Before the
UNITED STATES DEPARTMENT OF JUSTICE
ANTITRUST DIVISION
Washington, D.C.

COMMENTS OF NETFLIX, INC.

Introduction

Netflix, Inc. ("Netflix") submits these comments in response to the United States Department of Justice Antitrust Division ("DOJ" or the "Antitrust Division") request for public input regarding the Consent Decrees entered into between DOJ and each of the American Society of Composers, Authors and Publishers ("ASCAP") and Broadcast Music, Inc. ("BMI") (collectively, the "Consent Decrees"). *See* Antitrust Division Opens Review of ASCAP and BMI Consent Decrees, *available at*: http://www.justice.gov/atr/cases/ascap-bmi-decree-review.html (the "DOJ Inquiry").

Netflix is engaged in the on-demand Internet streaming of movies and television programming. It currently has over 36 million subscribers in the United States. Most of the programming available on the Netflix service is previously-produced content secured via licenses that Netflix enters into with film studios and program distributors. In recent years, Netflix also has begun to make available programming produced by or for initial airing on Netflix. Netflix's library of movies and television shows available to its subscribers numbers in the tens of thousands at any one time, and is frequently refreshed as available titles are regularly added and removed.

Netflix has engaged in negotiations over license fees and terms with each of ASCAP and BMI in order to secure licenses for the public performance of copyrighted musical works embedded in the programming it transmits to viewers. Since the inception of its streaming service, Netflix has relied upon the ASCAP and BMI Consent Decrees to secure interim licenses

upon request pending the negotiation of final agreements with ASCAP and BMI. And Netflix has conducted its negotiations with ASCAP and BMI with the knowledge that, if negotiations reach an impasse, it can rely upon the provisions of the Consent Decrees providing for federal "Rate Court" jurisdiction over ASCAP and BMI to secure reasonable license fees and terms. These Comments submitted by Netflix are based on its considerable experience in negotiating with ASCAP and BMI and in availing itself of various provisions of the Consent Decrees.

Netflix also has requested – along with Viacom, Inc., the Television Music License Committee and the Radio Music License Committee – that Professor Adam B. Jaffe provide comments from an economic perspective responsive to the DOJ Inquiry. Professor Jaffe's comments ("Jaffe Comments") – attached as Appendix A – are supportive of the positions espoused by Netflix.

Netflix Musical Composition Licensing Practices

Pursuant to longstanding industry practice described below, Netflix has been responsible for obtaining licenses for the public performance of copyrighted musical works embodied in all of the programming it transmits. As noted above, most of such programming is not produced by Netflix; it is produced by third parties who select and incorporate the music (along with all other programming elements) into the programming. The producers and distributors of such programming obtain and license to Netflix all of the copyright and other rights necessary to transmit the programming (including those for creative inputs such as a script, choreography, acting, and directing), with the sole exception of the non-dramatic public performance rights to the copyrighted musical compositions embedded therein. Indeed, pursuant to standard distribution contracts for such third-party-produced programming, television exhibitors such as Netflix are prohibited from altering the musical content of the programming.

In light of this practice whereby musical work copyrights are licensed differently than all other copyrighted elements of movie and television programming, downstream television exhibitors like Netflix have had to procure the necessary public performance rights in the musical compositions contained in programming they obtain from third parties. Because they must do so *after* the music has already been irrevocably embedded in the programming, the music is already "in the can" and there is no meaningful opportunity for downstream exhibitors to negotiate with the composers or publishers of that music regarding its value. By contrast, were composers and publishers to negotiate with program producers regarding the value of their works at the time of music selection, real competitive negotiations could occur. *See generally* Jaffe Comments at 9 – 12. Indeed, such competitive negotiations already happen today in the context of the licensing of the same rights (in the identical motion picture content) for exhibition in movie theatres. Theatrical motion picture music performance rights have been licensed in the foregoing manner for over 60 years as a result of a combination of private antitrust litigation, resultant provisions embodied in the ASCAP Consent Decree (which enjoin ASCAP's licensing of theatre exhibitors) and ensuing industry practice consistent with same.

As a consequence of the foregoing, television exhibitors such as Netflix have had no practical option but to enter into blanket license arrangements with ASCAP and BMI (and a third performing rights organization, SESAC, which is not currently subject to an antitrust consent decree but is the subject of two pending antitrust litigations) in order to comply with copyright law. The extraordinary market power and leverage created by the aggregation of copyrights and blanket licensing practices of ASCAP and BMI are beyond dispute by now, and have been the subject of many DOJ submissions and court decisions. *See, e.g.*, Memorandum in Aid of Construction of the Final Judgment, *United States v. BMI*, dated June 4, 1999 (S.D.N.Y.), at 3-4

("The PROs' pooling and blanket licensing of copyrights creates antitrust concerns. Because both ASCAP and BMI have so many compositions in their repertories, most music users cannot avoid the need to take a license from each PRO.... As a result, the PROs have market power in setting fees for licenses"); Brief for the United States as Amicus Curiae, *In Re Application of THP Capstar Acquisition Corp.*, dated May 6, 2011 (2d Cir.), at 1 ("The PROs aggregate rights from copyright holders, license them on a non-exclusive basis to music users, and distribute royalties to their members. These and other functions provide some efficiencies, but also give the PROs *significant market power*." (emphasis added)); *ASCAP v. MobiTV, Inc.,* 681 F.3d 76, 82 (2d Cir. 2012) ("[T]he rate-setting court must take into account the fact that ASCAP, as a monopolist, exercises market-distorting power in negotiations for the use of its music."); *United States v. BMI (In re Application of Music Choice),* 426 F.3d 91, 96 (2d Cir. 2005) ("[R]ate-setting courts must take seriously the fact that they exist as a result of monopolists exercising disproportionate power over the market for music rights.").

Professor Jaffe's Comments (at 4 – 5) further support these economic realities. Coupled with the citations above, his comments make quite clear that the Consent Decrees exist – and are still necessary – specifically to constrain the PROs' market power. *See also,* Memorandum of the United States In Support of the Joint Motion to Enter Second Amended Final Judgment, *United States v. ASCAP*, dated Sept. 4, 2000 (S.D.N.Y.), at 15-16 ("the [ASCAP Consent Decree] contains a number of provisions intended to provide music users with some protection from ASCAP's market power."); Brief for the United States as Amicus Curiae dated May 6, 2001 (2d Cir.) at 1-2, in *In Re Application of THP Capstar Acquisition Corp.* (the Consent Decrees are designed in part "to cabin the exercise of [the PROs'] market power").

Below, we respond to the specific questions raised by the DOJ's Inquiry. Lest there be any doubt, the Consent Decrees remain vital to constrain the market power of ASCAP and BMI. Particularly given the increasingly concentrated music publishing marketplace in which three companies control well over half of the music publishing market, the Antitrust Division also should use this opportunity to consider measures such as those outlined below which would inject greater competition into the musical works licensing marketplace. Those measures should include engendering the "source licensing" of music performance rights in audiovisual content so that such performance rights are licensed in a price-competitive market not just for theatrical exhibition, but for exhibition via all platforms.

Comments Responsive to Questions Set Forth in the DOJ Inquiry

1-*"Do the Consent Decrees continue to serve important competitive purposes today? Why or why not?"*

The Consent Decrees are just as critical today to constrain the market power of ASCAP and BMI as they were when they were enacted, if not more so. The Decrees provide a number of protections to users. Core among them are: (i) the effective compulsory license provided for thereunder upon a user's written application for a license; (ii) the right to secure a "reasonable" fee determination by the federal court overseeing the Consent Decrees in the event the user and ASCAP/BMI cannot reach a negotiated resolution; (iii) the right to obtain a "through to the audience" license covering all facets/platforms of distribution utilized by an originating service provider through to the end user (*see United States v. ASCAP (In re Application of Turner Broad. Sys.),* 782 F. Supp. 778 (S.D.N.Y. 1991), aff'd, 956 F.2d 21 (2d Cir. 1992)); (iv) the requirement that ASCAP/BMI may only secure a non-exclusive grant of rights from its members, which enables users to secure direct licenses from individual ASCAP/BMI members outside of the

PROs' blanket licenses; and (v) the requirement that ASCAP/BMI offer alternative structures to the traditional "blanket" license, including a "per program" and "adjustable fee blanket license" (or "AFBL"), which structures can facilitate price-competitive direct license transactions. These latter two features of the Consent Decrees, as Professor Jaffe explains (at 4, 6 – 7), allow for the possibility of competition side-by-side with ASCAP's and BMI's collective licenses.

Without these protections, the PROs and their major publisher members -- two of whom (SonyATV and Universal Music Publishing Group (UMPG)) now control some 50% of the US publishing market -- would be able to combine their enormous market power with the threat of crippling copyright infringement liability to extort supra-competitive rates from licensees. The findings in Judge Cote's 136-page decision after trial earlier this year in the *Pandora v. ASCAP* case are ample proof of the need for the protections of the ASCAP and BMI Consent Decrees to protect users from the PROs' aggregation of its members' licensing rights. *In re Petition of Pandora Media, Inc.*, Civ. No. 12-8035 (DLC), 2014 WL 1088101 (S.D.N.Y. Mar. 18, 2014) ("*Pandora*").

While ASCAP and BMI have competed with each other for writer members and affiliates, respectively, this form of competition is not meaningful to users who effectively require licenses from both ASCAP and BMI -- given that ASCAP's and BMI's huge repertories are mutually exclusive.

The PROs and major publishers' refrain that the decrees are "outdated" creatures from a bygone era ignores the reality that certain distribution technologies may be new, but the content being distributed (e.g., movies and television fare) remains essentially the same, as is the case as well regarding the PROs' negotiating methods and market power. *See, e.g.,* Jaffe Comments at 8. This refrain also ignores the fact that music rights historically have been subject to compulsory

licensing structures of one form or another under the U.S. Copyright Act—particularly with respect to industries that require prompt access to the rights in vast numbers of works in order to function properly. Compulsory licensing regimes are commonplace in music licensing where licensees need broad access to music rights in order to operate their businesses. *See, e.g.,* 17 U.S.C. §§ 112, 114, 115. If the ASCAP and BMI Consent Decrees had never been established decades ago to address the antitrust concerns created by collective licensing of composition performance rights, Congress almost certainly would have created a similar compulsory licensing regime for performance rights in compositions. *See* Reforming Section 115 of the Copyright Act for the Digital Age, Hearing Before the Subcomm. On Courts, the Internet, and Intellectual Property of the H. Comm. On the Judiciary, 110th Cong. 1, 1 (2007) (statement of Marybeth Peters, Register of Copyrights) ("Due to its concern about potential monopolistic behavior, Congress also created a compulsory license to allow anyone to make and distribute a mechanical reproduction of a musical composition without the consent of the copyright owner ..."). In this light, it is inconceivable that Congress and DOJ would have allowed the PROs and giant publishers to do as they are now urging -- that is, license musical work performance rights unregulated in any manner.

Nor is the need for judicial oversight over ASCAP/BMI rates outdated. The Rate Courts have interpreted the Consent Decrees' "reasonable" fee standard as requiring them to set rates that most closely resemble those that would emerge in a competitive marketplace. *United States v. ASCAP (In Re Applications of RealNetworks, Inc. and Yahoo! Inc.)*, 627 F.3d 64, 76 (2d Cir. 2010) ("fundamental to the concept of 'reasonableness' is a determination of what an applicant would pay in a competitive market"). The Antitrust Division has recognized the importance of both preventing PROs from withholding access to their repertories and subjecting the PROs to

Rate Court oversight of their pricing. Indeed, DOJ supported the addition of the BMI Rate Court provision in 1994 because, among other things, it "viewed the provision as promoting the public interest in competition as defined by the antitrust laws." Brief for the United States, *United States v. BMI (In Re Application of AEI Music Network, Inc.,)* dated June 26, 2000 (2d Cir.), at 22; *see also id.* at 24 ("BMI and the government agreed at the time the rate court provision was entered that it was to be a constraint on BMI's market power.... That BMI has market power, the ability to exercise some control over price, is plain" (internal citation omitted)). *Accord,* Memorandum of the United States in Response to Motion of Broadcast Music, Inc. To Modify The 1996 Final Judgment Entered In This Matter, June 20, 1994, *United States v. Broadcast Music, Inc.*, 64 Civ. 3787, (S.D.N.Y.), at 9.

Netflix's experience in negotiating with ASCAP and BMI, and in periodically implementing the effective compulsory licensing and other provisions of the Consent Decrees, reflects that nothing has changed as regards the licensing of musical composition performance rights that warrants revisiting these then-and-now sound conclusions. Indeed, Rate Court jurisprudence (from the *Showtime* case in the 1980s through the just-concluded *Pandora* trial) – resulting in rates set well below what ASCAP and BMI have asked for (*e.g., Showtime, Buffalo Broadcasting, DMX, MobiTV* and *Pandora*, all cited elsewhere herein) and Consent Decree constructions confirming users' entitlements to through-to-the-audience licenses and usable per-program and adjustable fee blanket licenses over the PROs' objections (*e.g.*, *Turner*, *Buffalo Broadcasting* and *DMX*) – itself attests to the continued need for the Consent Decrees and judicial oversight of the PROs.

Further, the non-exclusive licensing and alternative-to-blanket-license provisions within the Consent Decrees ensure that rightsholders are free to transact directly with users and that

licensees can seek to obtain rights directly from individual ASCAP/BMI members as an alternative to accepting ASCAP's or BMI's blanket license terms. As the Antitrust Division has noted, these provisions serve "to assure that music users have competitive alternatives to the blanket license, including direct and per-program licensing ...," so as to provide such users with "important protections against supracompetitive pricing of the [PRO] blanket license...." Memorandum of the United States in Response To Motion of Broadcast Music, Inc. To Modify the 1966 Final Judgment Entered In This Matter, dated June 20, 1994, *United States v. BMI*, 64 Civ. 3787 (S.D.N.Y.), at 10-11, 12; *see also Buffalo Broad. Co., Inc. v. ASCAP*, 744 F.2d 917, 925 (noting the importance of license alternatives); Jaffe Comments at 4, 6 – 7.

Nor is there is any need to allow for partial withdrawals (*see* discussion below) in order to enable such direct licensing transactions to occur. Indeed, competitive direct license transactions have occurred many times within the current Consent Decree structure. *See, e.g., BMI v. DMX Inc.*, 683 F.3d 32 (2d Cir. 2012); *BMI v. DMX Inc.*, 726 F. Supp. 2d. 355 (S.D.N.Y. 2010); *In re Application of THP Capstar Acquisition Corp.*, 756 F. Supp. 2d 516 (S.D.N.Y. 2010); *United States v. ASCAP (In Re Application of Buffalo Broad. Co.),* No. 13-95 (WCC), 1993 WL 60687 (S.D.N.Y. Mar. 1, 1993); Jaffe Comments at 15.

The Consent Decrees are no less important and vital today than in the past. The fundamental structure and operations of the PROs remains unchanged: they exist to license collectively, at maximum attainable levels, the copyright rights of tens of thousands of otherwise competing rights owners. The constraints viewed by the Government — at the time of the Consent Decrees' entry and subsequent modifications — to be necessary conditions for allowing such collusive behavior to exist remain every bit as necessary today.

2-*"Should the Consent Decrees be modified to allow rights holders to permit ASCAP or BMI to license their performance rights to some music users but not others? If such partial or limited grants of licensing rights to ASCAP and BMI are allowed, should there be limits on how such grants are structured?"*

Partial withdrawals should not be permitted. *See* Jaffe Comments at 12 – 17. Judge Cote's *Pandora* decision recites the instructive history here. *See generally Pandora* at *11 – 17, 22 – 29. Dissatisfied with the Consent Decrees' constraints (particularly the effective compulsory license and rate-setting provisions), but not wishing to abandon the benefits of collective licensing through PROs generally, ASCAP's and BMI's major publisher members conceived and sought to implement a PRO "partial withdrawal" scheme applicable to certain "new media" licensees in a classic effort to have their cake and eat it too. The evidence chronicled by Judge Cote demonstrated that SonyATV and UMPG had leveraged the upheaval created by their sudden new-media withdrawals from ASCAP, coupled with the threat of massive-scale copyright infringement in the vacuum created by the publishers' position that they were no longer subject to the Consent Decrees for rights they had "withdrawn," to establish dramatic, short-term price increases. *Id.* and at *35 – 38. Ultimately, Judge Cote held that ASCAP's decree did not permit such partial withdrawals. *Id.* at *29.

The same publishers attempted to orchestrate similar new-media withdrawals with BMI. Like Judge Cote, Judge Stanton held that BMI's Decree did not permit such partial withdrawals. *Broadcast Music, Inc. v. Pandora Media, Inc.*, 13-cv-4037, Order and Opinion dated Dec. 18, 2013. The publishers nonetheless, with BMI's assistance, created similar marketplace upheaval and short-term leverage by purporting to "completely" withdraw from BMI in late 2013, only to

"rejoin" BMI days after (based on published reports) they completed agreements with Pandora while they were ostensibly beyond the constraints of BMI's Consent Decree.

These courts' determinations that partial withdrawals were impermissible under the Consent Decrees were consistent with the principles of competition and efficiency that the Consent Decrees are meant to foster. Again, Judge Cote's decision is illuminating, as she made clear -- as did BMI's former CEO in an open letter to the public, *see* "BMI on Rights Withdrawal, an Open Letter to the Music Industry (Feb. 12, 2013), available at http://www.billboard.com/biz/articles/news/legal-and-management/1538785/bmi-on-rights-withdrawal-an-open-letter-to-the-music -- that the PROs facilitated their publishers' partial withdrawals with the intent to utilize deals struck by "withdrawing" publishers as benchmarks in ensuing PRO negotiations and/or Rate Court litigation (for the remaining works licensable by the PROs in the wake of the new-media withdrawals). Indeed, Judge Cote found that ASCAP made no effort to engage in price competition with the withdrawing publishers, and did not even consider charging lower prices than those secured by withdrawing publishers (in order to drive higher demand for the works of the remaining compositions licensable by ASCAP). *Pandora* at *35. In short, the interests of competition and efficiency that are the subject of many of the Antitrust Division's questions suggest that the Consent Decrees should continue to require that works in the ASCAP and BMI repertories be licensable to *all* applicants for ASCAP/BMI licenses.

3-*"Should the Consent Decrees be modified to permit rights holders to grant ASCAP and BMI rights in addition to rights of public performance?"*

If any augmentation of rights licensable through the PROs is to be considered, it would need to be subject to the same Consent Decree constraints (*e.g.*, automatic licensing and recourse

to Rate Court if the parties cannot reach agreement on license fees) that currently govern ASCAP's and BMI's licensing activities.

Moreover, one of the additional rights which the PROs apparently wish to be able to license – musical work synchronization rights – are currently licensed in a far more price-competitive marketplace than the one that exists for the licensing of composition performance rights. It seems dubious to permit the PROs to augment their ability to license in a marketplace that is currently functioning in a price-competitive manner (*see* discussion immediately below). Allowing PROs to license in this market creates a palpable and unnecessary risk that price competition would be reduced.

4-*"What, if any, modifications to the Consent Decrees would enhance competition and efficiency?"*

a. Principles of competition and efficiency favor expanding a particular provision of the ASCAP Consent Decree relating to audiovisual content -- and thereby ending the dichotomy in how musical work performances are licensed for audiovisual content as between (i) performances of such content in movie theatres, and (ii) when audiovisual content is exhibited via every other platform or venue (whether via broadcast/satellite television, internet, mobile, etc.). This dichotomy has arisen in the wake of the decisions in *Alden-Rochelle Inc. v. ASCAP*, 80 F. Supp. 888 (S.D.N.Y. 1948) and *M. Witmark & Sons v. Jensen*, 80 F. Supp. 843 (D.Minn. 1948), which led to certain injunctive provisions in the ASCAP Consent Decree (in section IV.E) prohibiting ASCAP from collectively licensing movie theatres for musical work performances associated with audiovisual content exhibited in theatres.

As a consequence of this injunction, based on longstanding industry practice (to which BMI and its affiliates have conformed), writers and publishers typically negotiate with movie

producers – in the same transaction and before production of a film is completed -- regarding the value of both the synchronization rights and theatrical (*i.e.,* movie theatre) public performance rights (as well as, in the case of score music written for a film, the compensation for the writer's time and effort) associated with all the music contained in films to be released theatrically. The transaction costs associated with obtaining theatrical performance rights in this fashion appear to be negligible, since it is merely one incremental aspect of a negotiation that is already taking place. And the negotiations are conducted in an essentially price-competitive market given that, if a licensor seeks a price deemed excessive by the producer, the producer – before the music is embedded in the film – is able to substitute in favor of alternative music writers/publishers. *See* Jaffe Comments 9 – 12.

Critically, however, this injunctive provision in ASCAP's Consent Decree applies only to movie theatre operators. As a result, writers and publishers overwhelmingly do not negotiate with producers of audiovisual content regarding (and do not grant to such producers) the right to publicly perform anywhere else the musical works embedded in audiovisual content – even for the exact same film that is initially released theatrically. As a consequence, uniquely for musical work performances, audiovisual content producers/distributors invariably exclude from the otherwise comprehensive copyright reps and warranties made to downstream exhibitors (such as Netflix) the right to publicly perform the musical compositions embodied in such content. So, for example, when Netflix enters into a motion picture supply agreement, the film distributor grants Netflix all rights in the licensed movies necessary for Netflix's exhibition, *except* for musical work performance rights. Downstream exhibitors are then left to obtain these performance rights in a market that is devoid of price competition, as the music is already

embedded in the audiovisual content they receive and such exhibitors lack the right and/or ability to remove/replace the music. *Id.*

Industry practice is such that Netflix and other exhibitors have taken blanket licenses from the three U.S. PROs in a process that is far more inefficient than the process whereby the identical rights are licensed seamlessly (and in a price-competitive manner) for theatrical exhibition. These negotiations are expensive and can lead to ASCAP/BMI Rate Court litigation. While the goal of Rate Court litigation is to arrive at a court-determined rate that is equivalent to what would result from negotiations in a competitive market, both the substantial costs of litigation and the uncertainties inherent in court-determined approximations of what a competitive market would yield could be avoided entirely were the same musical work licensing practices applicable to theatrical performances of audiovisual content applied to all audiovisual content performances.

Netflix enthusiastically supports measures (such as extending application of section IV.E of ASCAP's Consent Decree) which would enable audiovisual content to be licensed in a price-competitive environment not just for theatrical exhibition, but for exhibition via any and all platforms by which movies and television programs are distributed. At the same time, we must also emphasize that PRO blanket licensing subject to the Consent Decrees remains vital given the fact that there is an enormous amount of previously-produced motion picture and television content in distribution today, which will remain in distribution for decades (if not perpetuity). Thus, even in a world in which musical compositions would be licensed "at the source" on a going-forward basis, the problem of licensing "music in the can" would remain for a significant volume of previously-produced content which was distributed without non-theatrical public performance rights having been secured. The continued existence of the PRO/Consent Decree

structure is necessary to address the licensing of this content, which could be licensed via any one of the PROs' AFBL, per-program or blanket licenses (subject, if necessary, to Rate Court oversight). This would act as a bridge to a much more price-competitive marketplace for the licensing of music performance rights in audiovisual content without placing exhibitors of previously-produced movies and television programs at risk – and all within the existing PRO Consent Decree structure.

b. Expand the obligations of the PROs to provide transparency in relation to the works they license (*see* response to question 5 below).

c. The PROs should be prohibited from advancing as benchmarks direct licenses entered within the first five years of a major publisher's withdrawal from a PRO. This prohibition would build on the existing ASCAP Consent Decree provision (in section IX.C) barring ASCAP from advancing as benchmarks licenses secured in the first 5 years of an industry. Such a provision is warranted to address the circumstances detailed in Judge Cote's decision in the *Pandora* case about how withdrawing publishers were able to secure supra-competitive license fees in market settings that lacked the characteristics of a fair market transaction (*e.g.,* due to information asymmetries, effective compulsion to transact on the part of the licensee, etc.). *Pandora* at *35 – 38. And it is consistent with the reasons for the 5-year provision as initially adopted, *i.e.,* to not allow PROs to generate benchmarks from a marketplace in transition, *e.g.,* where there is a lack of licensing track record, or a new market in which licensees have generated little revenue (and therefore may have little incentive or ability to engage in Rate Court litigation concerning initial license rates expressed as a percentage of revenue), etc. *See also* Jaffe Comments at 18.

d. The Consent Decrees should provide explicitly that: (i) when a user applies for a license under the provisions of the ASCAP and BMI Consent Decrees, the user obtains a license; and (ii) consistent with past practices of ASCAP and BMI, licensees under license with a PRO at the time of a publisher withdrawal are entitled to a so-called "license-in-effect" which would continue to grant the licensee the right to perform works controlled by the withdrawing publisher for the duration of the license-in-effect. The Consent Decrees should further extend this protection to entities that obtain licenses by virtue of Consent Decree applications (under section IX of the ASCAP Consent Decree and section XIV of the BMI Consent Decree). Doing so would prevent publishers from using withdrawals to (i) "punish" entities that do not capitulate to PRO license demands, or (ii) affect licensees while negotiations or rate-setting litigation is pending.

e. The Consent Decrees should provide that a PRO must require any withdrawing publisher to give at least one year's notice to all existing PRO licensees, including those licensed by Consent Decree application, and that the PRO must publish a complete list of works subject to any such withdrawal, including data regarding co-owners. Such publication is necessary to enable users (if possible) to take down withdrawn works or otherwise take steps to address such withdrawals.

f. In many cases, a publisher does not own 100% of a work. The Decrees should clarify that works not 100%-owned by withdrawing publishers remain licensable from PROs without copyright infringement risk to licensees (so long as PROs are licensing on behalf of co-owners of those works). This is especially important given that an individual TV show or movie can have dozens (or more than 100) individual music cues, many of which can have multiple co-owners. This circumstance underscores the degree to which licensees could be subject to "hold-

up" circumstances by withdrawing publishers particularly as regards "music in the can." *See* Jaffe Comments at 17.

5-*"How easy or difficult is it to acquire in a useful format the contents of ASCAP's or BMI's repertory? How, if at all, does the current degree of repertory transparency impact competition? Are modifications of the transparency requirements in the Consent Decrees warranted, and if so, why?"*

Transparency is key to a competitive marketplace for performance rights. Judge Cote's decision in the *Pandora* case speaks volumes to how the lack of transparency to users can lead to material information imbalances or asymmetries between licensors and licensees -- which render a marketplace setting demonstrably noncompetitive. *See Pandora* at *35 – 38. The existing ASCAP and BMI song databases are fundamentally inadequate for users seeking to identify, for example, the songs licensable on a publisher-by-publisher or writer-by-writer basis.

This information is obviously available to each of ASCAP and BMI, each of whom (by their own rules and agreements with members) are obligated to create detailed lists of every work subject to a publisher's withdrawal. *E.g., Pandora* at *24. Accordingly, the PROs should be required to identify, with specificity, all the songs which they are able to license, searchable by publisher and writer, including information regarding co-ownership, along with (where available) corresponding performing artist and sound recording information. *See* Jaffe Comments at 17.

6-*"Should the rate-making function currently performed by the rate court be changed to a system of mandatory arbitration?"*

Netflix shares the PROs' concerns about the costs of Rate Court litigation. But the reliability of adjudications under the federal court structure and the cost deterrence to engaging in frivolous litigation have served the PROs and licensee community well, as the parties almost always have settled rather than litigated over their differences. *See* Jaffe Comments at 9. Indeed, when viewed over the history of the ASCAP and BMI Consent Decrees, the number of actual Rate Court cases that have gone to trial is miniscule. This history manifestly demonstrates that the Rate Courts are fulfilling their intended purpose.

Further, the licensee community likely would be prejudiced – relative to the PROs -- by a less-formal arbitration process because the PROs are in a demonstrably better position at the beginning of any rate case dispute to present their arguments, *e.g.,* based on the marketplace, as they know everything about all of their agreements with myriad licensees (and given that much information is publicly available regarding licensee businesses). Licensees, on the other hand, know only the terms of those agreements to which they are a party. There is a huge information deficit here that requires Federal Rules discovery (not typical arbitration rules) to cure.

We understand that Judge Cote has invited ASCAP to propose ideas to reduce the cost of Rate Court litigation. Yet we are not aware of any proposals ASCAP has made to Judge Cote on this front. Rather than forego Federal Rules discovery, the principles of *stare decisis* and embarking on uncharted arbitration rules in this setting, the better course is to take up Judge Cote on her offer and seek to establish streamlined procedures for Rate Court actions that can reduce costs.

7-*"Do differences between the two Consent Decrees adversely affect competition?"*

The Second Circuit, along with the ASCAP and BMI rate courts, have historically interpreted the material provisions of the ASCAP and BMI Consent Decrees in a consistent

fashion. So long as that remains the case, there appears to be no competitive issue relating to the current textual differences between the ASCAP and BMI Consent Decrees.

That said, Netflix sees no need to have different Consent Decrees. The service it operates is identically situated as relates to both ASCAP and BMI. Each PRO controls mutually exclusive repertoires; and Netflix effectively must secure licenses from each PRO under current market conditions. Moreover, licensees do not have access to information reflecting how much of the music embodied in their content falls within the respective repertoires of ASCAP and BMI (and SESAC). Indeed, licensees are often subject to claims by each PRO regarding the PRO's market share of works performed through their services -- which the licensees cannot feasibly assess and which (taking the PRO's market share claims at face value typically and of course impossibly) add up to well more than 100%. Providing for all 3 PROs (or at least ASCAP and BMI) to be subject to the same rate-setting authority would provide for greater certainty in result, less ratcheting efforts on the part of one PRO to increase rates based on what another PRO achieved and greater efficiencies/lower costs associated with any necessary rate-setting processes.

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We thank the Antitrust Division for considering these Comments.

Respectfully submitted,

Dated: August 6, 2014

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APPENDIX A

Before the

UNITED STATES DEPARTMENT OF JUSTICE

ANTITRUST DIVISION

Washington, D.C.

Comments of Dr. Adam B. Jaffe

August 6, 2014

I. Qualifications and Assignment

My name is Adam B. Jaffe. I am the Director and a Senior Fellow of Motu Economic and Public Policy Research, a non-profit research organization located in Wellington, New Zealand. I am also Fred C. Hecht Professor in Economics Emeritus at Brandeis University in Waltham, Massachusetts. From 2003-11, I was Dean of Arts and Sciences at Brandeis. Before becoming Dean, I was the Chair of the Department of Economics. Prior to joining the Brandeis faculty in 1994, I was on the faculty of Harvard University. During the academic year 1990-91, I took a leave of absence from Harvard to serve as Senior Staff Economist at the President's Council of Economic Advisers in Washington, D.C. At the Council, I had primary staff responsibility for science and technology policy, regulatory policy, and antitrust policy issues.

I have authored or co-authored over eighty scholarly articles and two books. I have served as a member of the Board of Editors of the *American Economic Review*, as an Associate Editor of the *Rand Journal of Economics*, and as a member of the Board of Editors of the *Journal of Industrial Economics*. I am a Research Associate of the National Bureau of Economic Research (NBER), in which capacity I co-founded and co-directed for many years the NBER *Innovation Policy and the Economy* Group. At Brandeis and Harvard, I have taught graduate and undergraduate courses in microeconomics, antitrust and regulatory economics, industrial organization, law and economics, and the economics of innovation and technological change.

I have served as a consultant to a variety of businesses and government agencies on economic matters, including antitrust and competition issues, other regulatory issues, and the valuation of intellectual property, including music performance rights. I have been qualified as an economic expert in federal courts in the Southern District of New York (proper basis for music performance license fees in cable television, 2001 and appropriate structure and benchmark fee for music performance license in background music service, two separate cases in 2010),

Idaho (evaluating market power and allegations of anticompetitive behavior, 2002), and in the Southern District of New Jersey (commercial success as a factor in patent obviousness determination, 2009). My testimony has also been accepted and used by state courts, state regulatory agencies, the Federal Energy Regulatory Commission and its Administrative Law Judges, private arbitration panels, and arbitration/royalty panels convened by the U.S. Copyright Office/Library of Congress.

I have consulted for both owners and users of intellectual property on its valuation and the interaction between intellectual property and competition. I have consulted for the Copyright Clearance Center on the valuation of photocopying licenses and the American Chemical Society on paper and digital journal subscriptions and the relationship between the two. I chaired the Brandeis committee that drafted its current Intellectual Property Policy. I have testified on behalf of both plaintiffs and defendants in patent cases involving a consumer product, a medical device, a software program, and pharmaceuticals. I testified at the request of the Chairman before the U.S. House Subcommittee on Courts, the Internet and Intellectual Property on patent policy reform.

With respect specifically to the licensing of music performances involving performance rights organizations (PROs), I have prepared written expert reports and presented testimony on behalf of local television stations, cable television channels, and a background music service in ASCAP and BMI "Rate Court" proceedings, conducted pursuant to Consent Decrees between these entities and the U.S. Department of Justice, Antitrust Division (DOJ), in federal court in the Southern District of New York. I assisted in the design and development of a television music use survey that the Television Music License Committee, LLC (TMLC) continues to use today. In 2006, I also testified on behalf of local television stations in their arbitration with SESAC for the 2005-07 license period. In addition, I testified on behalf of the Public Broadcasting Service in its copyright office arbitration with ASCAP and BMI in 1998.

In 2010, I testified on behalf of the background music service DMX in separate cases in the BMI and ASCAP Rate Courts.[1] My testimony in both cases was to the effect that: (1) the traditional method of licensing music performance rights through a "blanket license" that aggregates rights held by numerous different copyright owners confers market power on BMI and ASCAP; (2) the fees paid by DMX in direct licensing contracts with music publishers demonstrated that the historical blanket license fees charged by ASCAP and BMI were well above the competitive level; and (3) an Adjustable Fee Blanket License (AFBL) could mitigate that market power if designed correctly. My testimony was used by both Judge Stanton and Judge Cote in their decisions, both of which established an AFBL as an alternative to the traditional ASCAP and BMI blanket licenses, using the formula I recommended, and

[1] *In Re Application of THP Capstar Acquisition Corp.*, 756 F.Supp.2d 516 (S.D.N.Y. 2010); *Broadcast Music, Inc. v. DMX, Inc.*, 726 F.Supp.2d 355 (S.D.N.Y. 2010).

at a license fee level tied to the direct-license benchmark that I recommended. These decisions were affirmed by the Second Circuit in 2012.[2]

I submitted an expert report on behalf of the plaintiff local television stations in their Section 1 and Section 2 lawsuit against SESAC. My opinions regarding the appropriate definition of the market for antitrust analysis, SESAC's market power in that market, and the anticompetitive consequences of SESAC's actions were positively cited by Judge Engelmayer in his 2014 decision on SESAC's motion for summary judgment.[3]

I have been asked by the TMLC and the Radio Music License Committee, Inc. (RMLC), as well as Viacom, Inc. and Netflix, Inc., two other major distributors of television content via cable, satellite, Internet, and other means, to provide an analysis of the economic functioning of the ASCAP and BMI Consent Decrees, and to comment from an economic perspective on the issues raised in the Department's Request for Comments.

II. The Consent Decrees represent appropriate application of antitrust principles to the music licensing market

Copyright gives creators a monopoly over their own works; rightsholders licensing their works individually have the right to charge whatever they choose, and would not be subject to any restriction on their licensing practices or prices. There is no legal or regulatory restriction on the right of any individual composer to operate in this manner today.

Composers and music publishers have chosen, however, to organize themselves into Performing Rights Organizations or "PROs." The PROs (ASCAP, BMI and SESAC) offer "blanket" licenses that convey to broadcasters and other users the right of public performance to the works of thousands of individual composers at a single price. We would not allow wheat farmers or law firms to band together and offer access to their products only on a package basis at a fixed price, because we expect that if they did so they would insist on higher prices than each could get on their own.

It might seem that this logic does not apply to music performance rights, because music creators "already have" a monopoly granted by copyright. But the copyright monopoly covers only a creator's own works; it does not convey the right to monopolize the combined works of many creators. In some contexts, program producers might feel that they have to have a specific work or a specific composer, in which case competition from other composers would be irrelevant. But in many cases, such as the choice of background or theme music for a television series, there

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[2] *Broadcast Music, Inc. v. DMX, Inc.*, 683 F.3d 32 (2d Cir. 2012).

[3] *Meredith Corp., et al. v. SESAC, LLC*, 09 Civ. 9177 (PAE), _ F.Supp.2d _, 2014 WL 812795 (S.D.N.Y. Mar. 3, 2014).

might be many different works and many different composers that would do. We would expect in those circumstances that composers would compete with each other to have their music used and performed. This competition would determine the royalty rates for use of the music. This is precisely the type of competition we observe in the licensing of synchronization rights when music is embedded in audiovisual content, as discussed below. With respect to performance rights, however, the bundling of thousands of composers and thousands of works together in a blanket license eliminates that potential competition.

The ASCAP and BMI Consent Decrees came about because the Antitrust Division challenged this collusive behavior in which those PROs monopolized the combined works of many creators. The logic of the decrees is that appropriate restrictions on the behavior of the PROs can allow them to engage in collusive pricing while mitigating the anticompetitive consequences that would otherwise flow from such behavior.

The nature of the restrictions imposed by the Consent Decrees is directly tied to this function, that is, the restrictions control or mitigate the ability that the PROs would otherwise have, by virtue of collusive pricing, to elevate licensing royalties above the level that would result from competition among different music rightsholders. Specifically:

1. ASCAP and BMI must grant a license to anyone who requests one—because restricting access to the collective product is the mechanism by which a cartel (i.e., the PRO) elevates the price.

2. If ASCAP or BMI cannot reach agreement with a licensee on the royalty rate, that royalty is determined by a neutral party (the "Rate Court")—because otherwise the PROs' control of the repertory of thousands of composers would allow them to insist on royalty rates far in excess of what those composers could individually negotiate.

3. ASCAP and BMI are prohibited from restricting their affiliated rightsholders' ability to negotiate individually to license their works—in order to mitigate their collusive market power by allowing for the possibility of competition alongside the collective licensing.

4. ASCAP and BMI are required to offer licensees "genuine alternatives" to the blanket license, and to allow licensees to adjust to some limited extent their blanket license fees to reflect works for which they have secured performance rights directly from the rightsholders—again in order to mitigate the collusive market power of blanket licensing by allowing competing mechanisms to operate in parallel with the collective blanket license.

Not surprisingly, ASCAP and BMI would prefer to operate without these restrictions. But from a public policy perspective, the predicate for a performance-royalty-

licensing regime without these restrictions should be independent licensing by distinct copyright owners, subject to action under the antitrust laws (for example, if they attempt jointly to set the price for portfolios of works from multiple distinct rightsholders). If, on the other hand, the rightsholders wish to continue to price performance rights jointly through blanket licenses, then the above restrictions are entirely appropriate to mitigate the market distortions of unrestricted collusion.

III. The Rate Courts Have Functioned to Move Music Royalties Away from Monopoly Levels and Towards the Competitive Level

As noted above, part of the compromise inherent in the Consent Decrees is that ASCAP and BMI are permitted to engage in collective licensing, but given the likely effect of such collusion on royalty levels, royalties are set by the Rate Courts if the parties cannot agree. To fulfill this role, the Rate Court is charged with setting "reasonable" royalties, and has tied "reasonable" in this context to the rate that would prevail in a competitive market. *United States v. ASCAP (In Re Applications of RealNetworks, Inc. and Yahoo! Inc.)*, 627 F.3d 64, 76 (2d Cir. 2010) ("fundamental to the concept of 'reasonableness' is a determination of what an applicant would pay in a competitive market."); *United States v. ASCAP (In Re Application of Buffalo Broad. Co.)*, No. 13-95 (WCC), 1993 WL 60687, *16 (S.D.N.Y. Mar. 1, 1993) ("[T]he rate court must concern itself principally with defining a rate ... that approximates the rates that would be set in a competitive market.").

ASCAP and BMI have argued that the Rate Courts have operated, particularly in the digital domain, to suppress music performance royalties below "market" levels. Comments of the American Society of Composers, Authors and Publishers, dated May 23, 2014, U.S. Copyright Office, Docket No. 2014-03 ("ASCAP Copyright Office Comments"), at 24-27, 34-35; Broadcast Music, Inc.'s Comments on Copyright Office Music Licensing Study, dated May 23, 2014, U.S. Copyright Office, Docket No. 2014-03 ("BMI Copyright Office Comments"), at 8-9, 13-15. In particular, ASCAP has pointed to Judge Cote's decision to reject license agreements reached between publishers and Pandora during the period when ASCAP permitted partial withdrawal as a benchmark for the blanket license royalty. ASCAP Copyright Office Comments, at 26-27. As discussed further below, Judge Cote rejected these agreements as benchmarks because the evidence is clear that they were the result of the publishers' market power. This does not represent a structural flaw in the Rate Court process; it represents ASCAP's unhappiness with the Court's insistence on constraining its market power.

The underlying source of the PROs' and publishers unhappiness with the current performance royalty landscape seems to be that musical works performance royalties for non-interactive digital music services are much lower than the sound recording royalty rates for the same licensees. It is important to note in this context that this disparity results from an explicit decision by the CRB that sound recording performance royalties should not be tied to music composition performance

royalties. *See, e.g., Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings*, 72 Fed. Reg. 24,084 (May 1, 2007). And, of course, the zero royalty paid for sound recording performances in traditional radio has never been seen by the PROs as an appropriate reference point for determining if the music performance royalties for those licensees are too high.[4]

The available evidence from experience with the musical works performance royalty market itself suggests, to the contrary, that while Rate Courts exert downward pressure, performance royalties generally remain above the competitive level. First, in circumstances where licensees have been able to utilize direct (non-collective) licensing on a significant scale in a reasonably competitive marketplace in which individual rightsholders were competing against each other on the basis of price to have their works performed, the resulting prices have been well below the rates of collective licenses. DMX provides packages of recorded music that retail stores and other businesses play in the "background" in their establishments. As such, DMX has direct control over which music is "performed" by its service, and the nature of the service is such that programmers have great flexibility as to which music to use. While historically the rights to these public performances were conveyed by a blanket license, in 2006 DMX embarked on a campaign to secure public performance rights directly from individual music publishers ("direct licenses"), with the explicit intention of using these directly acquired rights in place of those secured through the PROs at the blanket license rates.

Over a period of 5 years, DMX was able to secure hundreds of direct licenses from music publishers – both small and large – whose catalogs collectively accounted for upwards of 30% of the musical works performed by DMX. *In re Application of THP Capstar Acquisition Corp.*, 756 F.Supp.2d 516, 528 (S.D.N.Y. 2010). The effective rate in these publishers' licenses for the music in the ASCAP repertoire was the publishers' pro-rata share of about $11 per DMX location. *Id.* at 548. In contrast, the previously established ASCAP rate, based on ASCAP's license with Muzak, another

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[4] The conclusion that the concern about musical works performance royalties in non-interactive digital media is not based on any evidence that they are below competitive market levels, but rather is purely a kind of sound recording "envy," was confirmed by Peter Brodsky of Sony/ATV in his negotiations with Pandora. He told Pandora that it was only the "differential" between the sound recording royalty and the musical works performance royalty that was the problem, and that if the sound recording rate were significantly lower Sony/ATV would not be seeking a higher musical works performance royalty. *In Re Petition of Pandora Media, Inc.*, __ F.Supp.2d__, 2014 WL 1088101, *22 (S.D.N.Y. Mar. 14, 2014). In this regard, it is worth noting that ASCAP attributes the Rate Court's putative failure to set its rates at the proper level to the Court's reliance on benchmarks that are, in ASCAP's view, depressed by the requirement that ASCAP not deny a license to any user. ASCAP Copyright Office Comments, at 25-27. Yet, the very sound recording performance rates that are at the heart of this so-called "disparity" were set by the rate-setting bodies under the compulsory license provisions of 17 USC section 114.

background music service was, on a comparable basis, approximately $30-40 per location, depending on how specific features of the Muzak license are considered. *Id.* at 524.

This dramatically lower rate for the direct licenses was the result, at least in part, of publishers' expectations that DMX would favor the music owned by its direct licensees in formulating its programs, so that the lower rate would be offset by a larger share of the overall DMX royalty pie. *Id.* at 550. That is, while the blanket license eliminates any possibility of competition for performances, this direct license regime effectuated competition. If the Rate Court and the Consent Decree regime more generally were suppressing royalties below the competitive level, publishers should be unwilling to license directly at an even lower rate. The fact that publishers in this competitive regime chose to accept royalty rates considerably less than half the Rate-Court-influenced ASCAP rate suggests strongly that the Rate Court, at least in this case, was perceived to be willing to sanction rates well above the competitive rate.

This licensing experience of DMX provides an example of a competitive market for musical works performance royalties at work, and demonstrates that in this context such competition produces royalty rates much lower than those produced by collective licensing. There is no way to know precisely how this experience would translate to other performance royalty licensing contexts, but it is at least suggestive that the economic prediction that collective licensing elevates royalties is correct and is quantitatively significant.

A second source of evidence regarding the relationship between Rate-Court-influenced royalties and the competitive price level is at the opposite end of the competitive spectrum. SESAC, the one United States PRO that is not subject to a consent decree, has clearly been able to raise its royalty rates in a manner inconsistent with normal competitive market forces. Despite the fact that it is far smaller than both ASCAP and BMI, SESAC has been able to amass, through collective licensing, monopoly power. With this monopoly power, SESAC, freed in 2008 from externally-imposed constraints, demanded from local television stations significant, ongoing royalty increases. This was so despite the fact that the data showed SESAC music use by local television stations declining, and the industry (and the economy generally) was in the throes of the "Great Recession." It is my understanding that SESAC dealt with radio stations in a similar fashion. Nevertheless, in part because SESAC does not publish a complete listing of the works it licenses and the individual writers/publishers owning all or part of those works, television and radio stations felt that they had no feasible alternative but to take a SESAC blanket license; indeed some stations were informed by SESAC that it was withdrawing interim authorization for performance of its music and therefore the station would be subject to copyright infringement claims if it did not agree to the license terms demanded. *RMLC v. SESAC, Inc.*, Civ. No. 12-5807, Report and Recommendation, (E.D.Pa. Dec. 20, 2013); *Meredith Corp., et al. v. SESAC, LLC*, 09 Civ. 9177 (PAE), __ F.Supp.2d __, 2014 WL 812795 (S.D.N.Y. Mar. 3, 2014). Eventually, all stations gave

in to SESAC's demands. This ability to dramatically raise one's price, as SESAC has done, without suffering any loss in business is the hallmark of monopoly power. *Meredith Corp., et al. v. SESAC, LLC*, 09 Civ. 9177 (PAE), _ F.Supp.2d _, 2014 WL 812795 (S.D.N.Y. Mar. 3, 2014).

IV. The ASCAP and BMI Rate Courts are reasonably flexible and appropriate mechanisms for the task of ensuring reasonable music performance royalties

The foregoing discussion shows that the problem the Consent Decrees are designed to solve is a real one. It is nonetheless fair to ask whether or not the decrees constitute a reasonable solution to this problem. ASCAP and BMI have portrayed the Consent Decrees and the Rate Courts as obsolete and/or heavy-handed regulatory mechanisms. ASCAP Copyright Office Comments, at 20-27, 37-39; BMI Copyright Office Comments, at 7-9, 13-21. These are misleading characterizations.

While the advent of digital technologies and the growth of the Internet have changed the modes of distribution by which music performances requiring licensing are delivered, they do not change the underlying reality that collective pricing for thousands of compositions creates monopoly power that is not present in the individual composers' copyrights. Hence while conducting a review of the Consent Decrees may be appropriate, there is no analytically valid basis to suggest that these new technologies undermine the need for the oversight the Consent Decrees provide.

Another issue raised by some PROs (in their prior comments responsive to the February 2014 NOI of the U.S. Copyright Office) is that the DOJ has a general presumption that antitrust consent decrees should "sunset" after some period of time. There are, however, good reasons why the general presumption that antitrust consent decrees should "sunset" after some time does not apply here.

First, most antitrust enforcement actions emerge out of a particular set of market conditions at a point in time. In most markets, companies that manage to establish some kind of monopoly position can be expected to be unable to sustain any such dominance if prohibited from engaging in anticompetitive behavior for some period of time. But the market power associated with the collective pricing by the PROs is fundamentally different. It is not the result of a narrow or temporary set of circumstances—it is inherent in the licensing structure they have chosen to establish, and around which the industry has organized itself for decades.

Second, the general presumption that consent decrees should be of finite duration in no way implies that when a consent decree ends the firms involved are subsequently somehow exempt from the antitrust laws. But BMI and ASCAP do not seem to be proposing ending their practice of collective licensing. What they apparently seek is weakening or removal of the Consent Decree restrictions, while

they would continue to be permitted to license collectively. The analogy to such a proposal is not "sunsetting" of a narrow consent decree, it is broad exemption from the antitrust laws that apply to everyone else.

Finally, some commenters have emphasized that the Rate Courts are expensive and time-consuming. The time and expense required for Rate Court proceedings has to be considered in context. First, it is only a very small number of cases in which it is needed. Year in and year out, ASCAP and BMI have thousands of licensees and license agreements. Only a handful of these agreements have been handled by the ASCAP or BMI Rate Courts over the decades in which the Consent Decrees have been in existence. For the rest, the Rate Courts provide a "backstop" that mitigates the monopoly pricing that collective licensing would otherwise generate, but they do so without actually being used. Thus, the time and expense of the small number of Rate Court cases that are actually needed is more than balanced by the benefit created in all licensing negotiations by its mere existence in the background.

Even in the cases where it is invoked, the cost of Rate Court should be viewed relative to the economic stakes involved in determining the reasonable fee. BMI and ASCAP have presented no evidence that the cost of Rate Court is burdensome or disproportionate. Indeed, both organizations brag that their overall administrative costs—of which participation in Rate Court is itself only a small fraction—are low by international standards and relative to the value that they deliver.[5]

V. The Opportunity for Greater Competition and Less Reliance on Collusive Pricing

The Consent Decree structure of accepting joint pricing of music performance rights, but constraining the ability of the PROs to exploit their resulting market power, is unnecessary and undesirable to the extent that it might be feasible instead to price music performance rights through a functioning competitive market. In this section, I will describe how such a competitive market could feasibly emerge, at least with respect to those music performances that come about through pre-recorded audiovisual broadcasts.

The essence of the problem faced by audiovisual broadcast media who wish to perform copyrighted music is that they are obligated to ensure that they have

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[5] That the cost of Rate Court is low relative to the stakes is demonstrated by ASCAP's behavior in the Pandora Case. In December of 2012, ASCAP and Pandora negotiators had reached agreement on the terms of a license. ASCAP then decided at the last minute that the consequences for its relationship with some of the publishers if it agreed to the license would be adverse, and so it rejected the negotiated agreement and allowed the Rate Court proceeding to move forward instead, presumably with reasonable knowledge of what that would cost. *In Re Petition of Pandora Media, Inc.*, __ F.Supp.2d__, 2014 WL 1088101, *21 (S.D.N.Y. Mar. 14, 2014).

permission for all of the music performances they broadcast, but they do not have complete control or the information necessary to satisfy that obligation. A potential solution to this problem would be for the parties that do have the information and control regarding music in programming and commercials to secure music broadcast performance rights at the time the music performance is embedded in the programming. This could include the producers of syndicated programs, movies and commercials, all of whom already secure all of the other creative rights needed to create and broadcast the program. The value of the performance rights secured by producers for the benefit of subsequent broadcasters would be incorporated in the contracts or other economic arrangements that govern the broadcaster's use of the material. Broadcasters would still need to acquire the rights for the music in the programs that they produce themselves; in that regard they would then be performing the same function that other programming producers perform.

In this world, the cost of acquiring the right to perform music in broadcasts would be determined by competition among composers/publishers. If a producer wished to incorporate a musical work into a program, movie or commercial, it would contact the copyright owner, and together they would determine the terms and conditions (including the compensation to be paid, if any) under which that owner would permit the desired broadcast performances. The producer could then consider whether to incorporate the music under these terms and conditions, try to negotiate better terms, or not incorporate the music at all.

Note that, in this hypothetical competitive market, even though the copyright owner has an absolute monopoly on the right of performance in *her* work, the terms and conditions that are specified for the license of that right are subject to the forces of competition, at least to some degree. If the copyright owner (whether a composer writing new music or a publisher licensing previously-created works) sets the price too high, then the producer has the option of either substituting a different pre-existing work available on more favorable terms and conditions from a publisher or hiring a composer to create a new musical work for the contemplated program. Of course, if the producer is making a documentary about the Beatles, then it is unlikely to want to do so without using any Beatles music. If the producer is making a documentary about rock-and-roll in the 1960s, there are many different songs, available from a wide variety of copyright holders, that it could use. For local news broadcasts, there may be many composers available to write a news theme. Thus, competitive market forces would determine the market price for the right to broadcast each particular performance. The extent of discipline that this competition would impose would depend on the musical work and the circumstances of the performance, but the principle that competition exists would always be present.

This hypothetical competitive market for broadcast music performance rights would involve transaction costs. That is, programming producers and copyright owners would potentially have to expend time and/or money negotiating and then paying the fees. These costs would likely be passed on to the downstream

broadcasters, so that the cost of programming would be increased to reflect both the value of the performance rights conveyed by the copyright holders and the costs of acquiring those rights.

Of course, virtually all real markets involve transaction costs; the observation that transaction costs would exist cannot be taken to imply that a hypothetical market structure is necessarily impractical. A typical audiovisual program embodies multiple creative or artistic inputs, such as a script, visual images, acting, and direction. Many of these artistic elements also involve copyright rights, and hence, diverse permissions are necessary to broadcast a television program (including copyright performance rights other than those for musical compositions). Generally, the producer of an audiovisual program or commercial obtains, and conveys to the broadcaster, all of the rights needed for the broadcast of the program – with the sole exception of the right to perform the musical compositions publicly.

Indeed, the creation of audiovisual programs (including movies) or commercials already requires the program producer to interact with the owner or agent of any musical works used. Whether the music is specially composed for the program or not, incorporating it in an audiovisual recording requires the acquisition of the "synchronization" right for that musical work. This "sync" right is distinct from the performance right, but it is held by the same party that must grant the performance right. It is not obvious why also acquiring the closely related public performance right for the same musical composition at the same time would entail burdensome transaction costs.[6]

Movies shown on broadcast media require the acquisition of the public performance rights for the music in those broadcasts, and under current practice those rights are typically secured by the broadcaster through one of the PROs. As discussed above, the right to perform the music in the movie on television could be secured by the movie producer at the time the movie is made. In the case of movies, the feasibility of this potential arrangement is dramatized by the fact that the movie theaters also need to secure the right for the public performance of the movie music in their venues—and *this* public performance right is, in fact, secured by the producer at the time of production and then conveyed to the theaters. Effectuating competition for broadcast performance rights in movies would require only adding the broadcast performance right to the theater venue performance right (and sync right) already secured by movie producers at the time of production.

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[6] At the time a program is produced, the number of future performances of the program would be unknown, so any compensation for the right to make these future performances would have to reflect that uncertainty, either by paying a fixed sum based on expected performances, or offering contingent compensation based on future success. But this difficulty is also present for the other artistic components of the production, for which all of the necessary rights are typically acquired at the time of production on either a buy-out basis or based on the future success of the production.

The competitive market for the music performance rights in movie theaters was brought about in large measure by a private antitrust lawsuit. In *Alden-Rochelle Inc. v. ASCAP*, 80 F. Supp. 888 (S.D.N.Y. 1948), operators of motion picture theatres challenged certain provisions of ASCAP's by-laws which prevented ASCAP's members from conveying music performance rights to movie producers, forcing theaters to take a blanket license for music performance rights which were not available from movie producers. A federal court concluded that ASCAP violated the antitrust laws and issued an injunction stopping ASCAP and its members from licensing music performance rights for performances in movie theaters to anyone but the movie producers. As a result, movie theaters do not need licenses to exhibit motion pictures; they pay for the music performances in their venues through the rental or other contracts they hold with movie distributors, and this compensation flows back through the distribution chain. Music creators and publishers are compensated for these performances as part of whatever contract they made with the movie producer.

The economics (including transaction cost considerations) of music performances in theaters and music performances in the broadcast of syndicated programs, movies and commercials are similar. (When I use the word "broadcast" in this sense, I mean any downstream exhibition of the audiovisual content, whether it be via broadcast, satellite, mobile, Internet or other means.) In both cases, the party making the performance (movie theaters in one case, broadcasters in the other) does not control the choice of music, but rather receives a pre-recorded set of musical choices. In both cases, the party making the audiovisual recording (who thereby does control the choice of music) is already negotiating at the time of production for other artistic rights, including other rights held by the same parties that hold the music performance rights. Thus, if it is the case that the licensing of public performances of music in all pre-recorded audio-visual programming can be handled in a workable unregulated competitive market like that which currently exists for licensing performances of music in movie theaters, then one should question the appropriateness of continuing to permit joint pricing in these media.

VI. Modification of the Consent Decrees to Allow Partial Withdrawal Should be Evaluated on the Basis of Its Likely Impact on Market Performance

ASCAP and BMI have proposed modifying the Consent Decrees so that music publishers could withhold their repertoires from collective licensing of particular potential licensees or classes of licensees. The Department should evaluate this proposal on the basis of its likely impact on market performance.

In the abstract, one could imagine that partial withdrawal would operate to increase competition and thereby improve market performance. The available evidence suggests, however, that the consequence of allowing partial withdrawal would be solely to allow publishers to exercise market power to increase performance

royalties. Given this, making this change would not be consistent with the underlying purpose of the Decrees.

As a threshold matter, it is important to note that under the existing Decrees, publishers are entirely free to negotiate directly with music users any license agreements they wish. Of course, in the current framework, any music user considering such a direct license will evaluate it with the knowledge that the licensee has the alternative of relying instead on the PRO license. The reason the publisher might wish to withdraw from the PRO before entering into negotiation over a direct license is that the PRO alternative weakens the publisher's bargaining power in the negotiation.

But consider more precisely the nature of the economic constraint PRO membership places on a direct-license negotiation. The potential licensee knows that it has access via the PROs to licenses that are supposed to reflect "reasonable" royalties, although the only mechanism available to the licensee to ensure that the royalties are indeed reasonable is the Rate Court, which the PROs and publishers complain is expensive and time-consuming. Logically this implies that any publisher that offers a potential licensee a direct license on "reasonable" terms could plausibly expect that such an offer would be accepted. It would be as good as the licensee should expect to get from the PROs, without the possibility of the cost of Rate Court. This suggests as a logical matter that the goal of partial withdrawal is to remove from the negotiating equation the licensee's access to reasonable royalties, so that royalties higher than the reasonable level can be extracted.[7]

A. Framework for analysis of market power in licensing of music performance rights

In determining whether permitting partial withdrawal is consistent with the purposes of the Consent Decrees, it will be important to analyze the consequences for competition in the licensing of musical works performance rights. The nature of music licensing, particularly on broadcast media, is such that even a relatively small share of the overall music library can make a seller's/ licensor's license essential or close to it. This results from the fact that there are circumstances in which licensees have little or no control over what music is actually performed, and the statutory

[7] At least some publishers appear to be claiming that the Rate Court imposes music performance royalties that are below the reasonable level, although the only evidence they have presented to support this complaint is that music composition performance royalties are substantially below sound recording performance royalties. If it were, in fact, the case that the Rate Court is systematically setting composition performance royalties below the reasonable level, then the appropriate solution to that problem is to change Rate Court procedures or criteria to address it. Allowing partial withdrawal is not a logically appropriate solution if the fundamental problem lies in the decisions that the Rate Courts are making.

penalties for even accidental infringement can be large. This background is vital to understanding the consequences of partial withdrawal.

The first question to analyze is the extent to which multiple withdrawn publishers might effectively compete against each other and the PROs in licensing music performance rights. For this to occur, it would have to be the case that the blanket license of one could substitute, at least to some degree, for the blanket license of the others. At a minimum, for broadcast licensees with limited or no control over the music they broadcast, this is not the case. In order to function, such a broadcaster must have a license to publicly perform music from the repertories of each of these organizations. The reason is that a blanket license from one publisher or PRO protects the station only against the possibility of infringement of that licensor's compositions. Since so much of the broadcaster's programming is pre-recorded, and they are responsible for the music performances in commercials and for programs for which they do not know the identity of the music and/or are not contractually permitted to edit/replace the musical works embedded in the programming, it is not possible for such a broadcaster to limit its music performances to compositions licensed by a few publishers or PROs.

SESAC controls a repertory that is comparable to or smaller than the repertory of a major music publisher. For the ongoing private antitrust litigation filed by a group of local television stations against SESAC, I prepared an analysis of the relevant antitrust market and SESAC's market power in that market. I found that the relevant market is the set of titles in the SESAC repertory, and because SESAC faces no competition from ASCAP or BMI, and, because of its anticompetitive practices, faces no competition from invidiual music rightsholders in its efforts to license that repertory; that SESAC holds literally a 100% market share in that market (no station operates without a SESAC blanket license); and that SESAC holds considerable monopoly power in the market because stations cannot operate without a SESAC license because, without a license, they cannot avoid infringing.

Although that litigation is ongoing, Judge Engelmayer has issued a decision dealing with SESAC's motion for summary judgement, and in that context he favorably cited all of the above-expressed opinions about the relevant market and SESAC's market power in it. *Meredith Corp., et al. v. SESAC, LLC*, 09 Civ. 9177 (PAE), __ F.Supp.2d __, 2014 WL 812795, **31-32, 36 (S.D.N.Y. Mar. 3, 2014). Although I have not undertaken this analysis for any individual publisher, and the conclusions would depend to some extent on the nature of the licensees against whom withdrawal were invoked, these results should provide a cautionary background for the analysis of the competitive consequences of partial withdrawal. Certainly, market shares calculated as a publisher's share of all music titles cannot be used naively as indicators of market power; depending on the context, a publisher with even a relatively small share of all titles may have the equivalent, for market power analysis purposes, of a 100% market share.

B. Evidence on likely consequences of partial withdrawal

In analyzing the likely consequences of partial withdrawal, it should be assumed that if partial withdrawal is allowed at the discretion of the publisher, it will be invoked only if the publisher expects it to result in increased profits. Conceptually, such an increase could come from one of three sources:

(1) the publisher could expect that it could negotiate a license with terms such that it would increase its share of the total royalties paid by a licensee or licensees (at the expense of other publishers);

(2) the publisher could expect that it could operate the licensing arrangement more efficiently than the PRO, and hence increase its *net* proceeds for a given royalty level; or

(3) the publisher could expect to use its market power to increase royalties over the "reasonable" level to be expected in a PRO license.[8]

To the extent that publisher motivation for partial withdrawal were driven by the first two considerations, market performance would be improved, so that permitting it could be seen to be consistent with the underlying purpose of the Decrees. To the extent, however, that the publisher motivation derives from the third source, permitting partial withdrawal undermines the Decrees.

There is considerable evidence that publishers do not intend to use partial withdrawal to compete for share or to reduce costs, but rather they see it as a vehicle for using their market power to increase royalties. The evidence derives from their actions and their statements during the period of time in which partial withdrawal was implemented by the PROs, before it was found to be inconsistent with the current Consent Decree language.

Consider first the theoretical possibility that a publisher might wish to withdraw in order actively to compete for a larger share of music performances and thereby increase its music royalties. Note first that as a conceptual matter, withdrawal from the PRO is not a necessary step in this strategy. If a publisher wishes to deviate from the collusive royalty level to compete for market share, it can do so without withdrawing. It would be, by assumption, offering royalty terms *better* than those offered by the PRO, so its continued membership in the PRO would not have an impact on a licensee's willingness to agree to a direct license.

The behavior of the publishers who did partially withdraw from ASCAP also makes clear that this was not about some kind of competition for share. In particular, both Sony/ATV and UMPG, when in negotiations with Pandora over a music performance

[8] As discussed above, if the Rate Courts are setting royalties below the "reasonable" level that problem should be addressed directly, so that theoretical possibility should not be considered in evaluating the proposal to allow partial withdrawal.

license outside of ASCAP, refused to provide Pandora with an electronic list of their titles.[9] *In Re Petition of Pandora Media, Inc.*, _ F.Supp.2d_, 2014 WL 1088101, **24, 27-28 (S.D.N.Y. Mar. 14, 2014). It is hard to imagine a seller in a workably competitive market believing that they could get away with negotiating to sell their product while actively concealing from the potential buyer the exact nature of the product to be purchased. Certainly, a seller that is trying to increase share at the expense of competitors would not behave in this way.

The publishers' behavior is also inconsistent with their desiring partial withdrawal to reduce costs. On the contrary, after withdrawal, ASCAP's largest publishers, namely each of EMI, Sony/ATV and UMPG, reached agreements with ASCAP so that ASCAP could continue to administer the collection and distribution of royalties from any licenses these "withdrawing publishers" concluded with Pandora or other affected licensees. *Id.* at *17. So that was not the reason.

In the end, there is no mystery about what the publishers sought and what they got. They induced Pandora to agree to a higher royalty rate because it could not rid itself of their music, or could do so only at great cost. Sony/ATV's Martin Bandier bragged that "Sony had leveraged its size to get this 25% increase in rate." *Id.* at *25.

ASCAP anticipated that the benefit of the higher royalties extracted via the publishers' market power would not be limited to Pandora. As stated by Judge Cote:

> The publishers found an ally on this issue in writer and ASCAP chairman [Paul] Williams, who agreed with the new media rights withdrawal strategy. His email illustrates the strategy he pursued to get writers to support the publishers' partial withdrawal of rights from ASCAP: My job is to make this transition as smoothly as possible in the board room ... to assuage the fears of the writers who may see this as an ASCAP death knoll ....[W]e are in fact giving [the major publishers] the right to negotiate. The end result being that *they will set a higher market price which will give us bargaining power in rate court. Id.* at *16 (emphasis added).

ASCAP agreed to grant the publishers the right of partial withdrawal at least in part because it anticipated that the publishers' market power would allow them to extract higher royalties, and that those higher royalties could in turn be used as benchmarks to achieve higher royalties for other rightsholders. Indeed, the evidence in the Pandora/ASCAP case referenced by Judge Cote indicated that ASCAP did not even consider charging a lower price than that achieved by withdrawing publishers in order to drive greater volume of use of the repertory of remaining works licensable by ASCAP – thus confirming that ASCAP was not competing (nor

[9] UMPG, after initial refusal, eventually provided a list, but only under a Non-Disclosure Agreement that explicitly prohibited Pandora from using the list to modify its programming.

intending to compete) over price with the withdrawing publishers, as Judge Cote noted. *Id.* at *35.

Thus the actual experience with partial withdrawal allows us to resolve the theoretical ambiguity as to what its impacts might be. As summarized by Judge Cote:

> The publishers believed that AFJ2 stood in the way of their closing this gap [referring to the gap between the musical works performance royalty and the sound recording royalty]. They believed that because the two PROs were required under their consent decrees to issue a license to any music user who requested one, they could not adequately leverage their market power to negotiate a significantly higher rate for a license to publically perform a composition. *Id.* at *14.

The Department should reject modification of the Consent Decrees to allow partial withdrawal because the evidence shows clearly that the motivation for partial withdrawal, and its likely consequence, is enhancement of market power.

VII. If Partial Withdrawal is to be Permitted, Conditions Should be Imposed to Mitigate the Likely Increase in Market Power

For the reasons explained above, allowing partial withdrawal is likely to increase market power and drive music performance royalties further above the competitive level. If, however, the Department nonetheless decides to agree to modify the Decrees in this direction, it should impose conditions that could partially mitigate the adverse consequences.

First, the PROs should make continuously available on the web an electronic listing of the repertoire that has been withdrawn, and any works not so listed should be deemed to remain licensable by the PROs, so as to limit the ability of the withdrawn publishers to use uncertainty as to the works in their repertories to enhance their market power. The publishers have demonstrated their inclination to use such uncertainty to enhance their market power, and this should not be permitted.

Second, although the desire for partial withdrawal seems to have emerged from publishers' desire to extract greater royalties from a specific class of licensees, if the right is granted it is not clear that it would be invoked only in that context. If the Department were to consider allowing partial withdrawal, the PROs and publishers should be asked to articulate the characteristics of potential licensees for which they believe allowing partial withdrawal furthers the purposes of the Consent Decrees. Of particular concern in this regard is that withdrawal should not be structured so that it could be used with respect to licensee categories that have minimal control over the choice of the music that is performed.

Third, depending on the definition of the licensees with respect to which partial withdrawal might be permitted, it may become necessary to specify that partial withdrawal should not be permitted to be effective with respect to incidental music uses (for example, music in commercials) and ambient music uses (music heard in the background of live events). These performances are generally not under the control of the licensee, and so a licensee who does not have the back-up option of a PRO license would be in a position of essentially unavoidable infringement if they did not agree to a proposed license from a significant publisher. This would give that publisher unacceptable market power and clearly result in outcomes inconsistent with the Decrees.

Finally, as noted above, it is clear from their own statements that the PROs and publishers desire partial withdrawal in part so that higher royalties extracted by publishers with market power can then be used as benchmarks to raise the PRO royalty levels. Indeed, ASCAP has gone even further, arguing for "establishing an evidentiary presumption that direct non-compulsory licenses voluntarily negotiated by copyright holders who have withdrawn rights from a PRO and similar licensees provide the *best evidence* of reasonable rates." ASCAP Copyright Office Comments, at 4 (emphasis added). For the reasons discussed above, this is an outrageous suggestion, and one that was explicitly rejected by Judge Cote in the Pandora decision. In effect, ASCAP is asking to nullify both the reasoning and the outcome of the Cote decision, and this should not be permitted.