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Super-Statutory Contracting

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SUPER-STATUTORY CONTRACTING

Kristelia García*

Abstract: The conventional wisdom is that property rules induce more—and more efficient—contracting, and that when faced with rigid property rules, intellectual property owners will contract into more flexible liability rules. A series of recent, private copyright deals show some intellectual property owners doing just the opposite: faced with statutory liability rules, they are contracting for more protection than that dictated by law, something this Article calls “super-statutory contracting”—either by opting for a stronger, more tailored liability rule, or by contracting into property rule protection. Through a series of deal analyses, this Article explores this counterintuitive phenomenon, and updates seminal thinking on property entitlements and private ordering in the intellectual property context.

While law and economics scholars have long grappled with the question of whether and when property rules or liability rules are preferable, they have traditionally ignored a key lever: “perceived control,” or a rights holder’s impression of their ability to grant or withhold permission to use their work, and/or to name their price for such use. In addition to proposing a recalibration of the relative importance of consolidation, transaction costs, defaults, and damages, this Article identifies and describes perceived control as an essential factor in the licensing enterprise. This has significant implications for legislators and policymakers seeking to better align incentives between licensors and licensees, and for administrators tasked with term and rate setting.

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INTRODUCTION

In his influential article on collective rights organizations, Rob Merges concluded that when faced with stringent property rules, intellectual property (IP) owners will contract into more tractable liability rules.¹ A series of recent, private copyright deals show IP owners doing just the opposite: faced with statutory liability rules, they are contracting for *more* protection than that dictated by law, a phenomenon this Article calls “super-statutory contracting”—either by opting for a stronger liability rule, or by contracting into property rule protection.² This Article explores why.

In many ways, intellectual property functions as the name suggests—like a property regime, operating under a series of property rules that afford IP owners a qualified right to exclude others from use of their

1. Specifically, via formation of collective rights organizations (CROs). See Robert P. Merges, *Contracting into Liability Rules: Intellectual Property Rights and Collective Rights Organizations*, 84 CALIF. L. REV. 1293 (1996).

2. Private parties cannot technically create legal rules; in other words, they can adopt property-like terms, but cannot obligate a court to grant the quintessential property remedy (an injunction). For this reason, I use the term “property rule protection” throughout this Article to refer to property rule-like protection.

property.³ One defining characteristic of property (as that term is used herein) is that its use by someone other than its owner requires prior permission and ex ante negotiation of terms. In the case of copyright, section 106 of the Copyright Act of 1976 (hereinafter, the Copyright Act), outlines the principal property rights of a copyright owner, including, among other things, the exclusive rights to reproduce, distribute, and publicly perform a copyrighted work.⁴

Notwithstanding this property right baseline, intellectual property law—and copyright law in particular—have become increasingly regulatory in practice.⁵ A regulatory regime can be characterized by its use of liability rules. In contrast to a property regime, a liability regime allows for use of another’s property without permission, and with ex post payment. This move away from traditional property rules and toward a regime of liability rules is reflected throughout the current copyright statute: The Copyright Act contains six explicit compulsory licenses covering everything from cable transmissions to the public performance of sound recordings.⁶ These statutory licenses permit use of a copyrighted work under specified circumstances without permission of the copyright owner. The statutory rates for these uses are set by the Copyright Royalty Board (the CRB), a panel of three administrative judges appointed by the Librarian of Congress.⁷

Other statutory sections of the Copyright Act also resonate in a liability

3. See, e.g., *Kaiser Aetna v. United States*, 444 U.S. 164, 179–80 (1979) (“[W]e hold that the ‘right to exclude,’ so universally held to be a fundamental element of the property right, falls within this category of interests [that the government must pay to take.]”); see also, e.g., Richard A. Epstein, *Liberty Versus Property? Cracks in the Foundation of Copyright Law*, 42 SAN DIEGO L. REV. 1 (2005) (examining the natural law justifications for copyright as property); Adam Mossoff, *Is Copyright Property?*, 42 SAN DIEGO L. REV. 29 (2005) (making a Lockean argument for treating copyright as property).

4. See 17 U.S.C. § 106(1)–(6).

5. See, e.g., Joseph P. Liu, *Regulatory Copyright*, 83 N.C. L. REV. 87, 91–92 (2004) (describing regulation as “the dominant mode of copyright lawmaking”); Mark A. Lemley, *The Regulatory Turn in IP*, 36 HARV. J.L. & PUB. POL’Y 109, 115 (2013) (observing a “turn in IP . . . towards a regulatory state”); Peter S. Menell, *Envisioning Copyright Law’s Digital Future*, 46 N.Y.L. SCH. L. REV. 63, 194–97 (2002) (describing copyright’s shift from property regime to regulatory regime). But see BJ Ard, *More Property Rules than Property? The Right to Exclude in Patent and Copyright*, 68 EMORY L.J. 685 (2019) (suggesting property rules are more prevalent in IP than in property law).

6. See, e.g., 17 U.S.C. §§ 111, 114 (establishing compulsory licenses for cable transmissions and the public performance of sound recordings, respectively). The other statutory licenses are included in sections 112 (ephemeral recordings); 115 (making and distributing phonorecords; note, the Music Modernization Act (MMA), effective 2021, makes significant changes to, but does not eliminate, the section 115 compulsory license); 119 (secondary transmissions for satellite carriers); and 122 (secondary transmissions by satellite carriers for local retransmissions).

7. *Id.* § 801.

rule approach⁸: For example, section 109 allows a lawful owner to sell, lease, or lend a copyrighted work without permission of the copyright holder.⁹ Section 107 outlines several categories of use in which a copyrighted work may be used without permission.¹⁰ Section 110 exempts certain performances and displays of copyrighted material from infringement, again without permission from the copyright owner.¹¹

In contrast, private ordering in the copyright space has followed a surprising trajectory in the opposite direction, toward super-statutory terms and protections. The debate over the desirability of property rules versus liability rules has a long and illustrious history in the literature.¹² So too does the application of property rules and liability rules in the intellectual property context. Starting with the canonical work of Guido Calabresi and Douglas Melamed—in which they coined the terms “property rules” and “liability rules” as used herein¹³—and continuing with IP-specific application by Robert Merges,¹⁴ Phil Weiser, Mark Lemley,¹⁵ and others—transaction costs play a central role in the debate over which regime is more efficient in a particular context.

In his seminal work on the subject, Merges describes how the granting

8. The statutory exceptions listed in this paragraph can all be said to have an implicit price of zero. There is some debate—orthogonal to the argument made herein—regarding whether anything that is not a property rule (i.e., anything that does not deter a taking) is a liability rule, or whether, in order to qualify as a liability rule, an owner must be compensated for the taking. My use herein is the former.

9. 17 U.S.C. § 109.

10. *Id.* § 107. Some commentators have suggested that these exceptions, commonly referred to as the fair use doctrine, can be thought of as a statutory license with a set price of zero. *See, e.g.*, Trotter Hardy, *Property (and Copyright) in Cyberspace*, 1996 U. CHI. LEGAL F. 217, 233 (“Fair use . . . can be seen as a kind of compulsory license—albeit one for which the payment required is exactly zero dollars.”).

11. 17 U.S.C. § 110.

12. There exists in the literature an ongoing tension between property scholars, on the one hand, and law and economics scholars on the other hand, over the lack of continuity between the idea of property *qua* property, and property rules. *See, e.g.*, Thomas W. Merrill & Henry E. Smith, *What Happened to Property in Law and Economics?*, 111 YALE L.J. 357 (2001) (lamenting the demise of in rem property in favor of an in personam view made popular by the law and economics literature). While law and economics scholars tend to conflate the terms, property scholars generally maintain that the fact that a thing is protected by a property rule doesn’t necessarily mean that the underlying thing is a property right. For example, specific performance is a property rule, but “specific performance” does not constitute property. In other words, property rules build on—but are distinct from—property rights, and the term “property rules” is primarily reserved for discussion of remedies. This distinction is well-taken, but is also orthogonal to my principal claim, for which purpose I adopt the law and economics approach, and herein use the terms “property,” “property regime,” and “property rules” more or less interchangeably.

13. Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1092 (1972).

14. *See* Merges, *supra* note 1.

15. Mark A. Lemley & Philip J. Weiser, *Should Property or Liability Rules Govern Information?*, 85 TEX. L. REV. 783, 784 (2007).

of strong property rights in intellectual property may lead stakeholders to voluntarily enter into liability rights regimes in the form of collective rights organizations.¹⁶ This in turn minimizes transaction costs by consolidating content, and with it, bargaining power.¹⁷ In a subsequent piece, Mark Lemley showed that while “parties can contract around inefficient property rules in IP cases . . . they can—and do—contract around inefficient liability rules as well.”¹⁸ The case analyses in this Article confirm this observation, and offer insight as to both the impetus for, and the result of, such contracting.

In their work on legal entitlements, Ian Ayres and Eric Talley challenge the convention that property rules always lead to more (and more efficient) contracting, arguing that where transaction costs are positive—but not prohibitive—poorly-tailored liability rules may actually encourage more bargaining.¹⁹ The reason, they suggest, lies in liability rules’ “information-forcing” quality; i.e., “liability rules may actually *facilitate* trade by reducing the effective amount of private information.”²⁰ This Article describes a trend that runs counter to the received wisdom on property versus liability rules in intellectual property, and supports the theory advanced by Ayres and Talley; namely, that a default of poorly-tailored liability rules can lead to more (and more efficient) contracting.

To demonstrate this proposition, this Article presents a series of recent, voluntary copyright agreements that opt for a stronger liability rule, or for property rule protection, despite the existence of a statutory liability rule default. This is interesting for a number of reasons, not least of all because the conventional justification for compulsory licensing is that it lowers transaction costs (many of which result from asymmetrical information) and alleviates potential bottlenecks. The interesting twist—and this Article’s primary contribution—is that this private ordering tends to result in more protection than that dictated by statute. This Article proposes that the impetus for this shift is a transfer of perceived control to the party who values it most.

The tendency toward super-statutory contracting in copyright—a regime based largely on liability rules—counters the conventional wisdom that property rules induce more (and more efficient) contracting by showing that liability rights can prompt stakeholders to voluntarily

16. See Merges, *supra* note 1, at 1296.

17. *Id.* at 1294.

18. Mark A. Lemley, *Contracting Around Liability Rules*, 100 CALIF. L. REV. 463, 464 (2012).

19. Ian Ayres & Eric Talley, *Solomonic Bargaining: Dividing a Legal Entitlement to Facilitate Coasean Trade*, 104 YALE L.J. 1027, 1033 (1995).

20. *Id.* at 1036–38 (emphasis in original).

enter into agreements with property right protections.²¹ This signifies a counterintuitive relinquishment of licensees' rights in order to put more perceived control into the hands of licensors.

The analysis of this phenomenon proceeds as follows: Part I offers an overview of the literature on property rules and liability rules, and their intersection with intellectual property. Part II outlines both the property rule and liability rule features of the current copyright regime. Part III describes a series of recent, private copyright deals in order to demonstrate how each marks an explicit move *away* from liability rules and *toward* property rules. Part IV discusses the implications of this counterintuitive shift. The Article concludes with thoughts on the future of public law and private ordering in copyright, and a call for appreciation of the central role that perceived control plays in licensing negotiations.

I. THEORY

The scholarly thought around property rules and liability rules, and their application to intellectual property, is perhaps best understood through the lens of transaction costs. Beginning with Coase and a world with perfect bargaining, this Part traces the theoretical evolution by varying level of transaction costs, then considers the intersection with intellectual property.

A. *Property Rules, Liability Rules, and Transaction Costs*

A natural starting point for the discussion of property and liability rules, the Coase Theorem holds that in a world with no transaction costs, property will go to its highest and best use through private negotiation, such that it doesn't matter who is granted the entitlement initially.²² Coase's seminal example describes a farmer and a rancher and a single plot of land in a world in which either the farmer can plant their crops or the rancher can graze their cattle, but not both.²³ In the absence of transaction costs, Coase posits that it doesn't matter which party is given the initial entitlement to the land; whichever party values the use most will

21. This temporal shift from a (public) liability rule to a (private) property rule arguably exemplifies the concept of a dynamic property entitlement known as a "pliability rule." See Abraham Bell & Gideon Parchomovsky, *Pliability Rules*, 101 MICH. L. REV. 1, 5 (2002) (defining pliability rules as "contingent rules that provide an entitlement owner with property rule or liability rule protection as long as some specified condition obtains; however, once the relevant condition changes, a different rule protects the entitlement—either liability or property, as the circumstances dictate. Pliability rules, in other words, are dynamic rules . . .").

22. See R. H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960).

23. *Id.* at 2.

simply pay the other party for exclusive use of the land and everyone will be better off. The end result—and Coase’s goal for property distribution—is that the property will be put to its highest and best use.

Of course, a world with no transaction costs is “a very unrealistic assumption,” as Coase himself recognizes.²⁴ Sometimes, “the cost of establishing the value of an initial entitlement by negotiation is so great that even though a transfer of the entitlement would benefit all concerned, such a transfer will not occur.”²⁵ In the real world, parties incur expenses associated with determining who holds an entitlement and figuring out how to contact that person, followed by the engagement of a lawyer and perhaps a land surveyor, a title search, etc. The level of transaction costs varies from transaction to transaction, and impacts the relative desirability of property rules versus liability rules when it comes to ensuring completion of a transaction that will put the property to its highest and best use.

In their seminal work, Calabresi and Melamed articulate three rules for governing entitlements: property rules, liability rules, and inalienability rules.²⁶ Each of these regimes involves some level of state intervention when it comes to enforcement, but the level of such intervention varies from regime to regime.

Calabresi and Melamed describe property rules as requiring that “someone who wishes to remove [an] entitlement from its holder must buy it from him in a *voluntary* transaction in which the value of the entitlement is agreed upon *by the seller* . . . the state does not try to decide its value.”²⁷ According to Calabresi and Melamed, property rules require the least amount of state intervention because once the original entitlement is bestowed, the state’s role is done.²⁸ It’s all private ordering from that point forward.

Liability rules, on the other hand, govern “[w]henver someone may destroy the initial entitlement if he is willing to pay an *objectively determined value* for it.”²⁹ Liability rules require more state intervention than property rules because the state must not only bestow the original entitlement, but then must also engage in value-determination.³⁰ In other

24. *Id.* at 15.

25. Calabresi & Melamed, *supra* note 13, at 1106.

26. *Id.* at 1089.

27. *Id.* at 1092 (emphasis added).

28. *Id.*

29. *Id.* (emphasis added).

30. *Id.* The third rule for governing entitlements, inalienability, is implicated where “transfer is not permitted between a willing buyer and a willing seller.” *Id.* Entitlements governed by inalienability

words:

[M]uch of what is generally called private property can be viewed as an entitlement which is protected by a property rule. No one can take the entitlement to private property from the holder unless the holder sells it willingly and at the price at which he subjectively values the property. Yet a nuisance with sufficient public utility to avoid injunction has, in effect, the right to take property with compensation. In such a circumstance the entitlement to the property is protected only by what we call a liability rule: an external, objective standard of value is used to facilitate the transfer of the entitlement from the holder to the nuisance.³¹

Calabresi and Melamed explain the shift from a default of property rules to the adoption of liability rules as owing to economic efficiency; namely, the reduction (or, in some cases, elimination) of transaction costs.³² In other words, liability rules can help efficient transfers happen where prohibitively high transaction costs might otherwise prevent them. Recent scholarship has served to further advance the idea that strong property rights are not a prerequisite for efficient exchange.³³

In practice, most markets operate somewhere between Coase's world with no transaction costs and Calabresi and Melamed's world of prohibitive transaction costs. In this economic purgatory—where transaction costs are positive but not prohibitive—conventional wisdom holds that property rules are preferable when transaction costs are low, presumably because those costs can be more readily overcome and bargaining can ensue. Property rules are also understood to encourage bargaining because their existence puts parties on notice that they need to do so.³⁴ Conversely, as transaction costs increase, liability rules are

rules—including such things as law licenses and kidneys—are not relevant for the purposes of this Article.

31. *Id.* at 1105–06.

32. *See id.* at 1127 (acknowledging the potential for distributional reasons as well, though these seem to play a smaller and less frequent role, particularly in the IP context).

33. *See, e.g.,* Oren Bar-Gill & Nicola Persico, *Exchange Efficiency with Weak Ownership Rights*, 8 AM. ECON. J. 230, 253 (2016) (arguing that whether property rules have an efficiency advantage when transaction costs are positive is “far from clear”); Daniel Markovits & Alan Schwartz, *Who Owns What? Re-Thinking Remedies in Private Law* 14 (Jan. 17, 2019) (unpublished manuscript) (on file with author) (suggesting that “weak property rights sometimes are more efficient than strong ones”).

34. *See, e.g.,* RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 57 (4th ed. 1992) (stating that “[in settings with low transaction costs], the law should require the parties to transact in the market; it can do this by making the present owner’s property right absolute (or nearly so), so that anyone who thinks the property is worth more has to negotiate with the owner”); Richard Craswell, *Property*

preferable as a means of overcoming transaction costs and allowing for completion of a transaction that might otherwise not take place.³⁵

From an efficiency standpoint, one of the most significant transaction costs is private information. Each side knows their own valuation of the property in question, but not that of the other party. In their work on the division of legal entitlements to property, Ian Ayres and Eric Talley challenge the conventional wisdom by proposing that liability rules—due to their “information-forcing” quality—may induce both more, and more efficient, contracting than property rules.³⁶ Thus, instead of viewing liability rules in their traditional role of “market-mimicking,” Ayres and Talley propose a conception of liability rules as “market catalysts,”³⁷ a role conventionally assigned to property rules.

Importantly, their analysis specifically contemplates *untailored* liability rules—i.e., rules under which the licensee pays a fixed amount upon use of the property, notwithstanding the property owner’s actual valuation. Where an entitlement is protected by an untailored liability rule, they argue, the property owner is encouraged to reveal private information regarding the property’s value by either (i) bribing the prospective user not to take advantage of the liability rule; or by (ii) offering the property at some price less than the statutory amount. Property owners who opt to bribe signal a valuation above the statutory rate, while property owners who choose to offer signal a valuation below the statutory rate.³⁸

Rules and Liability Rules in Unconscionability and Related Doctrines, 60 U. CHI. L. REV. 1, 1–15 (1993) (applying the conventional view in the contract context).

35. See Craswell, *supra* note 34, at 1–15. *But cf.* James E. Krier & Stewart J. Schwab, Essay, *Property Rules and Liability Rules: The Cathedral in Another Light*, 70 N.Y.U. L. REV. 440, 455 (1995) (questioning the conventional wisdom, and determining that “when (a) assessment costs promote inaccurate damage awards by the judge, and (b) bargaining between the parties is at the same time impeded by transaction costs, there is no a priori basis for favoring liability rules over property rules. If (a) and (b) are the real-world conditions—and we think they regularly are—then the conventional preference for liability rules makes no sense.”). For a comprehensive analysis of the Krier-Schwab take on Calabresi-Melamed, see Saul Levmore, *Unifying Remedies: Property Rules, Liability Rules, and Startling Rules*, 106 YALE L.J. 2149 (1997).

36. Ayres & Talley, *supra* note 19, at 1032.

37. *Id.* at 1033.

38. *Id.* at 1038. In a published response to Ayres and Talley, Louis Kaplow and Steven Shavell take issue with the characterization of liability rules as superior to property rules when it comes to facilitating bargaining. Louis Kaplow & Steven Shavell, *Do Liability Rules Facilitate Bargaining? A Reply to Ayres and Talley*, 105 YALE L.J. 221, 233 (1995). They note, for example, that parties may behave strategically to misrepresent their valuations. *Id.* at 233. Specifically, they argue that bargaining transacted under property rules leads to a greater increase in welfare, while gains from bargaining transacted under liability rules amount to mere wealth transfer. *Id.* at 229–30. In their reply, Ayres and Talley explain the divergence in view as a matter of consensual versus nonconsensual advantage. Ian Ayres & Eric Talley, *Distinguishing Between Consensual and Nonconsensual Advantages of Liability Rules*, 105 YALE L.J. 235 (1995). While all parties

B. *Property Rules, Liability Rules, and Transaction Costs in the Intellectual Property Context*

Information-forcing isn't the only justification for liability rules. In their work on the protection of information, Mark Lemley and Phil Weiser suggest that property rules are only useful if their remedy—namely, injunctive relief—can be effectively enforced.³⁹ “In the case of many technology markets, the inability to tailor injunctive relief so that it protects only the underlying right rather than also enjoining noninfringing conduct provides a powerful basis for using a liability rule instead of a property rule.”⁴⁰ Despite this endorsement, liability rules present unique challenges in the intellectual property context, as the rest of this section outlines.

The trouble with liability rules, as Calabresi and Melamed acknowledge, is the potential for the collectively-determined value to result in over- or under-compensation.⁴¹ In other words, liability rules are presumed efficient only where the rate-setting body has complete information; this is rarely the case.⁴² The problem of incomplete information is especially acute—or at least especially acutely complained about—in the IP context, where the establishment of liability rules has often occurred simultaneously with the establishment of a new market such that there is no opportunity for a true market rate to emerge.

The ongoing battle over the licensing of public performance rights is illustrative of this point. As of this writing, the rate for public performance royalties for musical compositions is set by performing rights organizations (PROs) such as the American Society of Composers, Authors, and Publishers (ASCAP) and Broadcast Music, Inc. (BMI), both of which are currently governed by consent decree.⁴³ By definition, a

acknowledge a nonconsensual advantage, or “head start,” afforded liability rules, Ayres and Talley maintain that other factors in the bargaining process play just as important (and possibly more important) a role, such that this advantage does not negate their thesis. *Id.* at 237–38.

39. See Lemley & Weiser, *supra* note 15, at 784.

40. *Id.*

41. Calabresi & Melamed, *supra* note 13, at 1108 (noting that in many cases “it is so hard to determine . . . true valuation” that a statute may simply assign an objective value “in the full knowledge that this may result in over or under compensation”). In his work on the structure of legal entitlements, Ian Ayres proposes several new types of liability rules that aim to reduce the risk of over- and under-compensation. See IAN AYRES, *OPTIONAL LAW: THE STRUCTURE OF LEGAL ENTITLEMENTS* 39–100 (2005).

42. Kaplow and Shavell note that so long as the estimate is unbiased, liability rules can still be more efficient than property protection, notwithstanding incomplete information. See Kaplow & Shavell, *supra* note 38.

43. ASCAP's original consent decree is *United States v. ASCAP*, [1940–1943] Trade Cas. (CCH)

market rate is determined in a market. Because of the existence of the consent decrees—which act like liability rules in dictating ex ante the terms and conditions under which licensing can take place—there is no market (in the economic sense) for the licensing of public performance rights. There never has been a market, and there can't be one unless and until the consent decrees are revoked in their entirety (an unlikely, and arguably undesirable, scenario).

This means that we don't know what the market rate is, or should be, for public performance royalties for musical compositions. To illustrate, consider the following series of events, both of which happened within months of each other during 2012–2013: First, music publishers Sony/ATV and UMPG withdrew their digital (but not analog) public performance rights from ASCAP, at which point the publishers approached internet radio service Pandora and privately “negotiated” an alleged “market rate” nearly double ASCAP's going rate.⁴⁴ If Pandora is to be believed, this rate was supra-competitive, and was obtained via thinly-veiled threat and coercion.⁴⁵ When music publisher BMG Chrysalis attempted the same withdraw-and-negotiate maneuver, Pandora removed BMG's content from its service until a much lower rate was agreed upon. If BMG is to be believed, this rate was sub-market, and was obtained via starve-out tactics on behalf of Pandora.⁴⁶

So which account is accurate? Since we don't have a market rate for public performance rights, we don't know if we have a supra-competitive rate, or a sub-market rate. The only way to eventually determine a market rate for public performance royalties is to do away with the consent decrees entirely—a decision which presents a number of concerns, including the potential to deny direct payments to artists, and the potential for powerful publishing companies to block entry of new streaming services.⁴⁷ Moreover, the incentive theory of copyright suggests that we grant creators a “monopoly” over their work in order to encourage more

¶ 56,104 (S.D.N.Y. 1941). BMI's is *United States v. BMI*, [1940–1943] Trade Cas. (CCH) ¶ 56,096 (E.D. Wis. 1941).

44. *In re Pandora Media, Inc.*, 6 F. Supp. 3d 317, 331, 348–49 (S.D.N.Y. 2014), *aff'd sub nom.* *Pandora Media, Inc. v. ASCAP*, 785 F.3d 73 (2d Cir. 2015).

45. Ed Christman, *Pandora and BMI Wrap Up Arguments, Await a Big Decision*, BILLBOARD (Mar. 17, 2015), <https://www.billboard.com/articles/business/6502302/bmi-rate-court-arguments-close> [<https://perma.cc/4YR8-4B8N>].

46. Ed Christman, *Pandora v. BMI's Court Battle Reveals Long-Term Strategies, Licensing Aims*, BILLBOARD (Feb. 17, 2015), <https://www.billboard.com/biz/articles/news/legal-and-management/6473036/pandora-vs-bmis-court-battle-reveals-long-term> [<https://perma.cc/Z8G4-MPXG>].

47. See Ed Christman, *Dept. of Justice Considering Major Overhauls on Consent Decrees, Sources Say*, BILLBOARD (Apr. 7, 2015), <https://www.billboard.com/articles/business/6524359/dept-of-justice-consent-decrees-overhaul-publishing-ascap-bmi> [<https://perma.cc/4RV9-RGNL>].

(not necessarily “better”) creation.⁴⁸ Despite centuries of debate, we still don’t know what the “right” level of incentivization is.⁴⁹

This example from the world of music publishing illustrates the special challenge to liability rules in IP: they are particularly subjective and poorly-tailored. While Calabresi and Melamed use examples of pollution and criminal sanctions to support their framework, later work has applied their theory in the IP context. Most notably, Merges’s influential work on collective rights organizations concludes that in the IP context, property rules are preferable to liability rules because the strong protections afforded by a property regime will enable the formation of institutions—namely, collective rights organizations—that effectively operate *like a liability regime*: “property rule entitlements drive IPR [intellectual property rights] holders in high transaction industries into repeat-play bargaining which leads to the formation of CROs.”⁵⁰ These CROs are superior to compulsory licensing, he suggests, because “[i]n a CRO, knowledgeable industry participants set the rules of exchange. These rules are not likely to be uniform, one-size-fits-all terms as in a statutory compulsory license”⁵¹

In the same piece, Merges rejects Ayres and Talley’s conclusion (that liability rules may lead to more bargaining than property rules) in the IP context, calling IP “different,” and noting that, unlike the examples in their work, “[i]t would be extremely difficult in most cases for an intellectual property right holder to identify all potential infringers” and that “[o]nce word got out that people were being paid not to infringe a right, the number of people who suddenly showed an interest in infringing (and who therefore needed to be bought out in advance by the right holder) would skyrocket.”⁵² He also worries that “a liability rule in the intellectual property context will tend to act as a ceiling on valuation, allowing only for bargaining rule downward from the liability. . . . The state in effect sets the top entitlement price.”⁵³ In other words, his concern is that liability rules may systematically undercompensate copyright owners. This is arguably true, although perhaps less uniquely concerning where—as is

48. See, e.g., *Harper & Row, Publishers, Inc. v. Nation Enters.*, 471 U.S. 539, 558 (1985) (“By establishing a marketable right to the use of one’s expression, copyright supplies the economic incentive to create and disseminate ideas.”).

49. See, e.g., Kristelia A. García & Justin McCrary, *A Reconsideration of Copyright’s Term*, 71 ALA. L. REV. 351, 405–06 (2019) (suggesting that copyright’s term is not nearly as important as the strength and timing of protections).

50. Merges, *supra* note 1, at 1296.

51. *Id.* at 1295.

52. *Id.* at 1305.

53. *Id.*

often the case in IP—the liability rule may be circumvented.

In other work, Merges notes a “strong preference for injunctions—the classic instance of a property rule—in IPR law” as further support for a property rule preference in the IP context.⁵⁴ He also suggests that property rules are particularly well-suited “where unique assets [as he asserts IP is] are exchanged.”⁵⁵

The examples presented in Part III below confirm Merges’s preference for strong property rights in IP, but challenge his faith in collective rights organizations’ ability to best represent rights holders’ interests. As the examples demonstrate, prospective licensors and licensees in the copyright space no longer feel the need to negotiate blanket terms, but instead are now willing to strike one-off deals, and with terms that often extend *more* rights than the relevant statutory section requires. So what has changed? Among other things, Part III will show that lower transaction costs and a loss of faith in CROs’ ability to achieve the best rate has worked to erode licensors’ and licensees’ former affinity for liability rules. But first, the next Part will discuss copyright law’s increasingly regulatory nature.

II. PUBLIC COPYRIGHT LAW: A REGULATORY REGIME

As a form of intellectual property, copyright law is rooted in property principles. Section A outlines the primary sources of statutory property right entitlements in copyright. The last few decades have seen copyright take an increasingly regulatory turn. Section B discusses copyright law’s shift toward a liability rule regime.

A. *Property Rules in Copyright*

Section 106 of the Copyright Act lays out the exclusive property rights afforded a copyright owner; namely, the right to make and distribute copies, the right to make derivative works, and the right to publicly perform and display a work, including (in the case of sound recordings) public digital performance.⁵⁶ Section 106(A), added to the Copyright Act by the Visual Artists Rights Act of 1990 (VARA), is applicable only to visual works of art—such as paintings and sculptures—and adds two additional property rights: the right of attribution—or the right to claim

54. Robert P. Merges, *Of Property Rules, Coase, and Intellectual Property*, 94 COLUM. L. REV. 2655, 2655 (1994).

55. *Id.* at 2656, 2665–67 (referencing A. Mitchell Polinsky, *Resolving Nuisance Disputes: The Simple Economics of Injunctive and Damage Remedies*, 32 STAN. L. REV. 1075 (1980)).

56. 17 U.S.C. § 106(1)–(6).

authorship of a work (as well as the inverse right to remain anonymous)—and the right of integrity, which bars intentional mutilation or distortion of a work deemed to be “of recognized stature.”⁵⁷

Collectively, the rights enumerated in sections 106 and 106(A) form the basis for the consideration of copyright law as a property regime. In his work on the justifications for copyright, Richard Epstein has suggested that this position also finds support in natural law theory.⁵⁸ Adam Mossoff has likewise argued for copyright as property regime under a Lockean framework:

As Representative Gulian Verplanck stated in defense of a bill that became the Copyright Act of 1831: “[T]he work of an author was the result of his own labor. It was a right of property existing before the law of copyrights had been made.” State laws protecting intellectual property rights prior to the 1787 Federal Convention also reflected a Lockean influence. New Hampshire, to name but one example, enacted legislation to protect copyrights and other forms of intellectual property because “there being no property more peculiarly a man’s own than that which is produced by the labour of his mind.” Moreover, the evolution and creation of new types of intellectual property rights in the nineteenth century, such as trademarks and trade secrets, followed the contours of a labor theory of property. The initial definition and protection of trade secrets as property entitlements, for instance, derived its justification from the courts’ belief that such rights were similar to other property rights born of valuable labor and already protected by the law.⁵⁹

57. *Id.* § 106(A)(a)(3)(B) (stating that the author of a work of visual art shall have the right “to prevent any destruction of a work of recognized stature, and any intentional or grossly negligent destruction of that work is a violation of that right”). The scant case law on the topic has established the following two-part test for whether a work should be deemed “of recognized stature” for VARA purposes: “(1) that the visual art in question has ‘stature,’ i.e. is viewed as meritorious, and (2) that this stature is ‘recognized’ by art experts, other members of the artistic community, or by some cross-section of society.” *Carter v. Helmsley-Spear, Inc.*, 861 F. Supp. 303, 325 (S.D.N.Y. 1994), *aff’d in part, vacated in part, rev’d in part*, 71 F.3d 77 (2d Cir. 1995).

58. See Epstein, *supra* note 3; cf. Tom W. Bell, *Indelicate Imbalancing in Copyright and Patent Law*, in *COPY FIGHTS: THE FUTURE OF INTELLECTUAL PROPERTY IN THE INFORMATION AGE* 1, 4 (Adam Thierer & Wayne Crews eds., 2002) (“[C]opyright . . . protection contradicts Locke’s justification of property. By invoking state power, a copyright . . . owner can impose prior restraint, fines, imprisonment, and confiscation on those engaged in peaceful expression and the quiet enjoyment of their tangible property.”).

59. Mossoff, *supra* note 3, at 36 (footnotes omitted); cf. Jessica Litman, *What We Don’t See When We See Copyright as Property*, 77 *CAMBRIDGE L.J.* 536, 536–58 (2018) (noting that labeling copyright a freely alienable property right might exacerbate extant inequalities in both wealth and bargaining power).

The availability of an injunction⁶⁰—an equitable remedy—in the event of a finding of copyright infringement also points to a traditional property right interpretation of a copyright owner’s rights. There is also an entire body of state-specific law—common law copyright—that operates under traditional property rules.⁶¹ Common law copyright is a regime of state laws that cover works outside of federal copyright law’s purview; for example, sound recordings fixed before 1972.⁶² Notwithstanding its property law origins, contemporary copyright law has assumed a distinctively regulatory flavor, as the next section details.

B. *Liability Rules in Copyright*

The public law of copyright began its trajectory toward liability rules with the Copyright Act of 1909 (the predecessor to our current regime), which introduced the compulsory cover license and the first sale doctrine, among others.⁶³ The current Copyright Act has continued the move toward regulatory copyright by introducing additional compulsory licenses, sometimes referred to as liability “call options.”⁶⁴ These licenses include certain uses of cable television retransmissions,⁶⁵ digital audio transmissions,⁶⁶ musical compositions,⁶⁷ public performances by

60. 17 U.S.C. § 502.

61. To be sure, federal preemption has not left much to the states, with one important exception: pre-1978 sound recordings. Prior to February 15, 1972, federal copyright did not protect sound recordings, though some state laws did. The passage of the Copyright Act of 1976 brought sound recordings into the fold, but only those recorded on or after January 1, 1978. Sound recordings recorded prior to that date remain the subject of state law. *See* U.S. COPYRIGHT OFF., COPYRIGHT REGISTRATION FOR SOUND RECORDINGS 6 (2019), <https://www.copyright.gov/circs/circ56.pdf> [<https://perma.cc/XU33-ZWEZ>].

62. These works are explicitly excluded from federal protection by 17 U.S.C. § 301(c). For more on the oft-neglected world of common law intellectual property, see Shyamkrishna Balganesh, *The Pragmatic Incrementalism of Common Law Intellectual Property*, 63 VAND. L. REV. 1543 (2010).

63. *See* Copyright Act of 1909, Pub. L. No. 60-349, 35 Stat. 1075 (1909); *see also, e.g.*, Pamela Samuelson, *Justifications for Copyright Limitations & Exceptions*, in COPYRIGHT LAW IN AN AGE OF LIMITATIONS AND EXCEPTIONS 12, 18 (Ruth L. Okediji ed., 2017) (“The 1909 Act had three L&E [limitation & exception] provisions. One was a codification of the exhaustion doctrine. A second limited the newly created right of composers to control mechanical reproductions of their music in sound recordings by subjecting their works to a compulsory license. Once a copyrighted song had been recorded once, anyone could re-record the song as long as they paid the license fee set forth in the statute.” (citations omitted)).

64. For a fuller description of, and history behind, the call-option reconceptualization of liability rules, *see* AYRES, *supra* note 41, at 13–15.

65. 17 U.S.C. § 111.

66. *Id.* § 114.

67. *Id.* § 115.

jukebox,⁶⁸ public broadcast,⁶⁹ and satellite transmission.⁷⁰ The statutory rates and terms for these licenses are set (and adjusted at five-year intervals) by statute, a task delegated by the Librarian of Congress (LoC) to the Copyright Royalty Board—a body of three appointed judges who serve staggered six-year terms—with input from interested parties.⁷¹ Challenges to the statutory rate can be made through the U.S. District Court for the Southern District of New York (SDNY) in its capacity as rate court.⁷²

Where an absolute right to exclude typically characterizes a property regime,⁷³ liability regimes are more likely to feature various permissions and exemptions. Consistent with this approach, the Copyright Act includes a series of exceptions to a finding of infringement. These include fair uses,⁷⁴ the first sale doctrine,⁷⁵ reproduction by libraries and archives,⁷⁶ and certain public performances and displays (mostly educational).⁷⁷

Prior work has also suggested that the existence, and recent proliferation, of copyright arbitrage further supports recognition of copyright as a regulatory regime.⁷⁸ Other scholars have made similar observations with regard to copyright's propensity toward liability rules. In his work on the impact of digital technologies on copyright law, Peter Menell describes increasingly polarized positions on the expansion or contraction of copyright protections as leading Congress to “delegate[] resolution of the problem to a regulatory agency.”⁷⁹

In his work on the subject of regulation in IP, Mark Lemley writes that

68. *Id.* § 116.

69. *Id.* § 118.

70. *Id.* § 119.

71. *See id.* §§ 801(b)(1), 804(b)(4). A typical CRB ratemaking for phonorecords involves the filing of Proposed Findings of Fact and Conclusions of Law from both copyright owners and platforms. *See* George Johnson's (GEO) Proposed Conclusions of Law and Findings of Fact, *In re* Determination of Royalty Rates & Terms for Making & Distrib. Phonorecords (Phonorecords III), No. 16-CRB-0003-PR (Copyright Royalty Bd. May 12, 2017).

72. The Music Modernization Act (MMA), H.R. 5447, 115th Cong. (2018), introduces a new “wheel” approach to the assignment of SDNY judges as rate court arbiters. Under the “wheel” approach, judges are assigned randomly for each rate, instead of assigning all rate disputes to the same judge. 28 U.S.C. § 137(b).

73. There are, of course, exceptions: necessity, adverse possession, and antidiscrimination laws, among others.

74. 17 U.S.C. § 107.

75. *Id.* § 109.

76. *Id.* § 108.

77. *Id.* § 110.

78. Kristelia A. García, *Copyright Arbitrage*, 107 CALIF. L. REV. 199 (2019).

79. Menell, *supra* note 5, at 195.

“[l]arge swathes of the Copyright Act really are regulation: regulating price, setting compulsory licenses, determining what can be done, etc.”⁸⁰ Tim Wu has described copyright as a little bit of both: “The first regime is the familiar system, run by the courts, that grants exclusive [property] rights to encourage creativity. The second is a messier regulatory regime comprised mainly of the sections of copyright that have always perplexed copyright theorists and have never fit the central theme of author incentives.”⁸¹

Joseph Liu describes copyright’s increasingly regulatory character as stemming from a willingness of Congress to intervene in the structure of copyright markets.⁸² He notes that:

The 1976 Act departed from the pure property rights view by introducing detailed, industry-specific exemptions and several complex compulsory licenses for certain industries. The Librarian of Congress was, for the first time, charged not only with registering copyrights, but also setting licensing rates, albeit in only a few industries. Since the 1976 Act, amendments to the Act have become increasingly more detailed and industry-specific, relying more on compulsory licenses and, in some cases, mandating adoption of certain technologies and banning others. The Librarian of Congress’s duties have similarly expanded beyond mere registration, encompassing not only ratemaking but also substantive rulemaking. Recently proposed legislation, as well as academic proposals for significantly revamping the copyright system, also exhibit similar qualities. The trend is such that this mode of “regulatory copyright” is now the dominant mode of copyright lawmaking.⁸³

The most recent copyright legislation—the Music Modernization Act⁸⁴ (the MMA)—is also regulatory in nature. It replaces the existing section 115 statutory cover license with another compulsory license. The new, alternative “blanket license” allows a digital music provider to obtain a compulsory license for any “covered activities,”⁸⁵ defined as “making a digital phonorecord delivery of a musical work, including in the form of a permanent download, limited download, or interactive stream.”⁸⁶

80. Lemley, *supra* note 5, at 110–11.

81. Timothy Wu, *Copyright’s Communications Policy*, 103 MICH. L. REV. 278, 279 (2004).

82. Joseph P. Liu, *Regulatory Copyright*, 83 N.C. L. REV. 87, 91 (2004) (citations omitted).

83. *Id.* at 91–92.

84. H.R. 5447, 115th Cong. (2018). The Act will take effect in 2021.

85. 17 U.S.C. § 115(d)(1).

86. *Id.* § 115(e)(7).

III. PRIVATE COPYRIGHT LAW: SUPER-STATUTORY CONTRACTING

Notwithstanding the public law's marked shift toward liability rules, the private law of copyright has taken a different tact, with parties opting out of copyright's liability regime in favor of super-statutory contracting. On the one hand, this is surprising given the conventional preference for liability rules in fields—like copyright—where transaction costs are typically understood to be prohibitive. On the other hand, the one-size-fits-all nature of copyright's compulsory licenses make them quintessential examples of the untailed liability rules that Ayres and Talley tell us should lead to more (and more efficient) contracting.⁸⁷

This Part tests Ayres's and Talley's theory in a series of recent private copyright agreements split into two categories: section A presents voluntary agreements that exceed statutory obligations. Section B describes private deals that explicitly reject a collective rights organization. For each example, I describe both how the deal represents a move away from the extant liability regime and toward super-statutory contracting, and discuss both the improvements in efficiency and concerns raised. Section C observes a split between the two deal types that aligns with the Coasean bargaining categories described by Ayres and Talley.⁸⁸ Finally, section D offers some factors predictive of super-statutory contracting in the shadow of liability rules in copyright.

A. *Voluntary Agreements that Exceed Statutory Obligations*

1. *Content ID*

Among other things, YouTube, the world's largest content delivery platform, hosts content uploaded by users. This user-generated content (UGC) has the potential to, and sometimes does, infringe rights holders' copyrights. In the absence of some form of protection, the secondary liability for YouTube would be crushing.⁸⁹ The Digital Millennium Copyright Act of 1998⁹⁰ (the DMCA) attempted to address this with the addition of section 512 to the Copyright Act. Section 512(c) limits the liability of online service providers (OSPs) like YouTube so long as they comply with certain requirements commonly referred to as "notice

87. See discussion *supra* section II.B.

88. See Ayres & Talley, *supra* note 19, at 1038–42.

89. See, e.g., S. REP. NO. 105-190, at 8 (1998) (discussing the need for the safe harbor in order to "ensure[] that the efficiency of the Internet will continue to improve and that the variety and quality of services on the Internet will continue to expand").

90. Digital Millennium Copyright Act, Pub. L. No. 105-304, 112 Stat. 2860 (1998).

and takedown.”⁹¹

So long as OSPs like YouTube comply with notice and takedown requirements, users can continue uploading infringing content, and rights holders cannot sue YouTube. In this way, section 512(c) can be said to act like a (limited time, zero-price) liability rule, effectively allowing the platform to use the rights holders’ property without permission, so long as they remove it when asked. As with all liability regimes, transaction costs—in this case, the cost of litigation and potential cost of statutory damages—are initially greatly reduced. Over time, however, these savings have faded in the face of an ever-increasing number of notices—the latest Transparency Report from Google, YouTube’s parent company, reports over four billion takedown notices received from over 226,600 unique copyright owners⁹²—and the concomitant need to hire entire teams of people to handle the takedown process.

In 2006, YouTube began working on a private solution called Content ID.⁹³ By 2007, Content ID—a proprietary, voluntary agreement between YouTube and a select group of content owners—was up and running.⁹⁴ When a user attempts to upload a video to YouTube, Content ID temporarily blocks the upload while it compares the content to a database of copyrighted works supplied by participating copyright owners who can then elect to either deny the upload, or to allow the upload and then “claim,” or monetize, the advertising revenues associated with it.⁹⁵

This private agreement does several interesting things: First, in allowing a rights holder to block a user’s upload, Content ID extends copyright owners a right to exclude—that quintessential feature of property right regimes—that is not contemplated by section 512(c). In addition, Content ID adds a monetization option—again, with no such allowance or obligation imposed by the governing statute.⁹⁶ In other words, Content ID establishes two remedies: (1) an effective injunction (a

91. 17 U.S.C. § 512(c).

92. *Content Delistings Due to Copyright*, GOOGLE, <https://transparencyreport.google.com/copyright/overview?hl=en> (last visited Oct. 12, 2020) (tally updated continually). This is the total with Content ID in place since 2007!

93. *History of Content Management*, YOUTUBE5YEAR, <https://www.sites.google.com/a/pressatgoogle.com/youtube5year/home/history-of-copyright> [<https://perma.cc/S4H2-PHQ8>].

94. *Id.*

95. Because monetization is not an option under section 512(c), Content ID is often referred to as a “DMCA-plus” agreement. See *How Content ID Works*, YOUTUBE, <https://support.google.com/youtube/answer/2797370?hl=en> [<https://perma.cc/GHA5-QE5J>]. The election on the part of the content owner to deny or to claim an upload happens before the video appears on YouTube. In theory, this could mean a user is waiting a while to see their post go live, but algorithms like Content ID largely automate the process making it much faster. For example, most major content owners default to “monetize ads” and let everything go up automatically.

96. *Id.*

traditional property remedy); and (2) a damages equivalent (a traditional liability remedy). Indeed, the Content ID agreement contemplates greater protection than provided for in section 512(c), which itself can be thought of as creating a private injunction via notice-and-takedown.

By its own account, YouTube has spent over \$100 million developing and refining Content ID,⁹⁷ demonstrating a blatant disregard for the minimization of transaction costs theoretically offered by section 512's liability rule. (Of course, by leaving the content up, the platform increases monetization—even with profit-sharing.) In shifting the burden for detection of infringement from the content owner (as it lies under the statute) to the platform (as it lies under Content ID), we also see an internalization of externalities that Harold Demsetz associated with the assignment of property rights.⁹⁸

There are several things going on here; arguably, they all stem from the fact that section 512's notice and takedown process was never particularly successful at curbing copyright infringement. For example, a recent quantitative study found that approximately 30% of takedown notices issued are “potentially problematic.”⁹⁹ Using a six-month data set, the researchers found that one out of every twenty-five notices were “fundamentally flawed,” with 19% of the notices analyzed raising fundamental questions about whether content owners had accurately identified the works involved, and about whether they had considered fair use, as required by Ninth Circuit case law.¹⁰⁰ Even fans of takedown believe the system is broken, with some commentators citing an “endless game of whack-a-mole” for artists and content owners, and pushing for a stronger “notice-and-staydown” system.¹⁰¹

97. Paul Sawers, *YouTube: We've Invested \$100 Million in Content ID and Paid Over \$3 Billion to Rightsholders*, VENTURE BEAT (Nov. 7, 2018), <https://venturebeat.com/2018/11/07/youtube-weve-invested-100-million-in-content-id-and-paid-over-3-billion-to-rightsholders/> [<https://perma.cc/LF2J-6CP8>]. The decision to invest in Content ID arguably stemmed from the very real threat of exorbitantly costly litigation from major content owners like Viacom. See, e.g., Geraldine Fabrikant & Saul Hansell, *Viacom Asks YouTube to Remove Clips*, N.Y. TIMES (Feb. 2, 2007), <https://www.nytimes.com/2007/02/02/technology/02cnd-tube.html> [<https://perma.cc/MCW4-3QFD>] (noting Viacom's demand that YouTube remove over 100,000 videos in 2007 alone).

98. Harold Demsetz, *Toward a Theory of Property Rights*, 57 AM. ECON. REV. 347, 348 (1967) (establishing that “[a] primary function of property rights is that of guiding incentives to achieve a greater internalization of externalities”).

99. Jennifer M. Urban, Joe Karaganis & Brianna L. Schofield, *Notice and Takedown in Everyday Practice* 2 (UC Berkeley Pub. L. Research Paper, Paper No. 2755628, 2017), <https://ssrn.com/abstract=2755628> [<https://perma.cc/6Y9P-V98A>].

100. *Id.*; see also *Lenz v. Universal Music Corp.*, 815 F.3d 1145, 1154 (9th Cir. 2016) (finding consideration of fair use required prior to issuance of a takedown notice under section 512).

101. See, e.g., Devin Hartline, *Endless Whack-A-Mole: Why Notice-and-Staydown Just Makes Sense*, CPIP BLOG (Jan. 14, 2016), <http://cpip.gmu.edu/2016/01/14/endless-whack-a-mole-why-notice-and-staydown-just-makes-sense/> [<https://perma.cc/8WQU-SU9V>].

At its core, the problem with section 512 is two-fold: First, its “penalty” (the takedown requirement) does not act upon the infringer (i.e., the user). When a user uploads an infringing video to YouTube, it falls to YouTube to accept the notice from the copyright owner, and to effect removal of the video. The worst that might happen to the user is that YouTube will terminate their account after a series of infringing uploads, at which point they can simply create a new user account and repeat. Over time, and cumulatively, this has led to an incredible quantity of takedown notices. While not quite as expensive as litigation, perhaps, the constitution and maintenance of dedicated “takedown departments” is far from costless—not to mention, every single notice must be responded to, whereas litigation does not result from every single infringing upload. As such, the initial transaction cost savings afforded by the statutory safe harbor have diminished, making the development of Content ID more attractive.

Second, the ability to takedown—but not to keep down—infringing content represents a meaningful loss of perceived control for content owners. For example, a recording artist cannot deny permission for their song to serve as the background track for my home video of my dog rubbing his bum on the carpet, nor—more consequentially—as the background track for an anti-Semitic propaganda video. Under the statute, the creator can only hope to remove it after the fact. Importantly, Content ID restores to the creator the perceived ability to control their IP’s use.

In addition, Content ID is more effective than notice and takedown on two principal measures. First, Content ID is extremely effective at preventing the uploading of infringing content, since content owners get first stab at stopping the upload before it goes up. Second, by introducing a monetization option that most content owners opt for, Content ID is better at keeping content up and available on the site, which benefits users and society.

That said, Content ID also introduces a series of concerns. From a user perspective, Content ID may block upload of non-infringing content (both because the algorithms are far from perfect, and because participating content owners tend to be overzealous in claiming).¹⁰² In addition, and relatedly, fair use may not be given sufficient consideration.¹⁰³ From a small content owners’ perspective, Content ID is not useful because it is not an option. Content ID was negotiated by and between YouTube and a

102. See, e.g., Matthew Sag, *Internet Safe Harbors and the Transformation of Copyright Law*, 93 NOTRE DAME L. REV. 499, 552 (2017) (describing “reckless and mistaken assertions of ownership” as a potential false positive of systems like Content ID).

103. *Id.* at 531 (noting that “[i]dentifying fair use is a hard problem for any automated system” (citing Dan L. Burk & Julie E. Cohen, *Fair Use Infrastructure for Rights Management Systems*, 15 HARV. J.L. & TECH. 41, 56 (2001))).

select group of major content owners who are the sole beneficiaries of the program.¹⁰⁴ From the perspective of YouTube's prospective competitors, the expectation set by Content ID—namely, that content owners should have preemptive control—sets a high barrier to entry (given the cost of setting up such a proprietary system). While some third-party rights management services are slowly coming to market,¹⁰⁵ their efficacy has yet to be proven.

2. *Copyright Alert System*

The recently terminated Copyright Alert System (CAS)—a voluntary agreement between large Internet Service Providers (ISPs) like Comcast and AT&T, and the two largest content industry organizations, the Recording Industry Association of America (the RIAA) and the Motion Picture Association of America (the MPAA)—functioned, arguably successfully, for four years.¹⁰⁶ The deal established terms in excess of the obligations embodied in section 512(a) of the Copyright Act.¹⁰⁷

Like section 512(c), section 512(a) aims to limit the liability of an intermediary for the infringing actions of its users. Where section 512(c) acts on OSPs, section 512(a) acts on ISPs, or companies that provide users with internet access. In order to enjoy protection from liability, section 512(i)(1)(A) requires ISPs to “adopt[] and reasonably implement[] . . . a policy that provides for the termination in appropriate circumstances of subscribers and account holders of the service provider’s system or network who are repeat infringers.”¹⁰⁸ Although recent case law

104. YouTube defines this select group of content owners as those who “own exclusive rights to a substantial body of original material that is frequently uploaded by the YouTube creator community.” See *Common Questions About Content ID: Who Can Use Content ID?*, YOUTUBE, <https://support.google.com/youtube/answer/2797370?hl=en> [https://perma.cc/698Q-LGR3].

105. See, e.g., HAAWK, <https://www.haawk.com/> [https://perma.cc/AT7B-JJNH] (claiming to specialize in “YouTube, Facebook, & Instagram rights management, UGC monetization, copyright enforcement, . . . and micro sync licensing”).

106. CAS was terminated in 2017. See, e.g., Ted Johnson, *Internet Service Providers, Studios and Record Labels Call It Quits on Copyright Alert System*, VARIETY (Jan. 27, 2017), <https://variety.com/2017/digital/news/copyright-alerts-piracy-mpaa-comcast-att-1201971756/> [https://perma.cc/8588-2VBG] (quoting a joint statement from the Center for Copyright Information noting that “[t]he program demonstrated that real progress is possible when content creators, Internet innovators, and consumer advocates come together in a collaborative and consensus-driven process . . . CAS succeeded in educating many people about the availability of legal content, as well as about issues associated with online infringement”).

107. Compare 17 U.S.C. § 512, with Chris Hoffman, *What Is the New Copyright Alert System, and How Does It Affect You?*, HOW-TO GEEK (Feb. 1, 2017, 3:23 PM), <https://www.howtogeek.com/140545/htg-explains-what-is-the-new-copyright-alert-system-and-how-does-it-affect-you/> [https://perma.cc/Q9NC-RYA5].

108. 17 U.S.C. § 512(i)(1)(A).

has attempted to put some meat on the bones of this requirement,¹⁰⁹ there is no further guidance in the statute as to what is “reasonable” or “appropriate.”

As with section 512(c), section 512(a) arguably allows ISPs to “use” rights holders’ content to attract subscribers, so long as they “pay” by adopting some kind of termination policy. CAS aimed to help ISPs meet their section 512(i)(I)(A) requirements while reducing piracy. Under CAS, users would receive a notice from participating ISPs whenever they attempted to access web sites identified by content owners as containing infringing content (e.g., a known torrent site). Users who received six or more such notices were subject to penalties, such as a throttling of their ispeed.

The private CAS agreement went beyond the statutory requirements of section 512(a) in several important ways: First, it concretely defined “repeat infringer;” the statute does not. Second, by soliciting a list of infringing P2P sites, CAS effectively required “notice” from rights holders where the statute does not. Once the threshold number of notices have been exceeded, CAS extended something approaching a “right to exclude” to rights holders, who could then ask to have a user’s access throttled, for example. This represents a meaningful gain in perceived control by the IP owner, who was previously powerless in the fight against unlawful use of their property.

Finally, by defining “repeat infringer,” setting the number of offenses until penalty at six, and specifying some acceptable forms of punishment, CAS afforded ISPs a concrete means of demonstrating compliance with their section 512(a) requirements. By alerting users when otherwise ambiguous behavior violated copyright, CAS was broadly considered a successful public-education platform.¹¹⁰

Despite these improvements over the statutory prescription, the CAS system fell short in several areas. Notably, CAS’s prescribed penalties did not include termination of service. For this reason, CAS was widely believed to be effective for small-scale users (e.g., the teenaged boy torrenting video games on the family account), but not for larger,

109. *See, e.g.,* BMG Rights Mgmt. v. Cox Commc’ns, Inc., 149 F. Supp. 3d 634, 654 (2015) (holding Cox’s policy of defining “infringer” as someone adjudicated to be an infringer in court—and thus suspending no one—to not meet the statute’s reasonable and appropriate standard).

110. *See, e.g.,* Johnson, *supra* note 106 (citing the statement issued by the Center for Copyright Information (the entity responsible for administering the program) upon its demise: “‘The program demonstrated that real progress is possible when content creators, Internet innovators, and consumer advocates come together in a collaborative and consensus-driven process,’ the statement said. ‘CAS succeeded in educating many people about the availability of legal content, as well as about issues associated with online infringement While this particular program is ending, the parties remain committed to voluntary and cooperative efforts to address these issues.’”).

sophisticated pirates. In addition, the type of piracy that CAS worked against was peer-to-peer file sharing, not online streaming-style piracy of the sort that most often takes place on YouTube. The latter is much more prevalent today than the former, and perhaps at least partially explains CAS's termination. One of the most frequent complaints about CAS focused on the unilateral curation of a list of "infringing web sites" by content owners (and without consultation with users or user representatives).¹¹¹ CAS's demise is also illustrative of a limitation of voluntary agreements of this sort: once they end, the onus falls once again to Congress to decide whether or not to establish or continue a comparable statutory arrangement. If nothing else, the existence and arguable success of CAS tells lawmakers that ISPs are willing to take on additional obligations (i.e., to move from a standard to a rule) in order to enjoy greater immunity from copyright infringement liability.

3. *Terrestrial Performance Rights*

Despite sweeping improvements to the bewildering world of music licensing, one important right left untouched by the MMA is the terrestrial performance right for sound recordings. Governed by section 114(d)(2) of the Copyright Act, these rights are a frequent source of contention due to the fact that internet radio stations, like Pandora, pay royalties to both the owner(s) of the musical composition and the owner(s) of the sound recording, while terrestrial radio stations, like Los Angeles's KROQ, pay royalties only to the owner(s) of the musical composition. This means, for example, that a spin of Taylor Swift's hit song *Shake It Off* on your local FM radio station requires a performance royalty be paid to the owner(s) of the musical composition only; Taylor Swift (in her capacity as owner of the sound recording) is not paid. A spin of the same track on an internet radio station like Pandora, however, would require royalties be paid to both the owner(s) of the musical composition and the owner(s) of the

111. Corynne McSherry & Eric Goldman, *The "Graduated Response" Deal: What if Users Had Been at the Table?*, ELEC. FRONTIER FOUND. (July 18, 2011), <https://www.eff.org/deeplinks/2011/07/graduated-response-deal-what-if-users-had-been> [<https://perma.cc/3L8L-MCZ3>] ("The Internet access providers will treat the content owners' notices of infringement as presumptively accurate, . . . [t]his burden-shift violates our traditional procedural due process norms and is based on the presumed reliability of infringement-detection systems that subscribers haven't vetted and to which they cannot object."). Similar concerns have been expressed, for example, with the MPAA's partnership with Donuts, a domain name registry, in which the MPAA may unilaterally report copyright-infringing websites for suspension. *See, e.g., Mitch Stoltz, MPAA May Like Donuts, but They Shouldn't Be the (Copyright) Police*, ELEC. FRONTIER FOUND. (Feb. 10, 2016), <https://www.eff.org/deeplinks/2016/02/mpaa-may-donuts-they-shouldnt-be-copyright-police> [<https://perma.cc/8P66-67QP>] (asserting that "domain registries and registrars shouldn't take part in policing the contents of websites and services").

sound recording.¹¹²

The disparity in royalties paid between digital and terrestrial performance of sound recordings has long been a point of contention between the sound recording and broadcast industries, and will continue to be under the MMA. Broadcasters have traditionally resisted paying a performance royalty for sound recordings on the basis that their programming provides a valuable promotional service to recording artists.¹¹³ In an effort to protect the terrestrial performance royalties to which they are entitled, music publishers (the traditional owners of musical compositions) have traditionally sided with broadcasters on this,¹¹⁴ even justifying the disparity by pointing to the fact that sound recordings are paid at a higher rate on the digital side.¹¹⁵

As a statutory license, section 114(d)(2) is a quintessential liability rule that sets a statutory rate for digital public performance of sound recordings. The rate is set by the CRB in five-year increments.¹¹⁶ Unlike the mandatory statutory licenses governing many industries—such as broadcast cable and satellite—section 114(e)(1) of the Copyright Act specifically contemplates an opt-out for licensors and licensees by

112. See 17 U.S.C. § 106(6) (granting an exclusive right, “in the case of sound recordings, to perform the copyrighted work publicly by means of a *digital* audio transmission” (emphasis added)). To further complicate matters, a spin of the same song on a so-called “preexisting satellite radio station,” like Sirius XM, also requires royalties be paid to both the owner(s) of the musical composition and the owner(s) of the sound recording, only here, the rate paid to the owner(s) of the sound recording are significantly lower (while the composition rate remains the same).

113. The existence of payola—the controversial (and sometimes illegal) phenomenon of record labels paying radio stations to play their music—arguably supports their claims, though there’s no reason to understand digital radio as not providing this same (or perhaps even greater) promotional value, particularly given digital radio’s ability to track listening habits. See, e.g., *Payola Probe Settled for \$12 Million*, CBS NEWS (May 11, 2006, 5:22 PM), <https://www.cbsnews.com/news/payola-probe-settled-for-12-million/> [https://perma.cc/WJD8-HLNY] (quoting then-New York State Attorney General Eliot Spitzer as finding that “UMG has illegally provided radio stations with financial benefits to obtain airplay and boost the chart position of its songs”).

114. See John R. Kettle III, *Dancing to the Beat of a Different Drummer: Global Harmonization and the Need for Congress to Get in Step with a Full Public Performance Right for Sound Recordings*, 12 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 1041, 1053 (2000). Kettle discusses the National Association of Broadcaster’s (the NAB’s) opposition to extending a terrestrial performance right for sound recordings and notes that “[j]oining the NAB’s position against a full public performance right for sound recordings are songwriters, music publishers, and performing rights societies. They claim it is the songwriter and music publisher who will lose a substantial portion of income.” *Id.*

115. See, e.g., *In re Pandora Media, Inc.*, 6 F. Supp. 3d 317, 334 (S.D.N.Y. 2014) (testimony of Martin Bandier) (declaring “[w]e were struck by the vast disparity between what the record companies received from digital music services for the sound recording rights that they conveyed and what was paid for the [musical composition] performance right”), *aff’d sub nom.* *Pandora Media, Inc. v. Am. Soc’y of Composers, Authors & Publishers*, 785 F.3d 73 (2d Cir. 2015).

116. 17 U.S.C. § 804(b)(1) (“Any change in royalty rates made under this chapter . . . may be reconsidered in the year 2015, and each fifth calendar year thereafter.”). By default, section 114(d)(2) also sets a statutory rate of zero for the terrestrial public performance of sound recordings.

authorizing “copyright owners of sound recordings” and “any entities performing sound recordings” to alternately “negotiate and agree upon the royalty rates and license terms and conditions for the performance of such sound recordings and the proportionate division of fees paid among copyright owners, and may designate common agents on a nonexclusive basis to negotiate, agree to, pay, or receive payments.”¹¹⁷

A private deal struck in June 2012 between recording artist Taylor Swift’s former record label, Big Machine, and media conglomerate Clear Channel Communications,¹¹⁸ circumvents the statutory section 114 license in favor of an agreement that effectively establishes a terrestrial performance right for sound recordings—i.e., a liability right—where one does not exist in the statute.¹¹⁹ In the deal, the parties agree to a lower royalty rate for digital performance in exchange for, among other things,¹²⁰ the establishment of a new, terrestrial performance right for Swift’s sound recordings. In other words, in exchange for a lower-than-statutory royalty rate on the digital side, Clear Channel agreed to recognize, and pay royalties on, a terrestrial performance right for Swift’s recordings. On the digital side, the parties agreed to a performance royalty to be calculated as a share of revenue, thereby circumventing section 114—and with it, the collective rights organization Sound Exchange—altogether.¹²¹

In so doing, the parties establish a new liability rule—a terrestrial performance right—that sets, *ex ante*, a negotiated rate for use of Swift’s recordings in Clear Channel’s programming. This sets Clear Channel up to internalize what would otherwise be an externality resulting from its gratis use of the recordings (and borne by the owner thereof). The deal might also be characterized as a form of “self-help”—another remedy traditionally associated with property rights—on the part of Swift: where the Copyright Act failed to afford her a property entitlement in her sound

117. *Id.* § 114(e)(1).

118. Clear Channel Communications rebranded itself as iHeartMedia in late 2016. *Clear Channel Becomes iHeartMedia*, iHEARTMEDIA (Sept. 16, 2014), <https://www.iheartmedia.com/press/clear-channel-becomes-iheartmedia> [https://perma.cc/5J24-DH7K]. For simplicity and consistency, I continue to use “Clear Channel” here.

119. To the extent that the non-existence of a terrestrial performance royalty in the statute can be seen as a “zero-price” license, the deal between Clear Channel and Big Machine could be viewed as contracting for a higher liability rule price.

120. One additional benefit for Clear Channel was the guarantee of exclusives from Swift, thereby giving the media company an advantage over its competitors. Ed Christman, *Exclusive: Clear Channel, Big Machine Strike Deal to Pay Sound-Recording Performance Royalties to Label, Artists*, BILLBOARD (June 5, 2012), <https://www.billboard.com/articles/business/1094776/exclusive-clear-channel-big-machine-strike-deal-to-pay-sound-recording> [https://perma.cc/359T-FX5D].

121. For a full discussion of the implications of this circumvention, see Kristelia A. García, *Private Copyright Reform*, 20 MICH. TELECOMMS. & TECH. L. REV. 1, 31–38 (2013).

recordings vis-à-vis broadcasters, she got it for herself. One framing might even view the statute's refusal to grant a terrestrial performance right as a sort of regulatory taking from the owner of the sound recording.

Finally, and perhaps most interesting of all, the deal reached between Big Machine and Clear Channel was not costless—lawyers were engaged, and time and money were spent. This is in stark contrast to the near costless use of the statutory license. In other words, the parties agreed to—and did—incur significantly higher transaction costs in order to get this deal done. As in the case of Content ID, this suggests that transaction costs may no longer have the same prohibitive effect they once had.

The private deal brings several advantages over the statutory regime. First, the shift from a per-play rate to a revenue share better aligns incentives between broadcasters and record labels. Under the statutory per-play regime, broadcasters are encouraged to minimize costs by playing less music.¹²² In contrast, a revenue share may encourage the playing of more music, since additional plays don't cost more, and may attract more listeners (and so more ad revenue), resulting in more money for both parties. Relatedly, the deal encourages cooperation between parties whose businesses are interdependent. A copacetic working relationship can lead to content exclusives, more listeners, and more revenue for both parties. The move to a revenue share model also improves predictability. According to Clear Channel CEO, Bob Pittman,

I can't build a business space based on paying money for every time I play a song, but I can build a business by saying I will give a percentage of revenue that I bring in. . . . What we are really trying to do is come up with a predictable model.¹²³

From Big Machine's perspective, the recognition of a terrestrial performance right marks a significant improvement in perceived control over the performance of its intellectual property over terrestrial airwaves (control that is perceived as nonexistent under the statute). In exchange for this perceived control, the label is willing to accept *less money* than the statute entitles it to on the digital side. This is particularly significant given both parties' recognition of the rise in digital revenues, and concomitant fall in terrestrial revenues.

Despite these advantages, the deal between Big Machine and Clear Channel introduces several concerns. Most directly, in its circumvention of the statutory license, the deal also circumvents statutory payments to third parties; namely, to session musicians and back-up singers as

122. See, e.g., Christman, *supra* note 120 (quoting Clear Channel CEO Bill Pittman as saying of the status quo: "I don't want to try and guess how much advertising I can sell It encourages us to try and play as little music as possible").

123. See *id.*

provided for in section 114(g) of the Copyright Act.¹²⁴ Congress explicitly intended to protect these parties¹²⁵—referred to collectively in the statute as “performers”—but those protections are unilaterally removed as a result of circumventing the statutory license. Performers aren’t the only ones losing out in the deal; SoundExchange also loses its administrative fee for royalties collected and distributed under the statute. As other entities move to follow in Swift and Clear Channel’s footsteps,¹²⁶ this collective reduction in fees could negatively impact SoundExchange’s ability to best serve its remaining members, while also setting a new industry norm unattainable by smaller, less powerful entities.

4. *UppstArt*

A new application called UppstArt uses blockchain technology to enable visual artists to track art they sell so that if and when it is later resold, they are able to enforce a so-called “resale royalty”¹²⁷—i.e., a mandatory payment at a predetermined price made by a subsequent purchaser to the artist who created the work. This royalty is paid in addition to whatever price the subsequent purchaser pays to the seller of the work, thereby contracting around the first sale doctrine.¹²⁸ Notably,

124. 17 U.S.C. § 114(g)(2) specifies the following distribution of royalties: 50% of receipts shall be paid to the copyright owner; 2.5% of receipts shall be deposited in an escrow account for distribution to non-featured musicians; 2.5% of receipts shall be deposited in an escrow account for non-featured vocalists; and 45% of receipts shall be paid, on a per sound recording basis, to the featured recording artist on the sound recording.

125. H.R. REP. NO. 104-274, at 23–24 (1995) (“Performers . . . receive their compensation for the performance from the rights holder on a contractual basis. The Committee intends the language of section 114(g) to ensure that a fair share of the digital sound recording performance royalties goes to the performers according to the terms of their contracts.”).

126. To date, parties have entered into a handful of similar agreements. *See, e.g.*, Glenn Peoples, *Big Machine Label Group Signs Terrestrial Royalties Deal with Entercom*, BILLBOARD BUS. (Sept. 20, 2012), <http://www.billboard.biz/bbbiz/industry/record-labels/big-machine-label-group-signs-terrestrial-1007954192.story#mjsf3atSRlbiYMil.99> [<https://perma.cc/T5K6-VAGY>] (describing the Big Machine-Entercom deal and quoting Entercom President and CEO David Field as calling the deal “a bold step forward to align our interests with those of Big Machine and their artists”); Dan Rys, *Clear Channel Inks Second Radio Royalties Label Deal, This Time with Glassnote*, BILLBOARD BUS. (Sept. 27, 2012), <http://www.billboard.biz/bbbiz/industry/radio/clear-channel-inks-second-radio-royalties-1007962302.story> [<https://perma.cc/AFG7-9HQQ>] (describing the Clear Channel-Glassnote deal and quoting Glassnote Founder and CEO Daniel Glass, who described the deal as a “partnership [that] aligns our business interests more closely with Clear Channel”); Ed Christman, *Big Machine Cuts Deal With Beasley Broadcasting to Share ‘Certain’ Revenue*, BILLBOARD BUS. (Feb. 5, 2013), <https://www.billboard.com/articles/business/1537936/big-machine-cuts-deal-with-beasley-broadcasting-to> [<https://perma.cc/359T-FX5D>] (describing a deal “which will bring terrestrial performance royalties to its artists in exchange for more predictable rates for its digital broadcasting”).

127. UPPSTART, <https://uppstart.io/> (last visited Jan. 11, 2020).

128. 17 U.S.C. § 109(a).

the first sale doctrine terminates an IP owner’s perceived control over their work after the initial sales transaction. UppstArt takes that perception of control back, and retains it with the artist.

UppstArt works by issuing a “digital certificate of authenticity” to participating works of art. Upon initial sale, the digital certificate records and preserves information about a work’s authorship and price history. When a work is later resold, the digital certificate goes with it, and the artist is automatically paid a resale royalty.¹²⁹ In other words, a subsequent purchaser agrees to terms of sale that include a resale royalty and the app then automatically enforces this term.

To be clear, UppstArt aims to enforce a right to payment (for the resale of a copyrighted work) that does not exist under the law. Indeed, the notion of resale royalties has been repeatedly considered and explicitly rejected by the legislature.¹³⁰ This is so despite a report from the Copyright Office urging their passage,¹³¹ and despite the existence of an equivalent *droit de suite* in the European Union.¹³²

Under current law, section 109 of the Copyright Act—commonly referred to as the First Sale Doctrine—terminates a copyright holder’s ownership rights at the point of first sale.¹³³ This means that “the owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord.”¹³⁴ Thus, sellers and buyers who use the UppstArt app to recognize and enforce a resale royalty are contracting into a liability rule with a higher price.

The primary argument in favor of a resale royalty is that the right is

129. *UppstArt Pays Resale Royalties to Emerging Artists with Blockchain Technology*, PR NEWSWIRE (July 24, 2018), <https://www.prnewswire.com/news-releases/upstart-app-pays-resale-royalties-to-emerging-artists-with-blockchain-technology-300685396.html> [<https://perma.cc/QR5H-66MU>].

130. American Royalties Too (ART) Act of 2015, H.R. 1881, 114th Cong.; Equity for Visual Artists Act of 2011, H.R. 3688, 112th Cong.; Visual Artists Rights Act of 1987, H.R. 3221, 100th Cong.; The Visual Artists Rights Amendment of 1986, S. 2796, 99th Cong.; and The Visual Artists’ Residual Rights Act of 1978, H.R. 11403, 95th Cong. Most recently, the Ninth Circuit Court of Appeals struck down California’s Resale Royalty Act—legislation that allowed artists to collect 5% of all secondary market sales of their work conducted either in California or by a California-based company—as an unconstitutional violation of the Dormant Commerce Clause. *Close v. Sotheby’s*, 894 F.3d 1061, 1067 (9th Cir. 2018).

131. U.S. COPYRIGHT OFF., *RESALE ROYALTIES: AN UPDATED ANALYSIS* (2013), <https://www.copyright.gov/docs/resaleroyalty/usco-resaleroyalty.pdf> [<https://perma.cc/2LR5-LKLP>].

132. Council Directive 2001/84, art. 1, 2001 O.J. (L 272) 32, 32 (EC).

133. 17 U.S.C. § 109(a).

134. *Id.*

generative of more artwork (a purported goal of copyright). There is some evidence from the UK suggesting that this is true. In 2006, the UK passed the Artist Resale Right (ARR) regime. The ARR implements resale royalties on a sliding scale (based on the sale price of the work). In the first twelve years following the ARR's passage, DACS, a non-profit visual artists' rights management organization, distributed over £65 million to more than 5,000 artists, over half of which sold their works in the lower end of the price range (suggesting these royalties don't just benefit wealthy artists).¹³⁵ Some in favor of resale royalties view them as necessary to right an imbalance of power (and with it, wealth) between artists, and galleries and auctioneers: "Such measures protect artists against speculators and dealers who can make millions as works appreciate in value without giving a cent back to the artists who made them."¹³⁶

The US reticence toward adoption of a resale royalty has been lauded by commentators who see it as a coup for elite artists (and their estates) at the cost of developing artists.¹³⁷ Concern has also been expressed about rights accretion, or the tendency for risk adverse licensees to "over license" uses (like resale) for which no such permission or payment is required.¹³⁸ The introduction of a resale right might also be criticized as potentially establishing an industry norm that exceeds the statute's protections. Indeed, many of the examples in this Part might be characterized as private parties facing legal uncertainty who are "paying" to avoid the risk of litigation.

135. Mark Waugh, *We Owe Artists the Crucial Income Resale Royalties Provide*, ARTSY (Aug. 8, 2018, 5:15 PM), <https://www.artsy.net/article/artsy-editorial-owe-artists-crucial-income-resale-royalties-provide> [<https://perma.cc/CL55-K5BW>].

136. Nate Freeman, *A U.S. Court of Appeals Judge Has Struck Down the Final Effort to Have Artists Receive Royalties When Their Work Is Resold*, ARTSY (July 10, 2018, 1:12 PM), <https://www.artsy.net/news/artsy-editorial-court-appeals-judge-struck-final-effort-artists-receive-royalties-work-resold> [<https://perma.cc/73F5-MWKH>].

137. Christopher Sprigman & Guy Rub, *Resale Royalties Would Hurt Emerging Artists*, ARTSY (Aug. 8, 2018, 5:00 PM), <https://www.artsy.net/article/artsy-editorial-resale-royalties-hurt-emerging-artists> [<https://perma.cc/Z7SU-G2JB>] (arguing that "[r]esale royalties take real money from the entire art world, including young and struggling artists, and transfer most of it to a tiny group of famous and rich super-artists").

138. See, e.g., James Gibson, *Risk Aversion and Rights Accretion in Intellectual Property Law*, 116 YALE L.J. 882, 885 (2007) (noting that "the combination of ambiguous doctrine and risk-averse licensing will, over time, cause entitlements to grow and public privilege to shrink").

B. *Voluntary Agreements that Explicitly Reject a Collective Rights Organization*

1. *Partial Withdrawal of Digital Public Performance Rights*

Under the current copyright regime, there is no compulsory license for the public performance of musical compositions. In the absence of an intermediary, this would require a content owner and prospective licensee to negotiate and agree to terms *ex ante*. In an analog world, individual negotiations around the public performance of musical compositions have been viewed as largely impractical. There is simply no reasonable means for even the most sophisticated content owner to monitor every café, bar and sports arena across the country for specific instances of its copyrighted works being played. For this reason, public performance rights for musical compositions have traditionally been handled by CROs.

ASCAP is one of the largest collectives for public performance rights—commonly referred to as performance rights organizations (or PROs). It is a non-profit organization that licenses, and collects royalties for, the public performance of its members' musical compositions. Like other PROs, ASCAP offers prospective licensees various licensing configurations, including the popular “blanket license,” which entitles a licensee to use any and all works in ASCAP's catalog. Without ASCAP and its blanket license, the transaction costs for, say, a restaurant hoping to play a mix of contemporary background music, might be hopelessly prohibitive.

In many ways, collectives like ASCAP effectively function like liability rules for their members, who—until recently—relinquished their ability to exclude prospective licensees from using their content by opting into the collective. This is precisely what Merges was referring to with the phrase “contracting into liability rules”: “initially higher transaction costs of property rule entitlements [such as those given to owners of musical compositions] actually serve a benign purpose: they lead individual [intellectual property rights] holders to form CROs [like ASCAP].”¹³⁹

In other words, the CRO substitutes for a compulsory license, only instead of the compulsory rate being set by the legislature, it is set by the collective. In theory, this should result in better-tailored rate-setting since the entity setting the rate—in this case, ASCAP—is ostensibly an “expert.”¹⁴⁰ In early 2014, something happened to suggest that this hypothesis may no longer hold: two of the country's three major music

139. Merges, *supra* note 1, at 1296.

140. *See id.* at 1295 (noting “two distinct advantages of CROs: expert tailoring and reduced political economy problems”).

publishers sought to withdraw their digital (but not analog) performance rights from ASCAP in order to negotiate a higher rate directly with prospective licensees.¹⁴¹

In doing so, these rights owners effectively rejected the CRO's liability regime, and instead "reclaimed" their property rights under section 106, putting digital licensees on notice that *ex ante* negotiation is now required. From the music publishers' perspective, this partial withdrawal of rights from ASCAP offered several efficiency advantages: In an analog world, the transaction costs involved in monitoring many thousand physical locations are prohibitive. In a digital world, where plays of a particular track are easily and readily tracked, the transaction costs are significantly diminished. There is even a cost savings—ASCAP's administrative fee—resulting from the publishers handling their own digital performance licensing. Most importantly, the negotiated rate achieved by the publishers was 25% higher than that dictated by ASCAP.¹⁴² And unlike ASCAP, which operates under a consent decree requiring it to license its catalog to all similarly-situated licensees at the same rate,¹⁴³ individual music publishers who have withdrawn now control their own catalogs, and can collect any price the market will bear.

The major music publishers' rejection of ASCAP introduces some concerns. Because only large, powerful publishers had the bargaining power to demand direct negotiation, their withdrawal from ASCAP left smaller, less powerful rights owners holding the bag: with reduced administrative fees coming in, but steady overhead costs (as most of those costs come from analog enforcement), fewer members must now pay more for less. Indeed, without the major publishers' content, ASCAP's bargaining power *vis-à-vis* prospective licensees—i.e., the appeal of its "blanket license"—is greatly diminished. In this way, adverse selection decreases the efficiency and efficacy of the abandoned collective.

Another concern is the potential for the privately negotiated rate to be misrepresented as a "market rate." This is particularly concerning in an industry like music publishing where collectives have always dominated and so no true "market" exists. Finally, collectives like ASCAP ensure access to content for all prospective licensees willing to pay the stated rate

141. For a full history of this move, including the controversy surrounding it and eventual outcome, see Kristelia A. García, *Facilitating Competition by Remedial Regulation*, 31 BERKELEY TECH. L.J. 183 (2016).

142. See *In re Pandora Media, Inc.*, 6 F. Supp. 3d 317, 346 (S.D.N.Y. 2014), *aff'd sub nom.* Pandora Media, Inc. v. ASCAP, 785 F.3d 73 (2d Cir. 2015). Due to various findings amounting, effectively, to tacit collusion and parallel pricing, the rate ultimately allowed by the rate court was lower than initially negotiated, but still higher than the ASCAP rate. García, *supra* note 141, at 203–06.

143. See *Pandora Media, Inc.*, 6 F. Supp. 3d at 339.

and to comply with the stated licensing terms. In ASCAP's case, this is enforced by consent decree.¹⁴⁴ The consent decree under which ASCAP operates does not permit it to extend a license to one internet radio service but not another. Private licensing, of course, makes no such guarantees. In a highly-consolidated market like music publishing, this opens the door for anticompetitive behavior.¹⁴⁵

2. *Pandora and SoundExchange*

Section 114(d)(2) of the Copyright Act establishes a compulsory license for the digital public performance of sound recordings.¹⁴⁶ That compulsory license is administered by a collective known as SoundExchange. Like other CROs, SoundExchange works by encouraging owners of sound recordings to claim/register their works with the collective, which then begins collecting and administering royalties in exchange for an administrative fee.¹⁴⁷ Like many compulsory licenses in copyright, the section 114(d)(2) license is circumventable, meaning that prospective licensors and licensees reserve the right to bypass the statutory option and instead to negotiate a private licensing deal.

In early 2018, with the backdrop of a poorly-tailored liability rule in section 114(d)(2), Pandora opted for circumvention and negotiation with fifty different major and independent record labels.¹⁴⁸ Specifically, they opted out of the section 114(d)(2) license with respect to two out of three tiers on which the service operates. Tier 1 is Pandora's ad-supported (i.e., free) radio service; Tier 2 is its subscription radio service (called Pandora Plus); and Tier 3 is its new, fully-interactive subscription streaming service (called Pandora Premium). Pandora currently uses the statutory license only for Tier 1 (the service's lowest-grossing platform).¹⁴⁹

As with the Big Machine-Clear Channel deal, here we see Pandora forego the cost-saving compulsory license to instead explicitly recognize the labels' property rule protections in their content. While the agreement is not publicly available, we can assume that it offers a predictable set of

144. *United States v. ASCAP*, No. 41-1395, 2001 WL 1589999, at *4 (S.D.N.Y. June 11, 2001).

145. *See* García, *supra* note 141, at 218.

146. 17 U.S.C. § 114(d)(2).

147. *See About Digital Royalties*, SOUNDEXCHANGE, <https://www.soundexchange.com/artist-copyright-owner/digital-royalties/> [<https://perma.cc/R5HM-EYXR>].

148. *See* Lennon Cihak, *Pandora Moves to Direct Deal with Labels, SoundExchange's Payouts Plunge 26.2%*, DIGIT. MUSIC NEWS (Mar. 18, 2018), <https://www.digitalmusicnews.com/2018/03/18/pandora-moves-direct-deal-labels-soundexchanges-payouts-plunge-26-2/> [<https://perma.cc/Q6XQ-XWC9>].

149. *Id.*

advantages: a known rate not subject to periodic adjustment; an administrative fee savings; and the opportunity for a better-aligned relationship between content owners and platform. For the content owners, we see the same reclaiming of perceived control over their property and its licensure.

The deals also present a now predictable set of concerns often seen upon withdrawal from a CRO, including the possibility of adverse selection (as smaller competitors are unlikely to strike similar deals), and the eventual setting of an industry norm based on a rate that might be misrepresentative of the market. Perhaps most concerning is the fact that—as with the circumvention seen in the case of terrestrial performance rights—third parties’ rights may be negatively affected. Specifically, artists themselves are only paid directly when paid through SoundExchange (which now handles only Pandora’s Tier 1 pay-outs). Whether, and what, they might be paid under the privately-negotiated deals for Tier 2 and Tier 3 plays is entirely dependent upon the terms of those deals (negotiations in which they took no part) and/or the terms of the individual artists’ deals with their respective labels, which may not account for such payments at all.

3. *Spotify’s “Fake Artists”*

Music streaming services like Spotify use both (i) the section 114 compulsory license for their use of sound recordings streamed by their users,¹⁵⁰ and (ii) the section 115 compulsory license for use of the musical compositions underlying the sound recordings streamed by their users.¹⁵¹ The section 114 license is administered by SoundExchange, while the section 115 license is administered by several collectives, including ASCAP, BMI and SESAC.¹⁵²

As discussed at section III.A.3 above, the initial property right entitlements afforded creators under the copyright laws can result in an untenable transaction cost problem. To overcome this, the holders of these property rights typically relinquish them to a collective—such as SoundExchange or ASCAP—that in turn effectively sets up a liability regime (in which the collective rate functions like a compulsory rate). Membership in a collective additionally offers consolidated bargaining

150. 17 U.S.C. § 114(d)(2).

151. *Id.* § 115(d). The MMA replaced former section 115(c)(3) with section 115(d), a blanket license for digital uses to be administered by a newly-formed Mechanical Licensing Collective (MLC).

152. The smallest of the “big three” collectives, SESAC originally stood for Society of European Stage Authors and Composers, but the organization now simply goes by SESAC. SOC’Y EUR. STAGE AUTHORS & COMPOSERS, <https://www.sesac.com/> (last visited Oct. 9, 2020).

power, and administrative and enforcement capabilities.

Recently, news stories surfaced accusing music streaming service Spotify of “padding” its platform-curated playlists with so-called “fake artists.”¹⁵³ Complainants alleged that Spotify “pays producers upfront to create fake artists.”¹⁵⁴ “These fake artists then rack up plays without the streamer [here, Spotify] having to worry about handing over further royalty payments.”¹⁵⁵ Simply put, Spotify and its “fake artists” were circumventing both the section 114 and section 115 licenses (and, by extension, the relevant collectives), and instead striking private, flat-rate deals on a track-by-track basis.

What these reports called “fake artists” turned out to be real-life music producers most likely commissioned by Spotify to create tracks for which they pay a lump-sum upfront (in lieu of statutory royalties).¹⁵⁶ In other words, “[d]escribing these [acts] as ‘fake artists’ is like calling J.K. Rowling a fake author when she published novels in a different genre under the name Robert Galbraith.”¹⁵⁷ Participating producers have opted out of the respective collectives for both sound recordings (i.e., SoundExchange), and musical compositions (i.e., ASCAP/BMI/SESAC) in favor of a private deal in which they sell Spotify a song the way a bike shop might sell a bike to a customer—straight out, for cash or its equivalent, without further obligation nor involvement.

Because they pay the private producers a negotiated rate upfront with no uncertainty as to what future royalties might look like, and no pesky per-stream calculations, the most obvious advantage to this deal for Spotify is a flat and predictable cost for their most expensive input. As with the introduction of a revenue share in the creation of a terrestrial performance right, the flat-fee agreement between Spotify and the private producers also better aligns the incentives: because its costs won’t increase with plays, Spotify is encouraged to place the tracks prominently in popular playlists. Indeed, it is precisely the prominent and frequent

153. See Daniel Sanchez, *Spotify Allegedly Creates Fake Artists to Avoid Paying Real Ones (Updated)*, DIGIT. MUSIC NEWS (July 7, 2017), <https://www.digitalmusicnews.com/2017/07/07/spotify-fake-artists-payment/> [https://perma.cc/B7CZ-CSMA].

154. See Tim Ingham, *Spotify Denies It’s Playlisting Fake Artists. So Why Are All These Fake Artists on Its Playlists?*, MUSIC BUS. WORLDWIDE (July 9, 2017), <https://www.musicbusinessworldwide.com/spotify-denies-its-playlisting-fake-artists-so-why-are-all-these-fake-artists-on-its-playlists/> [https://perma.cc/R45S-5W8F].

155. *Id.*

156. *Id.* (describing “a producer in Europe who claimed that he’d done a deal with Spotify to create songs under ‘fake’ artist names”).

157. Tim Ingham, *So . . . Who’s Actually Behind Spotify’s Fake Artists?*, MUSIC BUS. WORLDWIDE (July 10, 2017), <https://www.musicbusinessworldwide.com/so-whos-actually-behind-spotifys-fake-artists/> [https://perma.cc/S26N-NHV5].

placement of such tracks that brought this arrangement to light in the first place.

From the producers' perspective, more plays are also better, not so much for the exposure—they are producing the tracks under pseudonyms, after all—but because a successful track is more likely to lead Spotify to commission additional tracks in the future. Moreover, Spotify doesn't have to worry about competing with other streaming services for exclusives around its commissioned tracks, since the flat-fee buys the track outright, copyright and all. In other words, the agreement functions like a work-made-for-hire, in which Spotify commissions and buys a song like a consumer might design and buy a bicycle. The tracks are all “exclusive” to Spotify.

The deals between Spotify and the commissioned producers have the potential to suffer some of the same downsides as the establishment of terrestrial performance rights; specifically, they introduce concerns about adverse selection and distributive justice. In this context, however, these concerns—namely, that only powerful parties can participate, and that their doing so can set unattainable industry expectations—arguably carry less weight. First of all, the primary complainants in this case are large music labels (not smaller, weaker entities). Given that the deals are not public, we don't know what the flat fees are, but there is no shortage of music producers looking for work, and we've no information to suggest that an acceptable rate couldn't be reached between one of them and a streaming service of any size and bargaining position.

C. *Bribing v. Buying*

Each of these examples starts with a (poorly tailored) liability rule or its functional equivalent. This effectively grants a prospective licensee a “call option” under which they can “take” a licensor's work in exchange for some predetermined damage/royalty rate. The licensor, in turn, has an entitlement *subject to* the licensee's exercise of the call option. In other words, the licensee holds the “short” position while the licensor holds the “long” position.¹⁵⁸ When an entitlement is protected by such a liability rule, Ayres and Talley suggest that there are two categories of Coasean bargains that parties—they refer to a “plaintiff” and a “defendant”—can enter into: First, the plaintiff can “bribe” the defendant not to exercise the option. Alternately, the defendant can “buy” the plaintiff's entitlement.¹⁵⁹

158. The “bribe” and “buy” language is Ayres's and Talley's. I borrow the option language from the financial literature. For the classic statement on call options in finance, see Fischer Black & Myron Scholes, *The Pricing of Options and Corporate Liabilities*, 81 J. POL. ECON. 637–39 (1973).

159. See Ayres & Talley, *supra* note 19, at 1041–42.

For our purposes, these two categories can be framed as: (1) the licensor can “bribe” the licensee not to utilize the statutory license (or its equivalent); or, (2) the licensee can “buy” the licensor’s entitlement. In the first category, the statutory rate is set below either or both of the licensor’s and/or the licensee’s valuation. In the second category, the statutory rate is set above either or both of the licensee’s and/or the licensor’s valuations, like so:

**Table 1:
Two Coasean Bargains in the Shadow of a
Poorly-Tailored Liability Rule**

	Statutory rate too low	Statutory rate too high
Entitlement protected by a liability rule (or its equivalent)	Licensor can “bribe” the licensee not to utilize the statutory license	Licensee can “buy” the licensor’s entitlement

Breaking down the examples into these two categories, we see that all but one fall into the “statutory rate is too low” category, and only two fall into the “statutory rate too high” category. One of the examples—terrestrial performance rights—falls into both categories by virtue of the fact that the relevant deal both lowers the digital performance royalty rate, and raises (above zero) the terrestrial performance rate. Importantly, and predictably, all of the examples demonstrate a mismatch between the statutory rate and the actual valuation.

**Table 2:
Category Breakdown by Example**

	Rate too low = Bribe	Rate too high = Buy
Content ID	X	
Copyright Alert System	X	
Terrestrial Performance Rights	X	X
UppsArt	X	
Partial Withdrawals of Digital Performance Rights	X	
Pandora & SoundExchange		X

“Fake Artists”	X	
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In the case of Content ID, for example, the licensee is YouTube, the licensors are the participating content owners, and the statutory default is Notice-and-Takedown. The agreement reached via Content ID sees major content owners “bribe” YouTube (via threat of litigation) into foregoing its safe harbor rights under section 512(c), and instead to extend to them (i) a right to exclude (on the upload) allegedly infringing copies of their work; and/or (ii) payment of advertising revenues for works that they decide to allow and claim. Per the framework illustrated in Table 2, this “bribe/agreement” is the result of a statute (in this instance, Notice-and-Takedown) that sets the rate for use too low (relative to the parties’ respective valuations). This leaves room for both parties to improve their positions: On the one hand, the content owners value their content more highly than a useless and ineffective takedown. On the other hand, YouTube is willing to pay more in order to forego responding to a never-ending and costly barrage of notices while also avoiding unpredictable litigation (and potentially astronomical statutory damages) in the event of untimely or inadequate takedowns. In this case, YouTube paid something in the neighborhood of \$100 million for the development of Content ID, plus an ongoing share of ad revenues. The CAS bribe/agreement followed a similar track.

Terrestrial performance rights present a unique context in which we see both a bribing and a buying in the same agreement. In that deal, the licensee is Clear Channel and the licensor is Big Machine. There are effectively two poorly-tailored default liability rules (hence the dual bribing-and-buying nature of the deal): a too-high digital performance royalty rate, and a too-low (i.e., zero) analog performance royalty rate. As such, we see Big Machine “bribing” Clear Channel to pay something greater than zero on the analog side, while Clear Channel simultaneously “buys” Big Machine’s right to a higher statutory digital royalty in exchange for a lower one. The “bribe” is accomplished via acceptance of a lower digital rate and the offer of exclusive content. The cost of the “buy” is a terrestrial performance right.

The partial withdrawal of digital public performance rights shows that a “bribe” can be effected even in the absence of a willing licensee. In that example, Pandora is the licensee and the major publishers are the licensors. The default liability rule is ASCAP’s statutory rate, which the licensors (but not the licensees) have deemed too low. As such, the publishers unilaterally withdraw their digital content from ASCAP in order to “bribe” Pandora into paying a higher rate, as it no longer has any other way to access the content.

All of this demonstrates that where the statutory rate (or its equivalent) is lower than the valuation of the licensor, it makes sense for the licensor to try to get the licensee to pay more. It is helpful (but not necessary) if the statutory rate is also less than the licensee's valuation. We also see that in order for the licensee to agree to pay more than it has to, the licensor must offer something more (i.e., something not required, or contemplated, by the statute), or eliminate other options (i.e., face a circumventable statutory default) in order to force a deal. These conditions, it appears, can overcome previously prohibitive transaction costs.

D. Predictive Factors

From the preceding examples emerge several shared characteristics that may lend some predictability as to when parties subject to a default liability regime are likely to contract into super-statutory terms. First, we see that in each case, the underlying statute serves as a *penalty* default, which is to say, as an undesirable backstop to be avoided by parties with the means to do so.¹⁶⁰ This undesirability stems from several sources, the most significant and consistent being the uncertainty associated with them. Not only are the statutory rates established in the Copyright Act subject to adjustment every five years, but legislation, such as the MMA, can—and sometimes does—alter, and even eliminate, these licenses at any time.

In addition, the statutory rates are set by a process that is subject to manipulation. The CRB rate-setting procedure involves soliciting feedback from interested parties, the most vocal and frequent of which tend to be those with the deepest pockets and with the largest share of content subject to license. These licensors do not always represent the interests and preferences of smaller, more diverse rights holders.

The existence of differential regulatory treatment is another factor that may lead to a private preference for either stronger liability rules or for property rules over liability rules. As in the case of terrestrial performance rights, for example, where digital radio stations pay the owners of sound recordings for spins but terrestrial radio stations don't, unequal treatment of similarly-situated entities can serve as an impetus for agreements that opt out of a liability regime.

Of course, inefficiency can also serve as an impetus for private ordering. Individual negotiation allows for a rate tailored to a specific use and for specific content, thereby better aligning incentives between the

160. For more on penalty default licenses and their impact on private ordering decisions, see Kristelia A. García, *Penalty Default Licenses: A Case for Uncertainty*, 89 N.Y.U. L. REV. 1117, 1182–83 (2014).

parties. A private deal can also be readily amended in response to changes in business model, consumer preferences, or technology. Private ordering may also do a better job of taking market valuations into account, resulting in more accurate pricing for the ultimate consumer, while simultaneously encouraging licensors to create, and licensees to invest.¹⁶¹

Notably, each of the examples cited involves a situation in which previously prohibitive transaction costs have been mitigated, thereby reducing or removing a traditional hurdle to private ordering. This may also explain the waning interest in CROs, whose traditional strength—consolidation (both of content and of bargaining power)—has also been diminished.

Finally, a consistent predictive factor demonstrated by the examples is perceived control on the part of the rights holder. The examples unanimously demonstrate that a perceived diminution in control over the licensor's copyrighted work (via the statutory license or its equivalent) is highly likely to trigger private ordering. On the part of the licensor anxious to regain a sense of control over their work, we see unusual concessions; on the part of the licensee holding the perception of control as an asset granted under the compulsory license, we see it used as a valuable bargaining chip.

IV. THE PUBLIC-PRIVATE INTERFACE: IMPLICATIONS

Parts II and III portray a legal regime—copyright—taking an increasingly regulatory turn at the same time as private ordering in the space has plotted an undeniable turn to super-statutory contracting. This observation turns on its head the conventional wisdom in law and economics that says that property rules induce contracting, while liability rules induce litigation.¹⁶² On one hand, it might also be viewed as challenging the accepted notion that intellectual property is best protected by liability rules, both because of the unique character of IP as asset,¹⁶³ and because of the prohibitively high transaction costs traditionally

161. *Id.* at 1133.

162. See, e.g., ROBERT COOTER & THOMAS ULEN, *LAW AND ECONOMICS* 104 (5th ed. 2012) (stating that “[i]f transaction costs are so high as to preclude bargaining, then the more efficient remedy is damages, not injunctions”); Richard Craswell, *Property Rules and Liability Rules in Unconscionability and Related Doctrines*, 60 U. CHI. L. REV. 1, 8–9 (1993) (calling property rules more efficient where the goal is to “induce the parties to negotiate”); David D. Haddock, Fred S. McChesney & Menahem Spiegel, *An Ordinary Economic Rationale for Extraordinary Legal Sanctions*, 78 CALIF. L. REV. 1, 16 (1990) (suggesting that liability rules allow defendants to take plaintiffs and pay liability damages rather than negotiate as they would under property rules).

163. See Merges, *supra* note 54, at 2656 (noting that strong property rules are particularly well-suited “where unique assets [i.e., IP] are exchanged”).

associated with IP.¹⁶⁴ On the other hand, it might suggest that we don't need to be overly concerned about whether the government gets statutory rates right, since the parties can bargain around them.

Importantly, the private copyright deals described herein reveal information about private market valuations that might otherwise not be disclosed. This contribution is particularly valuable in copyright, where many uses of copyrighted works—e.g., streaming—developed simultaneously alongside (or after) the applicable statutory license(s). The phenomenon also comports with Ayres and Talley's theory of liability rules as information-forcing.¹⁶⁵ In some instances, the revealed information might be public-facing. For example, in both the case of terrestrial performance rights and the case of resale royalties, the existence of private deals recognizing newly established "rights" and their concomitant pricing might signal to the legislature that such a right *can* be sustained by the market, and may even suggest what the "market price" might look like. In other cases, the information revealed might be private-facing; for example, Spotify's flat-rate deals with music producers put prospective producer-partners on notice that an alternative to the traditional "record label-and-statutory royalty" exists.

Contrary to Ayres and Talley's prediction that the statutory rate necessarily sets a ceiling on the negotiated rate,¹⁶⁶ our examples show that a licensor may be willing to accept less—and/or a licensee may be willing to pay more—than the statutory rate in certain circumstances. In the example of Clear Channel and Big Machine, for instance, both parties agree to pay (or accept) more (or less) than they have to: Clear Channel agrees to pay more than zero for analog plays, and Big Machine agrees to accept less than the statutory rate for digital plays. This is due, in large part, to other considerations separate and apart from price.¹⁶⁷ Indeed, the shift away from a liability regime and toward a property one has several implications, as discussed in turn below.

164. See, e.g., WILLIAM M. LANDES & RICHARD A. POSNER, *THE ECONOMIC STRUCTURE OF INTELLECTUAL PROPERTY LAW* 213 (2003) (stating that "transaction costs may be prohibitive if creators of new intellectual property must obtain licenses to use all the previous intellectual property they seek to incorporate").

165. Ayres & Talley, *supra* note 19, at 1032 ("We show that liability rules possess an 'information-forcing' quality that property rules do not.")

166. See *id.* at 1046 (discussing the damage amount under a liability rule as a ceiling).

167. These considerations might include such things as exclusive content, early content, bundled content, etc. In some cases, it is possible that these separate considerations might constitute an illegal tying arrangement, but as such analysis exceeds the scope of this paper, it is reserved for future research.

A. *Transaction Costs and Collective Advantage*

One of the primary implications of a private move away from statutory protections is that transaction costs, in many cases, turn out to be lower than previously understood. These lower transaction costs reduce the utility of statutory licenses because it now costs less for parties to locate, and bargain with, their respective counterparts. Several factors have contributed to this shift: For one thing, consolidation in the copyright industries—film studios, record labels, publishing companies—has resulted in fewer parties to reach out to in order to secure the content necessary to launch a content-related business venture. A fledgling streaming music service, for example, ostensibly need engage in only four negotiations around sound recordings (one with each of the major record labels, and one with an organization representing a group of prominent independent labels). The digitization of content has also reduced the cost associated with delivering, sharing, using, and reworking content. As demonstrated in the case of music publishers seeking to withdraw their digital rights from ASCAP, the ability to handle digital rights licensing, collection, and administration in-house reduces both the cost of doing business, and the value of engaging in collective behavior.

Relatedly, the rejection of CROs—as seen in the examples at section III.B above—reflects not only a lower threshold of transaction costs to be overcome, but also a decreased need for consolidated bargaining power. Many of the other advantages traditionally attributed to CROs have similarly diminished over time. For example, compulsory licenses have been criticized for their susceptibility to lobbying and special interests.¹⁶⁸ The same concern can be seen, however, in the case of a CRO like ASCAP, where a very few members of the collective comprise the majority of revenues. When the major music publishers first sought to withdraw their digital rights from ASCAP, they hit a roadblock: ASCAP's governing documents didn't allow partial withdrawals—it was all or nothing. Faced with the looming threat of full withdrawal (and the concomitant decimation of administrative fees), ASCAP took the unusual step of actually amending its articles to allow for partial withdrawal, a move arguably against the interest of its smaller members.¹⁶⁹

CROs have also been lauded for their flexibility, and for their ability to

168. See, e.g., Merges, *supra* note 1, at 1308 (noting that “the fact that liability rules are established by the legislature and applied mechanically makes them susceptible to lobbying”).

169. *In re Pandora Media, Inc.*, 6 F. Supp. 3d 317, 333 (S.D.N.Y. 2014), *aff'd sub nom. Pandora Media, Inc. v. ASCAP*, 785 F.3d 73 (2d Cir. 2015). For a detailed discussion of this conundrum, see also García, *supra* note 141, at 200–03.

expertly tailor rates in a way that legislators cannot hope to do.¹⁷⁰ Unfortunately, the consent decrees under which large CROs like ASCAP and BMI operate under work to limit this ability. The consent decrees—widely accepted as necessary to prevent exertion of monopoly power—mandate that the same terms be extended to all similarly-situated entities, thereby curbing the collectives’ ability to act like true market players. As Peter DiCola and Matthew Sag have observed: “Contrary to the customary modern portrayal of ASCAP and BMI as private solutions to a transaction-cost or negotiating problem, the historical record clearly reveals that ASCAP and BMI have always been the hybrid products of both public and private ordering.”¹⁷¹

Finally, some commentators prefer a CRO-mandated rate to a legislatively-mandated rate because the former are believed to be “the product of internal negotiations by knowledgeable people in the industry;” as such, “the rules they devise are more likely than the compulsory license to approximate market bargains.”¹⁷² While it’s true that the members of a CRO like ASCAP are “people in the industry,” it is, unfortunately, not the case that the rules and rates ultimately devised represent the preferences of *all* members, but rather only those of a few large and powerful members. In this way too, the advantages of CROs over compulsory licensing are diminished.

The recent and highly-contentious contest for control of the newly-formed Music Licensing Collective, a non-profit organization charged with the collection and distribution of mechanical royalties under the MMA,¹⁷³ is a good exemplar of this tension. Per the MMA, the Register of Copyrights was given 270 days from the date of enactment to designate the members of a newly-formed collective.¹⁷⁴ Two groups applied for the role: one—composed of major music publishers—called itself (one might say, aspirationally) the Music Licensing Collective (the MLC). The other, composed of songwriters, musicians, tech developers, and executives from smaller rights organizations, called itself the American Music Licensing Collective (the AMLC). As the Register reviewed the applications, both groups took to both traditional and social media to badmouth the opposition. The AMLC called the MLC conflicted,

170. See *Merges*, *supra* note 1, at 1299 (“Industry participants faced with the need to transact over and over again could probably work out something much more in tune with their needs than a congressional scheme of one-size-fits-all transactions.”).

171. Peter DiCola & Matthew Sag, *An Information-Gathering Approach to Copyright Policy*, 34 *CARDOZO L. REV.* 173, 208 (2012).

172. *Merges*, *supra* note 1, at 1300.

173. 17 U.S.C. § 115(d)(3)(A)–(C).

174. *Id.* at § 115(d)(3)(B).

while the MLC called the AMLC unqualified.¹⁷⁵ At its core, this was a battle over whether larger and more powerful, or smaller and less powerful, members of the interested group would control the purse, with each side convinced that the other would not have their respective best interests at heart. On July 5, 2019, the Copyright Office appointed the MLC to run the collective.¹⁷⁶ It is too soon to determine whether the AMLC's fears will be realized.

From a competition perspective, perhaps the greatest drawback to CROs in today's highly concentrated content markets is the propensity for collective action to discourage (or eliminate) any attempt at price competition, particularly from the members with the largest market shares. In his testimony before the CRB with regard to Pandora in *In re Determination of Royalty Rates and Terms for Ephemeral Recording and Digital Performance of Sound Recordings (Web IV)*,¹⁷⁷ Carl Shapiro observed that:

[T]he three largest record companies, Universal Music Group, Sony Music, and Warner Music Group, only rarely offer discounted royalty rates to statutory webcasters to gain more plays from those webcasters One reason for this dearth of competition is that SoundExchange is able to negotiate on behalf of the record labels as a group. When SoundExchange is negotiating with a music user on behalf of a group of record companies, those negotiations by definition do not include any element of price competition among those record companies. In the language of oligopoly theory, if SoundExchange can achieve collusive rates, those rates can provide a convenient and attractive focal point for the record companies, which discourages individual record companies from breaking ranks by initiating price competition. In the language of antitrust economists, SoundExchange can facilitate coordinated interaction among the record companies. . . . [S]uppliers with the largest market shares

175. See generally Steve Brachmann, *Music Industry Groups Square Off Against Songwriters, Small Publishers in Mechanical Licensing Collective Battle*, IP WATCHDOG (May 6, 2019), <https://www.ipwatchdog.com/2019/05/06/music-industry-groups-square-off-songwriters-small-publishers-mechanical-licensing-collective-battle/id=108982/> [<https://perma.cc/P6KG-B4U7>]; Kyle Jahner, *Big Music Publishers, Songwriters Win Digital Collective Bid*, BLOOMBERG L. (July 5, 2019, 12:40 PM), <https://news.bloomberglaw.com/ip-law/bigmusic-publishers-songwriters-win-digital-collective-bid> [<https://perma.cc/2LGG-T6GL>] (noting that AMLC criticized MLCI for being “beholden to large music publishers” and “conflicted because its members would benefit the most whenever the Mechanical Licensing Collective can’t determine where royalties should go”).

176. *Copyright Office Confirms NMPA-Endorsed Mechanical Licensing Collective*, VARIETY (July 5, 2019), <https://variety.com/2019/music/news/copyright-office-confirms-nmpa-endorsed-mechanical-licensing-collective-1203260173/> [<https://perma.cc/A758-5T9G>].

177. No. 14-CRB-0001-WR (Copyright Royalty Bd. May 30, 2014).

are the least likely to “defect” from a coordinated outcome by offering discounts to gain market share. The larger a firm’s market share, the more that firm has to lose from disrupting the status quo. Plus, when a firm with a larger market share engages in discounting to win more business, it is more likely that its rivals will detect that discounting and respond in kind. Anticipating these responses, the firm with the large market share will be less inclined to initiate discounting in the first place. For all of these reasons, coordinated interaction is a greater risk to competition in more concentrated markets, as emphasized by the Horizontal Merger Guidelines.

The presence of the statutory license also can create an impediment to competition. In general, when one supplier is considering initiating a price discount to gain market share, it must consider how those discounts will affect the overall level of prices in the market. A supplier will be discouraged from offering a discount if it expects that discount to be widely matched, because this would lead to little or no change in market shares but a lower price level in the market overall. This tendency can create an anticompetitive dynamic when prices are negotiated in the shadow of a statutory license: record companies, especially the larger ones, will be discouraged from offering discounts if they expect that those discounted royalty rates will pull down the statutory rate in the future. Unfortunately, this dynamic can be especially powerful if the statutory rate is set well above the rate that would result from effective competition. In that case, the statutory rate serves as an anchor, keeping negotiated rates above the level that would result from effective competition.

Putting the pieces together, it appears that several features of the market for recorded music used by webcasters have combined to discourage record companies from competing royalty rates down to competitive levels: the presence of SoundExchange with its antitrust immunity to negotiate on behalf of the record companies collectively; the significant share of the market accounted for by the three major record companies; and the shadow of the statutory licensing regime.¹⁷⁸

It is possible that over time, and in sufficient number, private agreements that circumvent the statutory license—to the extent they begin to set an industry expectation—may actually work to overcome the

178. See Written Direct Testimony of Carl Shapiro at 14–15, *Web IV*, No. 14-CRB-0001-WR (citations omitted), https://www.crb.gov/rate/14-CRB-0001-WR/statements/Pandora/14_Written_Direct_Testimony_of_Carl_Shapiro_with_Appendices_PUBLIC_pdf.pdf [<https://perma.cc/E54E-946L>].

anticompetitive effects of collective action and compulsory licensing.

B. The Role of Law in Super-Statutory Contracting: Penalty Default vs. Backstop

There are a couple of different ways to view the role of the relevant law where private ordering amounts to super-statutory contracting: We can think of the law as prompting the behavior—a penalty default scenario—or we can think of it as a backstop—largely inconsequential, but available if needed. This section will consider these possibilities in turn.

Where a compulsory license (or its statutory equivalent) is circumventable, it may serve as a default license. In such a case, the statutory license kicks in only if parties don't make other arrangements. Compulsory licenses (or their statutory equivalents) that are poorly-tailored and subject to high levels of unpredictability, like those in copyright, may moreover be classified as “penalty default licenses,” or licenses that use “bounded uncertainty to induce private ordering.”¹⁷⁹ In other words, an inefficient statutory license can push parties out of the statute and into private negotiation. A predictable, well-tailored license perceived as accurately reflecting market valuations would be unlikely to lead to the levels of opt-out and private ordering seen in copyright today. Instead, we see parties opting for private deals where the default is perceived as untrustworthy and uncertain—private ordering as correction, if you will, to a statutory misvaluation. It is tempting to conclude, then, that so long as the statutory license is circumventable, we needn't worry much about tailoring or accuracy, since parties can always opt for a private agreement. This assumes, however, a level of bargaining power and access to resources that is rarely uniform across constituencies.

Another characterization of the phenomenon observed herein is that the statute is merely a backdrop, largely ignored, with the real action taking place in private deals. In his seminal work on community norms in property involving ranchers in Shasta County, Bob Ellickson identified five “controllers,” or entities that govern societal interaction: the self, express contracts, informal social norms, hierarchical private organizations, and the state.¹⁸⁰ Of these, he found social norms highly influential, while recognizing private contracting's relative advantage when it comes to recognizing subjective valuations and reducing deadweight loss.¹⁸¹ These benefits are amplified when parties are able to

179. García, *supra* 160, at 1122 (citations omitted).

180. See ROBERT C. ELICKSON, ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES 124–36 (1991).

181. *Id.* at 246–48.

lower transaction costs through repeat interaction, as is often the case in private copyright deals.

Unlike Ellickson's ranchers in Shasta County, however, private ordering that circumvents extant law is not (yet) the norm in copyright. Instead, the examples described in Part III involve superstars and industry players with large market shares and lots of bargaining power. For now, private ordering is for the haves; the (inferior) compulsory license is for the have-nots. This supports the view of the role of law here as that of penalty default, encouraging those who can to negotiate a better deal extralegally, while leaving those who can't to the less desirable compulsory license (or its equivalent).

To this point, context is extremely important for the observations made herein. The described dynamic of privately negotiating a super-statutory contract will be observed only where both parties (a) have the means and bargaining power to successfully navigate such a negotiation, and (b) will be better off under the private arrangement. Where these conditions are not met, we should instead find ourselves in Merges's world, where less powerful parties consolidate their respective positions in hopes of incremental improvement.

C. Damages

Breach of a liability rule generally leads to monetary damages, while breach of a property rule generally leads to an equitable remedy, like an injunction. In copyright, the owner of an infringed work can elect either actual or statutory damages.¹⁸² Statutory damages for copyright infringement range from \$750 to \$30,000 per infringed work,¹⁸³ jumping to \$150,000 in the case of willful infringement.¹⁸⁴

The shift toward super-statutory contracting in the shadow of a liability regime suggests that the practical distinction between equitable and monetary relief in copyright may be fading. In many instances, the threat

182. 17 U.S.C. § 504(b)–(c).

183. *Id.* § 504(c)(1).

184. *Id.* § 504(c)(2). Recent empirical work suggests that these numbers have little to do with actual harm, and everything to do with deterrence. *See, e.g.,* Ben Depoorter, *Copyright Enforcement in the Digital Age: When the Remedy Is the Wrong*, 66 UCLA L. REV. 400, 407 (2019) (“Plaintiffs sought enhanced damages for willful infringement in 81 percent of all copyright disputes in the examined period, yet courts awarded enhanced damages in less than 2 percent of all cases that moved to verdict. The striking gap between the demand and supply of statutory damages, as well as several additional factors relating to nature of claims and subject-matter areas, undermine the credibility of the nearly ubiquitous claims of willful infringement by plaintiffs.”); Pamela Samuelson & Tara Wheatland, *Statutory Damages in Copyright Law: A Remedy in Need of Reform*, 51 WM. & MARY L. REV. 439, 441 (2009) (finding that “[a]wards of statutory damages are frequently arbitrary, inconsistent, unprincipled, and sometimes grossly excessive”).

of very steep statutory damages in copyright effectively affords a rights holder an absolute right to exclude—i.e., property rule protection delivered via a liability regime. For example, an independent filmmaker may be able to make a case for fair use of a copyrighted work that appears in her film. If she doesn't, however, the possibility of statutory damages in the six figures could end the project altogether. In other words, too high damages under a liability rule cause it to effectively act like a property rule, forcing ex ante negotiation.¹⁸⁵ Of course, hiring a lawyer is also not a costless endeavor, and the filmmaker from our example above may be more likely to simply seek a license,¹⁸⁶ i.e., to simply recognize a *property* right in, or concomitant right to more protection for or a higher payment from, the work as the next and final section details.

D. *Perceived Control*

The private deals described in Part III indicate a propensity to recognize stronger protection for copyrighted works than that contemplated by the statute. A reduction in transaction costs, the lack of a tailoring in the compulsory license, and the possibility of very high statutory damages all help to explain why a party might avoid or circumvent the extant statute. The more difficult thing to explain is why these circumventions result in super-statutory terms.

One explanation might lie with the improved stability and predictability that property rule protections lend. A property right puts licensees on notice that negotiation is required, period. As such, no time and energy need be spent attempting to discern the allowability or fairness of a particular use. In addition, once an agreement is reached, both parties have every incentive to maximize use of the licensed work.

Another plausible impetus for super-statutory contracting is that the existence of a liability rule default effectively acts as an asset to be conceded on the part of the licensee. Where a licensee would otherwise have only cash (or its equivalent) to exchange for the granting of a license, a compulsory license gives her an additional (and valuable) object of trade: perceived control, in the form of a stronger liability right, or property rule protection. Many licensors value control over their work, and compulsory licenses inarguably diminish (and in some cases, eliminate) their perceptions of that control (and, indeed, their actual

185. See Louis Kaplow & Steven Shavell, *Property Rules Versus Liability Rules: An Economic Analysis*, 109 HARV. L. REV. 713, 761 (1996) (“Under [a] liability rule, we presume damages are set equal to the . . . owners’ average common value. . . . [W]hen takers expect courts’ estimates of common value to be too high . . . the result will be close to that achieved under [a] property rule.”).

186. Arguably unnecessarily. For more on the phenomenon of risk-averse users over-licensing IP, see Gibson, *supra* note 138, at 885.

control in many cases). In agreeing not to utilize a compulsory license, but instead to recognize a licensor's right to deny use, a licensee returns the licensor's perceived control over her work. For example, the "fake artists" in the Spotify example are still subject to the compulsory license, should Spotify decide to utilize it. In offering them a negotiated payment, Spotify allows those artists to perceive more control over the valuation of their work. In creating Content ID, YouTube gives record labels a perception of more control over their content—block, monetize, take-down—than they are afforded under the safe harbor.

Notwithstanding the tenuous nature of this "control" (so long as the statute operates in the background), it is in some ways more valuable than cash: it returns the rights holder to the status of partner, rather than counterparty. Instead of spending time and money preparing lawsuits and litigating, YouTube and the major content owners worked together to structure and build Content ID as a means of improving both partners' businesses. Rather than pouring additional money into the broadcasters' lobby against a terrestrial performance right, Clear Channel forged a partnership with Swift and her former label that earned the media company invaluable exclusives from one of the world's biggest artists, who now had a stake in the endeavor's success.

All of this suggests that perceived control in the intellectual property context acts as an analog to the right to exclude in the real property context. This notion comports with empirical work by Jonathan Klick and Gideon Parchomovsky looking at the value of the right to exclude to real property owners. Using "right to roam" laws in the UK as a natural experiment, they determine that "the right to exclude is very valuable to property owners, and even so-called slight intrusions on owners' exclusion right in favor of more public access seem to come at a real cost to owners."¹⁸⁷ Similarly, the examples in Part III above suggest that the perception of control is very valuable to intellectual property owners, and the perceived (and actual) deterioration of that control by compulsory licenses and collective rights organizations has a significant negative impact on those rights holders. The significance of this perceived (and actual) loss of control, and the determination of IP owners to regain it, is reflected in the proliferation of super-statutory contracting.

CONCLUSION

Ayres's and Talley's important and novel observation—that liability rules can induce bargaining just as well as, if not better than, property

187. Jonathan Klick & Gideon Parchomovsky, *The Value of the Right to Exclude: An Empirical Assessment*, 165 PA. L. REV. 917, 961 (2017).

rules—is playing out in copyright law today. Merges’s proposition that property rules are superior to liability rules in the intellectual property context due to their propensity to induce the formation of CROs marks another influential contribution, one informed by an assumption that transaction costs are prohibitive, and that numerous and dispersed ownership recommends consolidation of bargaining power. The private deals presented in this Article reveal that neither of these assumptions necessarily persist in copyright today. Instead, as copyright law has increasingly become a liability regime, private agreements in the space have gone in the other direction, opting out of collectives and adopting stronger protections than those afforded by law.

This observation contradicts the conventional wisdom that says that licensors and licensees favor liability rules for their ability to overcome transaction costs associated with property entitlements, and that if faced with property entitlements, form CROs with the goal of establishing liability rules under which they can operate. Instead, the shift toward super-statutory contracting offers evidence of the diminishing import of consolidated bargaining power (in a space, like copyright, where the number of players continues to shrink), and of a substantive and meaningful reduction in transaction costs, such that they can no longer be viewed as prohibitive in many cases. The trend away from copyright’s liability regime also comports with the theory that its compulsory licenses—owing to poor tailoring and uncertainty—act like penalty default licenses, thereby pushing parties to engage in private negotiation, where they can achieve greater efficiency and flexibility.

In this way, super-statutory contracting serves to highlight the inefficiencies and inadequacies of the extant liability regime. For example, Content ID’s popularity suggests that participating licensors and licensees are dissatisfied and/or poorly-served by the statutory safe harbor. The deal between Big Machine and Clear Channel demonstrates a willingness on the part of a broadcaster to pay a terrestrial performance royalty. The withdrawal of digital performance rights from ASCAP by the major music publishers points to a collective that has failed its membership. By revealing information about both preferences and pricing, these examples make positive contributions to the legislative discourse.

At the same time, super-statutory contracting can undermine public law values, such as the making available of copyrighted content to similarly-situated licensees at a common rate. In some cases, the liability rule may have gotten it “right,” meaning the parties opting out are merely extracting rents from third parties. The proliferation of super-statutory contracting in copyright also introduces concerns around holdup, adverse

selection, and misrepresentation. In making their case in support of liability over property rules in IP, Lemley and Weiser argue that the application of an equitable remedy, such as an injunction, in the IP context can lead to overprotection due to the uncertain scope of many IP rights, and that “an overprotective injunction—if not ameliorated through a liability rule—will facilitate holdup strategies and undermine economic efficiency goals.”¹⁸⁸

Similarly, super-statutory contracting in an oligopolistic market like copyright can suppress the development of a workably competitive market, and can exacerbate the possibility of adverse selection as more powerful companies opt for more efficient private deals and leave less powerful entities to the penalty default license. Where oligopolists are additionally able to exert influence over a counterparty without recourse—such as in the case of Pandora and the music publishers’ withdrawal of their digital rights from ASCAP—the risk of establishing a misrepresentative “market” rate is increased as well. Lawmakers would do well to recognize the propensity for extensive compulsory licensing, like that seen in copyright, to induce parties to opt out, thereby revealing important information about market preferences and pricing.

Perhaps the most striking lesson to be taken from the phenomenon of super-statutory contracting is the underappreciated role of perceived control as a key lever in the licensing enterprise. The perception of control serves as a valuable asset for licensors and as a bargaining chip for licensees. Importantly, this insight requires the existence of a default liability rule that transfers control from licensor to licensee, setting the stage for a private deal that transfers it back.

188. See Lemley & Weiser, *supra* note 15, at 796.

