OLD FRIENDS:
ASCAP AND DOJ REACH A NEW CONSENT DECREE[1]

On June 11, 2001, the Southern District Court of New York approved a Joint Motion by the U.S. Department of Justice and ASCAP to enter a Second Amended Final Judgment (AFJ2)[2] that vacates previous judgments (AFJ1)[3] established in 1941 and 1950. The new Consent Decree expands and clarifies ASCAP's obligation to offer genuine license alternatives in addition to its basic blanket service. In addition, the Decree modifies or eliminates restrictions that now govern royalty payments and relations among songwriter and publisher members of ASCAP. The Department's underlying rationale is available for reading in a memorandum posted on its web site.[4]

The new Consent Decree is generally a competitive improvement over its predecessor. With regard to licensing, rules are tightened in a manner that makes ASCAP's program license more competitive with its "all or nothing" blanket license; broadcasters and other users will now have more economic ability to substitute out of the blanket contract. This could save shareholders in the broadcast industry considerable amounts. With regard to writer payments, market adjustments and joint collective bargaining between writer groups and licensees will replace government rule-making as a means of valuing the relative worth of different types of music. Here the Decree may be too optimistic in its assessment of the health of competition in the market for performing rights and its ability to restore market-based compensation for all writers.

License Reform

The key area of competitive concern for the Justice Department in its ongoing relationship with both ASCAP and BMI has been the design of *blanket licenses* that convey to a music user the right to perform, without limit, all catalogued works that are registered with the performing rights organization (PRO) for the duration of a license contract. Blanket fees for a licensee can be based upon its revenues, size, or some

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[2] U.S. Department of Justice, Antitrust Division, Second Amended Final Judgment, at http://www.usdoj.gov/atr/cases/f63000/6395.html (visited May 5, 2001)

[3]*U.S. v. ASCAP, et al*., 1941 Trade Cases, 56, 104 (S.D.N.Y. 1941); *U.S. v. ASCAP*, 1950-51 CCH Trade Cases, 62, 595 (S.D.N.Y. 1950)

[4] U.S. Department of Justice, Antitrust Division, Memorandum of the United States in Support of the Joint Motion to Enter Second Amended Final Judgment, at http://www.usdoj.gov/atr/cases/f63000/6396.html (visited December 20, 2000)

measure of usage capacity, but do not vary with its actual music usage during the contract. If offered alone, blanket licenses would compel users to make "all or nothing" choices between a full-size license or having nothing at all. If unchecked, a blanket license of this nature would present market power to the seller and confine smaller users to "tie-ins" of unwanted material.

By earlier Consent Decrees, ASCAP and BMI must permit members to make alternative arrangements directly with users; consequently, local stations now employ other means of "clearing" music for radio and television use without having to go to the PRO. *Direct licensing* entails contracts between broadcast stations and writers of individual musical works, such as introductory themes for local news and talk shows. *Source licensing* entails writer/publisher deals with program producers, who hire music to produce soundtracks that are conveyed with the program to station buyers.

ASCAP itself must offer two other licenses besides the blanket contract. *Program licenses* confer full usage rights for all catalog music that is used during the presentation of specified programs or day parts. *Commercial "mini-blanket" licenses* confer rights to off-program ambient and incidental uses of music, including commercials.

A broadcast licensee now chooses its most preferred licensing system by comparing blanket fees with its best combination of the direct, source, program, and commercial license elements. The choice is evidently affected by ASCAP's relative fees for the program, commercial, and blanket alternatives that are now under its domain. Per Sections VII and VIII of AFJ1 (1950), ASCAP is obliged to offer non-blanket arrangements that present a "genuine choice" to the blanket. To this end, a main objective of AFJ2 is "to ensure that a *substantial number of users* within a similarly situated group will have an opportunity to substitute away from the blanket." (Memorandum, III(F)). As enacted, the new Decree will be in marked contrast to previous Rate Court policy, which designed alternative contracts purposely to limit migration from the blanket license.

Parts VII and VIII of AFJ2 modify existing rules for program licenses. While Subpart VII(A)(1) reestablishes ASCAP's obligation to offer program licenses to broadcasters, Subpart VII(A)(2) obliges ASCAP additionally to offer *segment licenses* to background/foreground music services and on-line music users. The purpose of segment licensing is to enable users who lack formal program structure to have access to other forms of competitive licensing. (Memorandum, III(E)). Accordingly, AFJ2 would allow ASCAP's arbitrating Rate Court magistrate great flexibility in the design of the segment alternative. (Memorandum, III(E)).

Part VIII of AFJ2 governs the relationship between program and blanket fees. Music licensees are to be categorized in groups of similarly situated customers with a designated *representative user*, which is an actual or hypothetical licensee whose frequency and usage intensity are typical of the entire group (AFJ2, II(P)). The total expected payment for a necessary slate of ASCAP-program licenses to this

representative user should approximate the corresponding blanket fee that ASCAP charges. Per Section VIII(B), "it shall be assumed … that all of the music user's programs or segments that contain performances of ASCAP music are subject to an ASCAP fee."

The meaning of the last sentence is as follows. Suppose that 50 percent of a representative station's programs use *any* music written by an ASCAP composer (called "ASCAP music") *regardless* of how it is eventually licensed. This would translate to an allowed program-to-blanket multiple of 2 (2 = 1/.5). In the standard percentage-of-revenue arrangement, any licensee in the station group may then pay to ASCAP a blanket fee of (hypothetically) 1 percent of its adjusted total advertising revenues, or a program fee of 2 percent of advertising revenues for those individual shows produced with music that is actually licensed from ASCAP. If ASCAP were able to license each of these music-bearing programs, blanket and program fees would evidently be identical. However, if a station is able to migrate all music on a program to direct or source options, payments due to ASCAP for the particular show would be eliminated.

The reform is a substantial competitive improvement upon earlier practices, which deployed a program multiple based on the fraction of station programs that finally chose an ASCAP program license. Readers interested in the technical differences and its consequences are referred to a companion piece on music performing rights available from this author (meinhorn@lecg.com) and forthcoming in the Columbia Journal for Law and the Arts.

Another possible gain for the broadcast user appears in the design of a "mini-blanket" to cover off-program (i.e., ambient and incidental) uses that are not now covered in source, direct, and program license contracts that deal only with music in the program. Before AFJ2, ASCAP offered a "mini-blanket" for off-program uses that was based on a percentage of total station adjusted advertising revenue. This addition made the program option less attractive compared with the blanket arrangement, which did not affix any additional fee for off-program uses. The essential "genuine choice" is better preserved in Section VII(A)(1) of AFJ2, which permits to each program licensee a full offsetting dollar allowance for any fees paid for the "mini-blanket" license for ambient and incidental uses. (Memorandum, III(F)).

Other Licensing Matters

Two other matters regarding licensing in AFJ2 are interesting.

"Through to the Audience": Under Section V of AFJ2, ASCAP must offer to each requesting user a "through to the audience" license that automatically conveys performance rights to secondary users. Primary licensees, who control decisions regarding the use and licensing of musical content, can then convey any negotiated cost savings to downstream users who need not carry any supplemental licenses to perform the works.

First Time Rules: Under Section IX(C), ASCAP may not use license fees negotiated during the first five years with a new party as a later benchmark for subsequent fees that it may seek. New music users are perceived here as fragmented, inexperienced, lacking in resources, and unduly willing to acquiesce to ASCAP's early proposals.

Writer Relations

As a second modification to the historic Consent Decrees, Section XI of AFJ2 dispenses with earlier rules that had prescribed allocation factors for dividing ASCAP's pool of collected royalties among alternative uses of music (theme, feature, background, or commercial), as well as rules for voting, performance surveys, and dispute resolution. These rules were established in 1960 to protect theme, soundtrack, and commercial writers who felt that feature songwriters on the ASCAP member board discriminated against them.

This protection is no more. Under Section XI(B)(1), ASCAP may now distribute, without DOJ oversight, collected royalty monies to writers and publishers based on its own assessment of their relative worth in contributing value to its catalog. However, ASCAP's chosen weighting method must be consistently applied and made public.

For dissatisfied members, Section XI(B)(3) now allows withdrawal of all catalogued works from ASCAP at the end of any calendar year. Furthermore, under Section IV(B), ASCAP may not interfere with a member's right to license compositions to a particular user (or group) collectively through any agent --other than another PRO -- that can negotiate and contract on behalf of a number of writers and publishers. This reform now permits independent joint bargaining and may enable dissatisfied writers to flex some negotiating muscle by banding from time to time into "virtual PROs" for a particular license application.

Regarding prerecorded tracks that appear in music libraries, the Department and the District Court both rejected arguments by the Production Music Association and its expert economist that opposed the liberalization of Section XI(B)(1). The Department here is perhaps content with believing that the bargaining provisions of Section IV(B), as well as the competition between the PROs, is sufficient to provide a competitive market place. This matter is now discussed below.

Competition in Performing Rights

If the Decree can be faulted, it seems too secure that ASCAP's power over writers is reduced because it lost market share since 1960 (Memorandum, III(I)). While ASCAP's measured market share of license revenues decreased from 85 to nearly 50

percent in 1960-1994 (Memorandum, III(I)), this fall occurred when ASCAP's rates were court regulated, while BMI had never yet appeared before a Rate Court. ASCAP had also maintained an outdated four-pool system that siphoned off a share of revenues to pay off legacy writers of historic catalog.

ASCAP's weakened years are now history. ASCAP has new management and BMI has an active Rate Court. Both organizations now pay writers only for music usage in the current reporting period and ASCAP generally enjoys higher license fees. ASCAP now dominates the market for performances of urban and contemporary music and the initiations of top writers.

The Department should have been more cautious about competitive restraint. It is not now possible to purchase the performance rights to more than a handful of songs from more than one PRO. Consequently, any prospective licensee must generally sign contracts with all three PROs, which can use each other's rates as negotiation benchmarks to raise their own.

Furthermore, competition for writers and publishers is limited. If a writer were to moves to, e.g., ASCAP, the organization cannot immediately adjust any license fee to reflect the gain. Consequently, royalties can be paid to the migrant only by reducing payouts to others (but for some possible limited reductions in employee compensation and overhead). Moreover, no license fee must immediately decline if a writer leaves; ASCAP would then have more free cash to attract other writers. With choked incentives, ASCAP then does not have the financial ability to increase its market share considerably, nor does it face much danger of losing it.

Presumably, ASCAP can earn more at its next major negotiation if it can attract particular talent, such as a "hot writer" or genre that adds "prestige" to its catalog. This is arguable. Any licensing dispute that lasts sixty days can go before a Rate Court, where "prestige" is neither measurable nor translatable into any financial consequence. Furthermore, many "prestigious" writers in one format (e.g,. Madonna) would of little importance to a large number of radio stations (e.g., country) that participate in all-industry negotiations to obtain a group-based rate.

As a final matter, the two independent Rate Courts have imposed no common indices of market share that should be binding upon the collectives and their music licensees. Unless fees for each license group can be tied directly to coincident increases or decreases in a related market share, the two organizations will remain in basic balance. The two could more competitively play a "zero sum" game where fees are adjusted for periodic changes in the market share of each. Such a reform would require the simultaneous renegotiation of two Consent Decrees.

The third society, SESAC – which now licenses three percent of American songs -- may make some future inroads in the market as long as it can continue to evade Rate Court arbitration by virtue of its small size. However, SESAC's growth is the result of administrative asymmetry more than superior market performance.

"Creamskimming" from ASCAP and BMI may benefit those particular individuals who join SESAC, but does not reflect real improvements in market efficiency.

If competition cannot be established in performing rights, we can consider the purpose of having three performing rights organizations. Licensees would benefit from the transactional efficiency of negotiating all deals with one performing society, which now prevails in all other countries except Brazil. Writers and publishers would also benefit from scale economies in litigation, administration, and "marketing" costs that one organization may achieve. Based on web site data for the year 2002, ASCAP retains roughly 14 cents for every dollar paid out to writers and publishers.[5] With considerable overhead, unit costs for ASCAP writers might reasonably be halved were the collecting societies combined.

Recognizing the potential for digital transmissions to be monitored directly, the Department's accompanying memorandum (footnote 10) states:

> The Department is continuing to investigate the extend to which the growth of [digital] technologies warrants additional changes to the antitrust decrees against ASCAP and BMI, including the possibility that the PROs should be *prohibited* from collectively licensing certain types of users of performances. (emphasis mine)

Transactional and administrative economies in the digital sphere would be possible if a common agent were empowered to monitor usage and dispense revenues for performances of sound recordings and their underlying musical compositions.

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[5] At http://www.ascap.com/press/financial_020502.html (visited February 26, 2002); historic BMI numbers of 18 cents were at http://www.bmi.com/iama/media/faq/money.asp (visited May 1, 2000; link no longer active)

In the technology sector, Dr. Einhorn worked at Bell Laboratories and the U.S. Department of Justice (Antitrust Division) and consulted to General Electric, AT&T, Argonne Labs, Telcordia, Pacific Gas and Electric, and the Federal Energy Regulatory Commission. He has advised parties and supported litigation in matters involving patent damages and related valuations in semiconductors, medical technologies, search engines, e-commerce, wireless systems, and proprietary and open source software.

Litigation support involving media economics and copyright damages has involved music, movies, television, advertising, branding, apparel, architecture, fine arts, video games, and photography. Matters have involved Universal Music, BMG, Sony Music Holdings, Disney Music, NBCUniversal, Paramount Pictures, DreamWorks, Burnett Productions, Rascal Flatts, P. Diddy, Nelly Furtado, Usher, 50 Cent, Madonna, and U2.

Matters involving trademark damages have included the Kardashians/BOLDFACE Licensing, Oprah Winfrey/Harpo Productions, Madonna/Material Girl, CompUSA, Steve Madden Shoes, Kohl's Department Stores, *The New York Observer*, and Avon Cosmetics. Matters in publicity right damages have involved Zooey Deschanel, Arnold Schwarzenegger, Rosa Parks, Diane Keaton, Michelle Pfeiffer, Yogi Berra, Melina Kanakaredes, Woody Allen, and Sandra Bullock.

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