M. Grant, "Toward a Knowledge-Based Theory of the Firm," *Strategic Management Journal* 17(1996)109.

advantage.<sup>14</sup> It has become a dominant paradigm for studies regarding the strategic management of the business enterprise: “At the heart of this theory is the idea that the primary role of the firm, and the essence of organizational capability, is the *integration of knowledge*.”<sup>15</sup> The collective knowledge, know-how, and learning maintained by the organization, its so-called “core competency,” is difficult for a competing organization to replicate.<sup>16</sup> A great deal of knowledge is tacit know-how, i.e., knowledge that is “inside people’s heads” and that is not easily codified, and it tends to be “sticky” in ways that make it easier to use inside an organization than to transfer it to, share it with, or have it appropriated by people and organizations on the outside.<sup>17</sup> If a business enterprise organizes itself so that it constantly acquires new information and organizes itself so that it synthesizes and combines the information in useful ways so that it can turn the information into actionable knowledge, then that organization can be the kind of dynamic business enterprise that innovates new products and services for changing marketplaces.<sup>18</sup> Disruptive technologies pose especially difficult strategic challenges for existing business enterprises; how enterprises respond explains whether they merely survive, thrive, or expire in the marketplace.<sup>19</sup>

Managerial economists, with help from sociologists, have analyzed the implications for business organization of the maxim that “it’s not just what you know, it’s who you know.” Social organizational scholars have supplemented the conceptual framework of the firm and its

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<sup>14</sup> Kathleen Connor and C.K. Prahalad, “Resource-Based Theory of the Firm: Knowledge Versus Opportunism,” *Organization Science* 7(1996)477.

<sup>15</sup> Robert M. Grant, “Prospering in Dynamically-Competitive Environments: Organizational Capability as Knowledge Integration,” *Organization Science* 7(1996)375.

<sup>16</sup> C. K. Prahalad and Gary Hamel, “The Core Competence of the Corporation,” *Harvard Business Review* 68(1990)79.

<sup>17</sup> Eric Von Hippel, “Sticky Information and the Locus of Problem-Solving: Implications for Innovation,” *Management Science* 40(1994)429.

<sup>18</sup> Bruce Kogut and Udo Zander, “Knowledge of the Firm, Combinative Capabilities, and the Replication of Technology,” *Organization Science* 3(1992)383; David J. Teece, Gary Pisano, and A. Shuen, “Dynamic Capabilities and Strategic Management,” *Strategic Management Journal* 18(1997)509.

<sup>19</sup> Clayton Christensen, *The Innovator’s Dilemma* (Boston, MA: Harvard Business School Press, 1997).

organizational capacity for knowledge management by focusing analysis on knowledge networks, or communities of practice in which knowledge is shared across organizational boundaries. Rather than focus on the firm itself, the “new institutionalism” focuses on the “organizational field” and connected-ness, especially cognitive connected-ness, among individuals across and outside of firms and organizations.<sup>20</sup> The 21<sup>st</sup> century business enterprise searches for information in knowledge networks outside its organizational boundaries. How well people inside the organization gather information from external networks and turn this raw information into actionable knowledge for their enterprise contributes sustainable competitive advantage.<sup>21</sup> The notion of “social capital” emphasizes that modern intellectual capital owes in substantial measure to social ties.<sup>22</sup>

The PROs are real-world examples of these economic principles at work in the marketplace. They expertly manage music rights. In the historic course of their involvement in the industry, they have refined the institutional mechanisms that ensure the orderly flow of rights, licenses, and royalties. The proof of the organizational utility of the PRO lies in their numbers in the music marketplace. We provide some vital statistics for all the PROs. We studied BMI as a case study in PRO capacity and explain its organizational structures, strategies, and competencies. BMI collects royalties on behalf of 375,000 songwriters, composers, and music publishers in the U.S. music marketplace (as well as thousands more abroad). The BMI portfolio of songs and compositions totals 6.5 million.

The BMI core competencies cluster in the following areas:

- Talent identification and affiliation;

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<sup>20</sup> Walter W. Powell and Paul J. DiMaggio, eds., *The New Institutionalism in Organizational Analysis* (Chicago, IL: University of Chicago Press, 1991).

<sup>21</sup> Paul D. DiMaggio, ed., *The Twenty-First Century Firm: Changing Economic Organization in International Perspective* (Princeton, NJ: Princeton University Press, 2001).

<sup>22</sup> Nan Lin, *Social Capital: A Theory of Social Structure in Action* (New York: Cambridge University Press, 2001).

- Song and composition database management;
- Copyright valuation modeling and calculation;
- Copyright analysis and licensing;
- Music use tracking;
- Complex copyright ownership fractional sharing;
- Royalty accounting distribution and settlements, domestic and international; and
- Global network creation and reciprocal relationships.

It all starts with the talent. BMI takes an active role in artist development by nurturing an emerging stable of artists; creating new venues for artists to disseminate their music, both online and in real space; and educating artists about industry trends, new opportunities, and avenues for exposure and commercial enterprise. BMI brings emerging musicians to live audiences by sponsoring real-case showcases, or concerts that are attended by key industry participants.

The basic business activity at BMI is the catalogue of songs and compositions, so a key capacity at BMI is the management of that massive database of 6.5 millions works. BMI adds about 350,000 new works each year using a process of registration which is similar to that used by the U.S. Copyright Office. BMI logs the work and the copyright ownership and contact information. The registration process went online some years ago so that more than 90% of current registrations are submitted to BMI electronically and thereby providing an efficient mechanism to insure that titles, ownership, shares, and royalty participants are accurately tracked.

A second basic business activity at BMI is music use tracking and sampling. In the old days, the PROs relied on playlists provided by the radio and television stations, random tape recordings of live broadcasts, and a veritable army of people who listened on headsets all day to

the tape recordings of the broadcasts to verify the accuracy of the playlists. BMI has long tracked music performances using playlist logs for radio stations, “cue sheets” for broadcast and cable television, electronic title and performance counts supplied by digital music outlets, and other playlist logging mechanisms from other venues performing music. “Trust but verify,” they say, so about 30 years ago BMI devised a sophisticated sampling technique, especially for use with commercial radio. The sampling technique, legitimized in U.S. court, gathers logs from radio stations, collects census data, tracks client music uses with sampling techniques, and, using statistical methods, extrapolates to broader music distribution activity. From these tracking and sampling activities BMI is able to determine who in the media industry is using BMI represented music and models the number of plays for each BMI title. The non-media users—pubs and restaurants, hotels, retail stores, etc.—have traditionally required a good deal of labor-intensive, shoe-leather-wearing, work for BMI to pursue on behalf songwriters.

The basic functions of registration, tracking, and sampling drive the financial activities—accounting, valuation, royalty collection and distribution—and licensing activity. A “blanket license” is offered to all licenses. That is, a licensee gets access to all works in a PRO’s catalogue. Licensing fees vary from industry to industry, though licensees with similar circumstances must be treated similarly by the PROs.

Broadcasters pay fees related to their advertising revenues. Fees paid by general establishments, such as restaurants, bars, and hotels, are based on variables such as seating capacities, admission prices, the centrality of music to the business activity, and total entertainment expenditures. A music-user who wants to contest the fee as unreasonable filed suit under U.S. copyright law in the United States District Court for the Southern District of New York. In 1998, Congress authorized music-user suits to be brought by small business owners in

their own federal court district. The PROs, through long practice of working with their music users and of competing with each other, have established rate schedules that apply to categories of music users. Distribution of the royalties by the PROs to their songwriters is based on analysis of the various performance counts from radio, television, satellite audio, general establishments, and, increasingly as discussed below, the new media of the music electronic marketplace and other copyright valuation criteria.

In fiscal year 2008, BMI reported record revenues; all sources of revenue increased and that means revenues increased from all sources of the *traditional* music marketplace and increased from international sources as well.<sup>23</sup> A summary of BMI revenue is the following:

	Revenue \$million	% Change
Radio	223.4	+3.7
Television	116.7	+5.4
Cable television	167.3	+21.8
Satellite audio	25.7	+21.8
General	97.3	+3.7
Overseas	237.7	+4.3

ASCAP revenues for 2007 show similar results:<sup>24</sup>

Radio	238.4	+6.6
Television	109.7	+1.5
Cable television	133.9	+17.8
General	107.1	+7.9
Overseas	265.6	+16.9

<sup>23</sup> *Informa Telecoms & Media* (5 September 2008)5. The BMI 2008 fiscal year ended 30 June 2008.

<sup>24</sup> *Informa Telecoms & Media* (22 February 2008)4.

That ASCAP revenues are quite similar to BMI revenues suggests that (a) the two major PROs compete vigorously across their music marketplace, (b) that they possess similar organizational competencies, and (c) that neither PRO has been able to break away from the other with respect to how it provides services to songwriters.

In total, including digital “new media” revenues discussed below, BMI collected \$900.3 million, an increase of 7.2%. BMI distributed \$795.4 million to its songwriter, composer, and music publisher affiliates, an increase of 8.5%. The BMI administrative overhead was thus 11.7% of revenues in fiscal year 2008. In total, including digital “new media” revenues discussed below, ASCAP collected \$863.3, an increase of 9.9%. ASCAP distributed \$741.3 to its songwriter, composer, and music publisher clients, an increase of 9%. The ASCAP administrative overhead was thus 11.9% of revenues in 2007. SESAC reports \$52 million in U.S. revenues on behalf of its songwriters.<sup>25</sup> The PROs in total generated more than \$1.8 billion in compensation for songwriters for the use of their works.

The PROs do not grant reproduction and mechanical right licenses, i.e., the right to reproduce a piece of music onto records, audio tapes, and CDs, or onto sheet music. Reproduction and mechanical rights royalty fees are paid by record labels and often to the copyright owners, which are usually music publishers. In the United States, another collective rights management organization that serves songwriters and music publishers—the National Music Publishers Association (NMPA), through the Harry Fox Agency—carries out that collective management effort. NMPA, founded in 1917, has about 700 members, including both relatively large and small-business music publishers.<sup>26</sup> Members must have been in business for one year and must pay annual dues of, at minimum, \$100. NMPA performs the policy advocacy

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<sup>25</sup> [www.sesac.com](http://www.sesac.com).

<sup>26</sup> [www.nmpa.org](http://www.nmpa.org).

role of a trade association, but also is the parent organization of the Harry Fox Agency, which NMPA established in 1927 to be the mechanical rights organization for its music publisher companies. The Harry Fox Agency collects a royalty, either fixed by statute or separately negotiated, from the record companies for each song mechanically reproduced and distributed on CDs and audio tapes. In recent years the Harry Fox Agency has expanded to ringtones and Internet downloads. These reproduction rights royalties then are distributed to their members. However, their core organizational competencies have long clustered around their relationships with the record companies and sales of hard copies of LPs, audio tapes, and CDs, which are easily countable transactions. Unlike the PROs, the Harry Fox Agency has not heretofore had a reason to develop expertise in tracking and sampling music uses over the radio, broadcast and cable television, and audio satellite services nor in restaurants, clubs, hotels, concerts, and sporting events, so its capacity to adapt its operations to ringtones, Internet downloads, and the emerging music electronic marketplace is unclear.

*Digital Distribution Creates the Music Electronic Marketplace for Songwriters*

The Internet, which came into widespread use in the mid-1990s, was a disruptive technology for music distribution. Digital technologies allow music users the means to produce perfect copies of music at nominal cost. Anyone with a computer can borrow a friend's CD and "rip" a song with close to commercial quality digital resolution. One copy, or multiple copies, can be made in a very short time and at only the cost of a blank CD—which is very cheap—on which to record the songs. But a listener can also borrow a CD and copy the song directly onto a computer hard drive without losing any reproductive quality of the song. Whether saved on disc

or hard drive, the song can be distributed, i.e., shared at no cost, or sold at nominal transaction cost, to the sender and receiver.

The Internet ushered in a new era for music use by networking individual computers. The Internet enhances a user's ability to copy and expands a user's ability to disseminate. Internet users, such as college students, share "files" of music just as they had shared "files" of seminar papers. A college student named Shawn Fanning got the clever idea to design software to make the sharing of music files easier and, with some business help from a family member and some venture capital investment, launched Napster as a website for the exchange of music. Napster was an innovation that anticipated market demand brilliantly, and exchange on the site grew rapidly. Peer-to-peer (P2P) file sharing was born. Among individual consumers, this model of peer-to-peer dissemination of music vastly expanded access to, and use of, music that can be copied, shared, and circulated.<sup>27</sup>

First Napster, then Grokster, offered large-scale file sharing sites on which users could upload and download songs in MP3 format to be shared for free by an ever-expanding network of users. Record labels and their trade association, the Recording Industry Association of America, acted to thwart music file sharing by pursuing a series of legal actions against P2P file sharing sites. The legal basis for their actions was that the copying and distribution activities undertaken on P2P file sharing networks violated U.S. copyright law<sup>28</sup> by infringing the exclusive rights of copyright holders to authorize copying and distribution of their music and by injuring the copyright owners commercially by providing no compensation to them.

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<sup>27</sup> File sharing refers to providing and receiving digital files over a network, usually following the peer-to-peer model, where the files are stored on and served by personal computers of the users. Most people who engage in file sharing on the Internet both provide (upload) files and receive (download) files. P2P file sharing is distinct from file trading in that downloading files from a P2P network does not require uploading, although some networks either provide incentives for uploading, such as credits, or force the sharing of files being currently downloaded.

<sup>28</sup> 17 USC 106(3): "to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending."

The recording industry argued that Napster and Grokster were infringing their copyrights and causing commercial injury. U.S. federal courts agreed. New P2P music websites arose, the progeny of Napster and Grokster. Kazaa and Gnutella introduced a clever innovation to the Napster business model: they took themselves out of the centralized role of storing and exchanging music files and became a network node for music uploaders and downloaders to find each other. The recording industry filed law suits against them, too, arguing that they were contributing to or enabling the infringement of their copyrights and causing commercial injury. The U.S. federal courts agreed with them, again. The recording industry won the copyright legal battles and thereby forced P2P network players to seek authorization from copyright holders and to expect to compensate the record companies and their artists and the songwriters if they wanted to be in the business of electronic music distribution.

In 2001, the record labels and media companies entered the distribution end of the music electronic marketplace. Vivendi Universal purchased MP3.com. BMG partnered with Warner Records to launch MusicNet. Sony and Universal united to launch Pressplay. Listen.com launched and was re-branded as Rhapsody after being acquired by Real Networks. In 2002, BMG tried, but failed, to buy Napster. Over the past several years, new sites have continued to spring up, but none of these P2P music services have achieved the market dominance among user groups that the Napster did. Nonetheless, P2P music networks challenged traditional music distribution business models in apparently unrecoverable ways. The marketplace result was stunning—traditional CD album sales plummeted. Consumers appear to have lost interest in purchasing CD albums, preferring a song-by-song choice model, and traditional bricks-and-mortar record store sellers of album CDs are exiting the marketplace.

However, one company waded into the flood of P2P music service providers with a different business model that has proved hugely popular with music listeners. Apple created the iTunes Music Store, an online catalogue of music licensed from many record labels. A consumer can access the iTunes Music Store, using the free iTunes software, on any computer with an internet connection. The consumer uses the software to shop for music song by song, paying 99 cents for each downloaded selection. All songs downloaded from the iTunes Music Store can only be played in one of two ways—transferred to a personal music device called the iPod purchased from an Apple retail store or a licensed dealer, or directly from the iTunes music software on the computer. The iPod and iTunes are compatible with both Apple and PC computers, so there is a very broad consumer base for these products.

By 2007, Apple had sold 100 million iPods, and by June 2008, the iTunes Music store boasted a catalogue of 8 million songs and cumulative sales of some 5 billion songs. It is estimated that Apple's iTunes system has seized about 70% of the worldwide online music sales. None of the other music distribution competitors—not the sites of the record label sites, nor behemoth retailer Wal-Mart, nor newcomer Amazon MP3—have achieved anything like it. Apple proved that consumers are willing to pay for music when the price matches their perceived value experience.

The Internet has enabled yet another innovation in music distribution—web radio streaming. Web radio streaming, or web-casting, means audio broadcasting services transmitted through the Internet. Examples of Internet radio services are Pandora, Rhapsody, Last.fm, and Imeem. These services sometimes, but not always, require subscription fees and also generate revenue through advertisements. Some Internet radio services feature “personalized music” and “shared playlists” enabled by algorithms embedded in the site. They allow the user to input a list

of personal music preferences. Based on the list, the site suggests or directs the user to compatible music choices. The user approves or disapproves of the choices, which the service takes into account when making subsequent suggestions. The site may also direct the user to other users who have expressed similar music preferences, so that users are given the opportunity to network with others with similar music tastes, share information, and become part of a particular music-listening community.

An example service, Pandora, was created by the Music Genome Project. Pandora additionally offers users the opportunity to buy the song online from Amazon MP3 or iTunes or a hard copy CD album from Amazon.com. Users choose to subscribe at one price if advertisements appear and at a higher price if no advertisements appear. Pandora Mobile also has the capability to stream music to compatible mobile phones, such as the iPhone, as well as certain home digital music systems. This is important for the emerging music electronic marketplace, because not just individuals, but businesses such as restaurants, clubs, hotels, health clubs, and retail stores might want to use such a service. Jazz in a particular restaurant, hip-hop dance in a particular club, adult contemporary in a particular hotel, a workout mix in a particular health club, and New Age in a particular retail shop—without advertising interruptions and deejay talking as with standard radio—allow them to customize music selections in line with their business strategy and customer preferences.

Mobile telephones have become an important part of the music electronic marketplace. Ringtones, the music played by a mobile telephone to announce an incoming call or text message, have been popular for some 10 years. BMI estimates that ringback tones, a new network-based streaming service that replaces the “ringing” sound that a caller hears when they

call a ringback subscriber, will generate about \$210 million in U.S. retail sales in calendar year 2008 for BMI affiliates.<sup>29</sup>

Many of the music services and associated devices that we know today in the music electronic marketplace will likely not be with us in the years ahead. Some observers predict that the future music electronic marketplace will be a “celestial jukebox” that permits listeners to access music without actually downloading a song. Listeners will pay a fee, possibly by subscription, possibly by agreement to accept advertising or share personal information, to listen to whatever they want, wherever they are, whenever they want to hear it. However, nobody knows yet who will produce the hardware or design the software or provide the network mechanisms for making this happen. The music electronic marketplace is still unfolding in dramatic but unpredictable ways.

Nevertheless, regardless of the twists and turns the music electronic marketplace takes in the years to come, for the songwriter the beauty of all these new electronic marketplace services and business models is that they are providing new ways to reach the appreciative listening public. Just as when radio created a huge new music marketplace to supplement, and in some ways to eclipse, live performances, while contributing to the decline in sheet music sales, the Internet is creating a huge new music marketplace to supplement and, perhaps, in some ways to eclipse other music distribution means such as CDs. The performing rights organizations are thereby challenged to adapt the services they provide their songwriters to the music electronic marketplace. We share additional information from the case of BMI, as an example of how PROs have adapted their organizational capacities to the music electronic marketplace.

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<sup>29</sup> “Ringback Tones Lead Mobile Music Market Growth,” BMI (27 March 2008), available at <http://www.bmi.com/news/entry/536285>.

With respect to talent identification and development, BMI co-sponsored the online launch of [www.Songwriter101.com](http://www.Songwriter101.com) in 2004. It was the first website dedicated to helping the next generation of songwriters learn the ins and outs of the business side of the creative process. As of December 2006, the website had attracted more than 25,000 members. This initiative supplements the numerous artist development workshops that BMI has initiated, sponsored, and supported in the music community. For instance, their musical theater workshop in New York has been a trailblazer and has helped build talent that feeds directly into New York's famed Broadway, Off Broadway, and Off-Off-Broadway musical theater venues. In 2005, BMI launched "See It Hear First" trademarked online podcasts. The initiative is the first music industry podcast to be featured in the iTunes directory. On "See It Hear First," emerging songwriters are featured on a promotional basis so that their songs can reach a wide new audience. Several featured groups on the BMI site have since landed major publishing and recording deals.

BMI has initiated an "experimental" license for the use of all its music on the Internet. Any music or entertainment website may contract with BMI for access to its catalogue of songs and compositions for an annual fee of 1.75% to 2.5% of the portion of the website's revenue that comes from the music service, or a minimum fee that ranges from \$259 to \$517 per year. The BMI license authorizes listen-only services for the music that is performed. The BMI license is quick and simple for users. The agreements can be executed on paper or, for smaller properties, an instant electronic license can be issued. This electronic agreement is referred to as BMI's "Klik-Thru" Internet music license solution. The user accesses the BMI website, clicks a few choices on the screen, completes a short questionnaire, and pays with a credit card. Individuals and small businesses can use it to gain quick access to the 6.5 million-strong BMI repertoire of

songs and compositions. However, it does not clear the reproduction and mechanical rights controlled by music publishers, record labels, and performers, as we discuss below. Users would have to get that license from the individual copyright owners or their agents.

In 2000, BMI and major international PRO partners set up “FastTrack” to manage songwriters’ rights around the world. FastTrack creates a global network, the “Global Documentation and Distribution Network,” that makes it easier for PROs to share information about music licensing, speed up the global distribution of royalties, and do so with greater accuracy and accountability. FastTrack creates an “Online Works Registration” system and a “Licensing On-Line” and fee payment system for users. FastTrack is becoming the software-enabled model for how the functions of PROs are being carried out globally.

In 2005, BMI launched an innovative software-enabled system to streamline collective management of the public performance right by using digital technology to monitor over-the-air and online music performances. The “Blue Arrow” system employs a patented pattern recognition algorithm to identify music performances from any source containing audio—radio, broadcast and cable television, mobile telephony, and the Internet. The system database consists of all the musical “signatures” and the metadata (name of artist, song, and recording details) that is embedded in the recording.

To identify a song, the signature extractor software samples the music and attempts a match against the database. When it finds a match, the software automatically generates the identifying metadata, as well as the time, date, and source of the performance of the song. The system achieves extraordinary 99% accuracy after “hearing” a song for less than two seconds. With a database of almost 5 million audio signatures, BMI uses the system to monitor and identify hundreds of commercial radio stations using numerous music formats, 24 hours a day,

seven days a week, 365 days a year. When fully implemented, the Blue Arrow technology will monitor commercials, promotional announcements, local programming, syndicated programming, and others, whether delivered via radio, television, cable, mobile telephony, hand-held devices, or the Internet. New technology systems, such as BMI's Blue Arrow, when combined with new music services provided to all music users including individuals, restaurants, clubs, hotels, health clubs, and retail stores as discussed above, may take some of the expensive and labor-intensive effort out of monitoring and collecting royalties and result in a larger revenues for songwriters, composers, music publishers, and their small businesses.

For BMI's affiliates, the benefits of the music electronic marketplace are clear—collections are *growing*, not declining, as are the revenues for the music labels and retail stores. New media revenue increased by 25.6% from fiscal 2007 to fiscal 2008 to \$15.2 million;<sup>30</sup> it has increased over the last five years by 250%. BMI has negotiated licenses covering more than 6,500 digital media businesses, including mobile operator Verizon Wireless, web-caster Last.fm, social networking websites Imeem and Project Playlist, concert promoter/record label Livenation.com, and the indefinable Oprah.com. New media is also an important source of revenue for ASCAP and its songwriters, and it totaled \$8.6 million in 2007.<sup>31</sup>

### *Copyright Law Uncertainties in the Music Electronic Marketplace*

Congress granted songwriters and music copyright owners two basic rights—the public performance right and the reproduction right. Congress provides some definitions in Section 101 of the 1976 Copyright Act that matter to discussions of copyright law regarding the music electronic marketplace:

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<sup>30</sup> *Informa Telecoms & Media* (5 September 2008)5.

<sup>31</sup> *Informa Telecoms & Media* (22 February 2008)4.

- “To ‘perform’ a work means to recite, render, play, dance, or act it, either directly or by means of any device or process or, in the case of a motion picture or other audiovisual work, to show its images in any sequence or to make the sounds accompanying it audible.”
- “To ‘transmit’ a performance or display is to communicate it by any device or process whereby images or sounds are received beyond the place from which they are sent.”
- “A ‘performing rights society’ is an association, corporation, or other entity that licenses the public performance of nondramatic musical works on behalf of copyright owners of such works, such as the American Society of Composers, Authors and Publishers (ASCAP, Broadcast Music, Inc. (BMI), and SESAC, Inc.”
- “A work is ‘fixed’ in a tangible medium of expression when its embodiment in a copy or phonorecord, by or under the authority of the author, is sufficiently permanent or stable to permit it to be perceived, reproduced, or otherwise communicated for a period of more than transitory duration. A work consisting of sound, images, or both, that are being transmitted is ‘fixed’ for purposes of this title if a fixation of the work is being made simultaneously with its transmission.”
- “‘Sound recordings’ are works that result from the fixation of a series of musical, spoken, or other sounds, but not including the sounds accompanying a motion picture or other audiovisual work, regardless of the nature of the material objects, such as disks, tapes, or other phonorecords, in which they are embodied.”
- “‘Phonorecords’ are material objects in which sounds, other than those accompanying a motion picture or other audiovisual work, are fixed by any method no known or later developed, and from which the sounds can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device. The term ‘phonorecords’ includes the material object in which the sounds are first fixed.”

Section 106 of the 1976 Copyright Act states *inter alia* that, subject to some limitations described in sections 107-120, “the owner of a copyright under this title has the exclusive rights to do and to authorize any of the following:

- (1) to reproduce the copyrighted work in copies or phonorecords;
- (2) ...
- (3) to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending;
- (4) in the case of literary, musical, dramatic, and choreographic works, pantomimes, and motion pictures and other audiovisual works, to perform the copyrighted work publicly;
- (5) in the case of literary, musical, dramatic, and choreographic works, pantomimes, and pictorial, graphic, or sculptural works, including the individual images of a motion picture or other audiovisual work, to display the copyrighted work publicly; and
- (6) in the case of sound recordings, to perform the copyrighted work publicly by means of a digital audio transmission.

It is within this copyright law context that in the era of the music electronic marketplace, music professionals, as well as music users, have been arguing over these two questions: is an online distribution a reproduction or a public performance? Or is it both? Two current digital music distribution means are implicated—music downloads, such as purchasing a song from the iTunes Music Store, and music transmissions, such as listening to songs on web-streaming services. Two copyright law questions must be asked in each case. First, does a digital download or digital transmission of a song involve a copy or a reproduction being made? And, second, does a digital download or digital transmission of a song involve a public performance? The answers to these questions are extremely important for the future of the music business, for it determines which of the contending organizations—the record labels, the performers, the PROs, the music publishers, or some combination of them—will receive the royalty payments generated by online music distribution.

The answers require conceptual analysis of the digital transaction. When a musical work is conveyed digitally to a user, is a copy made? If some or all digital transmissions are determined to involve “copying,” then they will fall under the reproduction right. When a musical work is conveyed digitally to a user, is it a performance? If some or all digital transmissions are determined to be a performance, then they will fall under the performance right. If some digital transmissions permit both a reproduction and a simultaneous performance, then they would fall under both rights.

Congress, to its credit, wants to do the right thing and resolve what seems to be an intractable controversy in U.S. copyright law, and to do so as quickly as possible in order to allow the music electronic marketplace to reach its full potential. We suggest, building on the PRO model, a system that encourages competition through several competing entities charged

with providing easy access to copyrights for users, and fair valuation for each of the copyrights granted to songwriters may be the optimal solution. We agree with Professor Robert Merges when he states in his paper “The Continuing Vitality of Performance Rights Organizations in the Digital Age”: “It makes sense to *increase* rather than decrease the functional role of PROs today. No other established organizations with a long track record of effectively monitoring music use and royalties are in place today.”

It appears that the music electronic marketplace is in an early, not late, phase in its legal and technological evolution. It may turn out that this apparent conceptual problem about whether a digital music transmission is a performance or a reproduction is a transient problem in the evolution of the music marketplace. As the marketplace continues to evolve, the notion of “copies” of sound recordings and the reproduction right may be quaint anachronisms of a bygone era. Any music that a listener wants will be immediately available at the click of a mouse, a cell phone command, a voice-activated instruction, or some other means of request. A listener will call up a musical genre, a musical era, an album, the collective works of a particular songwriter or composer, the collective renderings of a particular artist, or just a particular song and do so without storing “copies” on a CD, an iPod, or a hard drive. If this scenario is the future of the music electronic marketplace, then everything will be a public performance. The performance right/reproduction right question thereby recedes from policy discussions into irrelevance.

Leaving aside the uncertainty about how the music electronic marketplace will evolve and how the performance right/reproduction right question will be settled over time, the proposal to establish a single “One-Stop-Shop,” a Mega Music Rights Organization offering copyright clearance for all sound recordings and music publishing interests should be assessed. It is basic principle of modern neo-classical economics that monopolies tend to be bad policy prescriptions

unless attainment of some public good can persuasively be demonstrated to be better achieved that way, such as in the case of a natural monopoly for a public good.<sup>32</sup> But even with respect to natural monopolies and public goods, the U.S. marketplace trend has been to encourage competition where possible: Congress privatized telecommunications providers, and they now compete; the National Science Foundation competes with private foundations to fund science research; the federal and state governments are competing with respect to health and environmental regulation. Monopolies tend neither to be as responsive to the needs and preferences of their customers, nor to be as innovative with respect to new products and services. The music marketplace for songwriters had an unhappy experience in its early days with monopoly. As a result, competitors emerged and vigorous competition began between, especially, ASCAP and BMI. Over these many decades, their competition has put pressure on them both to manage collective performance rights with organizational skill, with attention to organizational cost containment, and with eyes open for opportunities to innovate on behalf of their affiliates in the music marketplace.

### *Conclusions*

The Internet and electronic distribution of music has roiled the music industry. Some people believe the future for the music industry looks bleak. Declining sales volumes for CD albums, rampant Internet sharing of music, and shrinking profits for record labels and recording artists appear to be indicators of an industry in inexorable decline. But the music electronic marketplace represents innovative ways for music to reach the listening public. Songwriters, composers, and music publishers have seen their collective revenues grow thanks to the efforts

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<sup>32</sup> Richard A. Posner, "The Social Costs of Monopoly and Regulation," *Journal of Political Economy* 83(1975)807.

of the PROs that are in business to represent these interests by securing royalty payments for them.

PROs were established to solve the collective rights management problems of songwriters, composers, and music publishers, who are small businesses that lack the organizational capacities to carry out the activities that PROs have come to organize themselves to do. They also lack individually the scale of activities to develop these capacities internally themselves. PROs provide orderly mechanisms for the flows of licensing rights, allowing efficient ways for songwriters and music users to find each other in the marketplace. The PROs license the intellectual property rights of the creators to the users, and the users pay royalties to the PROs, who then distribute the money to the songwriters.

The vigorous competition between ASCAP and BMI, with SESAC also competing for the business of the songwriters, has served songwriters well. ASCAP and BMI have for nearly 70 years provided similar services. The PROs have devised sophisticated ways of monitoring music use by radio, television, and other users. Each PRO takes in about the same total revenue; each gives to its songwriters about the same total payouts with about the same percentage of administrative overhead. The PROs have demonstrated that they possess the organizational capacities to leverage their core competencies in the digital era. They are negotiating and licensing performance rights with sites such as iTunes, web-streaming services such as Pandora, media devices such as mobile telephones with ringtones, and so on. They are innovating sophisticated technologies to identify the origins and means of transmission of music performances and tracing them back to their sources. Both ASCAP and BMI have new revenues generated by the music electronic marketplace; if the most recent annual revenue figures show BMI to be a bit ahead of ASCAP suggests only that the latter needs some combination of

increased innovation and organized effort. Without continued innovation and organized effort at BMI, five years from now the situation may be reversed.

Congress is evaluating proposals to refine U.S. copyright law for the music electronic marketplace. But it appears that the music electronic marketplace is in an early, not late, phase in its evolution. It may turn out that this apparent conceptual problem—about whether a digital music transmission is a performance or a reproduction—is a transient problem in the evolution of the music marketplace. But leaving this scenario aside, we suggest that Congress should allow the future evolution of the music electronic marketplace to determine the future meaning and relationship of the reproduction and performance right, one to the other. What is clear from our analysis is that the present PRO model, a system that encourages collective rights management through several competing entities charged with providing easy access to copyrights for users and fair valuation for each of the copyrights granted to songwriters, may be the optimal solution. Congress should insure the continued existence of competing PROs that provide digital music distribution monitoring, royalty-collecting, and other services on behalf of songwriters, composers, music publishers, and their small businesses. Indeed, their competition, growth, and co-evolution as organizations have created capabilities that will be useful models for other copyright licensors and licensees seeking to cope with the challenges posed by digital technology. Congress and marketplace participants should evaluate how we can apply the core competencies, technology/organization systems, and business practices developed by the PROs to new systems for copyright licensing and management to help facilitate electronic commerce in intellectual property in the years ahead.