

# COPYRIGHT REFORM AND COPYRIGHT MARKET: A CROSS-PACIFIC PERSPECTIVE

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## ABSTRACT

Policymakers around the world are working to unlock copyrighted works from substantial transaction costs in the digital environment. Copyright reform initiatives largely follow one of two directions. Policymakers may change copyright from an opt-in regime into an opt-out or all-in regime (e.g., extended collective licenses and compulsory licenses) to eliminate the necessity of copyright transactions and allow downstream users to exploit copyrighted works without authorization. Alternatively, policymakers may streamline private transactions in the marketplace, create incentives for authors to provide licensing information, and eventually allow market players to innovate on efficient business models. In comparison to the market approach, compulsory licenses have a number of drawbacks (e.g., divesting authors of exclusive rights in copyrighted works, resulting in wasteful rent seeking, and setting arbitrary prices for copyright royalties). However, the fundamental concern is that compulsory licenses would undermine the incentives for collecting societies and other market players to improve their services in order to decrease transaction costs. While the United States and the rest of the world are at a crossroads in copyright reform, the road taken (and the road not taken) by Chinese policymakers provides a valuable lesson: We cannot, in the name of lowering transaction costs, completely sidestep transactions and sidestep the market as the principal mechanism to allocate social resources for intellectual creation.

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### **I. INTRODUCTION: A TALE OF TWO COPYRIGHT BACKLASHES**

In 2012, there were massive public backlashes against copyright reform bills in both the United States and China. However, the two backlashes pointed to dramatically different directions. In the United States, the Stop Online Piracy Act (“SOPA”)<sup>1</sup> and the PROTECT IP Act (“PIPA”)<sup>2</sup> were proposed in Congress, designed, inter alia, to enlist the assistance of Internet service providers to block overseas websites engaged in copyright infringement. Concerned that the two bills, if passed, could significantly affect Internet governance, leading websites—including Wikipedia, Google, and Twitter—launched an online protest against SOPA and PIPA by temporarily blacking out their services or front pages simultaneously on January 18th. Many Internet users quickly followed suit and sent millions

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1. *Stop Online Piracy Act: Hearing on H.R. 3261 Before the H. Comm. on the Judiciary*, 112th Cong. (2011).

2. PREVENTING REAL ONLINE THREATS TO ECONOMIC CREATIVITY AND THEFT OF INTELLECTUAL PROPERTY (PROTECT IP) ACT OF 2011, S. REP. NO. 112-39, at 6–14 (2011).

of messages to their representatives in Congress to express their opposition.<sup>3</sup>

The concurrent backlash in China, resulting from the 2012 Chinese Copyright Reform Bill, was of a totally different nature.<sup>4</sup> First, instead of opposing copyright expansion, the public was protesting against copyright limitation, specifically compulsory licenses that would degrade exclusive rights in copyrighted works to rights of remuneration.<sup>5</sup> Second, Internet companies or users did not initiate the campaign. Instead, Chinese musicians, artists, and authors led it. They expressed their views in newspapers, blogs, and microblogs, filed petitions to the Chinese government, and debated the relevant issues with government representatives on TV shows.<sup>6</sup> During the one-month period of public inquiries for the new bill, the National Copyright Administration of China (“NCAC”) received over 1,600 formal petitions and found more than one million comments posted on its official website.<sup>7</sup> Most remarkably, in a country with a 90% piracy rate, the general public appeared to be highly sympathetic to authors and applaud their efforts against rent seeking and

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3. For detailed discussions, see Jonathan Band, *The SOPA-TPP Nexus*, 28 AM. U. INT’L L. REV. 31, 42–43 (2012-2013); Yafit Lev-Aretz, *Copyright Lawmaking and the Public Choice: From Legislative Battles to Private Ordering*, 27 HARV. J.L. & TECH. 203, 222 (2013); Yochai Benkler, Hal Roberts, Robert Faris, Alicia Solow-Niederman & Bruce Etling, *Social Mobilization and the Networked Public Sphere: Mapping the SOPA-PIPA Debate*, BERKMAN CENTER FOR INTERNET & SOCIETY AT HARVARD UNIVERSITY (July 25, 2013), [http://cyber.law.harvard.edu/publications/2013/social\\_mobilization\\_and\\_the\\_networked\\_public\\_sphere](http://cyber.law.harvard.edu/publications/2013/social_mobilization_and_the_networked_public_sphere).

4. *Notice of Inquiries Regarding the Draft Amendment to the Copyright Law of the People’s Republic of China*, NATIONAL COPYRIGHT ADMINISTRATION OF CHINA (Mar. 31, 2012), <http://www.ncac.gov.cn/chinacopyright/contents/483/17745.html> [hereinafter “First Draft”]; *Notice of Inquiries Regarding the Second Draft Amendment to the Copyright Law of the People’s Republic of China*, NATIONAL COPYRIGHT ADMINISTRATION OF CHINA (July 6, 2012), <http://www.ncac.gov.cn/chinacopyright/contents/483/17753.html> [hereinafter “Second Draft”]; *Notice of Inquiries Regarding the Draft Amendment for Review to the Copyright Law of the People’s Republic of China*, LEGISLATIVE AFFAIRS OFFICE OF THE STATE COUNCIL (June 6, 2014), <http://www.chinalaw.gov.cn/article/cazjgg/201406/20140600396188.shtml> [hereinafter “Third Draft”].

5. See e.g., Sina Entertainment, *Copyright Amendment Bill Causes Controversies: Gao Xiaosong and Song Ke Opposed on Weibo*, SINA NEWS (Apr. 3, 2012), <http://ent.sina.com.cn/y/n/2012-04-05/12163597772.shtml>; *Record Industry Commission Requests that Section 60 and 70 of the Draft Copyright Law Be Eliminated*, CHINA NEWS (Apr. 28, 2012), <http://www.chinanews.com/cul/2012/04-28/3853299.shtml>.

6. See National Copyright Administration of China (NCAC), *Annual Report of the Third Copyright Reform in China*, G. ADMIN. PRESS & PUBL’N (Nov. 16, 2012), <http://www.gapp.gov.cn/govpublic/96/116997.shtml>.

7. See *id.*

government taking.<sup>8</sup> The leading traditional and Internet media, controlled primarily by the Chinese government, produced extensive coverage on the controversies surrounding copyright reform, again surprisingly in a rather impartial way.<sup>9</sup> For those familiar with Chinese media, it is a rare treat to see headlines calling a government initiative “controversial,” “under fire,” and “muzzling.”<sup>10</sup>

The NCAC has unprecedentedly prepared three different revised drafts in response to the public outcry over earlier versions.<sup>11</sup> Over 90% of the proposed provisions in the first draft were abolished or revised in the subsequent drafts. Among other things, the compulsory license for mechanical reproductions of musical works has been eliminated<sup>12</sup> and the scope of the proposed extended collective license (“ECL”) has been narrowed significantly.<sup>13</sup>

In the meantime, copyright laws in many other countries, including the United States, Canada, and European Union member nations, are also undergoing profound changes in the wake of the rapid advance of digital technologies. Various proposals for digital copyright reform generally revolve around four different forms of legal entitlement: (i) an opt-in regime, with traditional exclusive rights,<sup>14</sup> where an author may prevent the use of her copyrighted works unless she has granted a license; (ii) an opt-out regime where an author may not prevent the use of her copyrighted

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8. For detailed discussions of copyright piracy in China, see generally Jiarui Liu, *Copyright for Blockheads: An Empirical Study of Market Incentive and Intrinsic Motivation*, 38 COLUM. J.L. & ARTS 467 (2015); Eric Priest, *Copyright Extremophiles: Do Creative Industries Thrive or Just Survive in China's High-Piracy Environment?* 27 HARV. J.L. & TECH. 467 (2014); Peter K. Yu, *From Pirates to Partners: Protecting Intellectual Property in China in the Twenty-First Century*, 50 AM. U. L. REV. 133 (2000).

9. See, e.g., Xinhua, *Controversial Copyright Amendment to See Legislative Review* (Nov. 01, 2012), <http://en.people.cn/90785/7999907.html>; Lu Na, *New Copyright Law Amendment under Fire* (Apr. 6, 2012), [http://www.china.org.cn/arts/2012-04/06/content\\_25077760.htm](http://www.china.org.cn/arts/2012-04/06/content_25077760.htm); Ember Swift, *Law Revision Could Muzzle China's Music Industry* (Apr. 26, 2012), [http://www.china.org.cn/opinion/2012-04/26/content\\_25247058.htm](http://www.china.org.cn/opinion/2012-04/26/content_25247058.htm).

10. See, e.g., Xinhua, *Controversial Copyright Amendment to See Legislative Review*, PEOPLE'S DAILY ONLINE (Nov. 01, 2012), <http://en.people.cn/90785/7999907.html>; Lu Na, *New Copyright Law Amendment under Fire*, CHINA.ORG.CN (Apr. 6, 2012), [http://www.china.org.cn/arts/2012-04/06/content\\_25077760.htm](http://www.china.org.cn/arts/2012-04/06/content_25077760.htm); Ember Swift, *Law Revision Could Muzzle China's Music Industry*, CHINA.ORG.CN (Apr. 26, 2012), [http://www.china.org.cn/opinion/2012-04/26/content\\_25247058.htm](http://www.china.org.cn/opinion/2012-04/26/content_25247058.htm).

11. See *supra* note 4 and accompanying text.

12. See *id.*

13. See *id.*

14. See, e.g., WIPO Copyright Treaty, Dec. 20, 1996, S. TREATY DOC. NO. 105-17, 36 I.L.M. 65 (“WCT”); WIPO Performances and Phonograms Treaty, Dec. 20, 1996, S. TREATY DOC. NO. 105-17, 36 I.L.M. 76 (“WPPT”).

works unless she takes affirmative steps to allege her rights, such as ECLs,<sup>15</sup> notice-and-takedown procedures,<sup>16</sup> and traditional formalities;<sup>17</sup> (iii) an all-in regime where an author may not prevent the use of her copyright works, but is entitled to reasonable remuneration in the form of compulsory licenses<sup>18</sup> or public levies;<sup>19</sup> and (iv) an all-out regime where fair use and other exemptions allow third parties to use copyright works without permission and without paying compensation.<sup>20</sup>

Notably, in North America and the European Union, compulsory licenses and ECLs receive widespread support as potential solutions to the thorny questions regarding orphan works, mass digitization, and online music.<sup>21</sup> This enthusiasm for regulation and collectivism in digital copyright dramatically contrasts the general attitude of the Chinese public. China, often viewed as a pirate kingdom in the eyes of international observers,<sup>22</sup> is apparently moving towards strengthening exclusive rights and removing roadblocks to the formation of efficient copyright markets.

Such parallel developments provide us with a golden opportunity to evaluate how compulsory licenses and ECLs fare for modern creative industries in the digital age. These extra-market mechanisms are often

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15. For detailed introductions of the ECL, see World Intellectual Property Organization [WIPO], *Annotated Principles of Protection of Authors, Performers, Producers of Phonograms and Broadcasting Organizations in Connection with Distribution of Programs by Cable*, 20 COPYRIGHT 131, 151 (1984); H. Lund Christiansen, *The Nordic Licensing Systems – Extended Collective Agreement Licensing*, 13 E.I.P.R. 346, 349 (1991); Daniel Gervais, *Application of an Extended Collective Licensing Regime in Canada: Principles and Issues Relating to Implementation* (Dept. of Canadian Heritage, 2003), at 5, [http://aix1.uottawa.ca/~dgervais/publications/extended\\_licensing.pdf](http://aix1.uottawa.ca/~dgervais/publications/extended_licensing.pdf).

16. See 17 U.S.C. § 512 (2012).

17. See generally Christopher Sprigman, *Reform(aliz)ing Copyright*, 57 STAN. L. REV. 485 (2004) (suggesting the U.S. reintroduce copyright formalities to decrease transaction costs).

18. 17 U.S.C. §§ 111, 112(e), 114(f), 115(b)(1), 118(b), 119, 122 (2012).

19. 17 U.S.C. § 1003 (2012).

20. See, e.g., *Authors Guild, Inc. v. HathiTrust*, 755 F.3d 87 (2d Cir. 2014).

21. See, e.g., Enterprise and Regulatory Reform Act, 2013, c.24, § 77(3) (U.K.) (amending The Copyright, Designs and Patents Act of 1988) (inserting §§ 116A(1), 116B(1)); U.S. COPYRIGHT OFFICE, ORPHAN WORKS AND MASS DIGITIZATION 6 (June 2015), <http://copyright.gov/orphan/reports/orphan-works2015.pdf> [hereinafter 2015 Orphan Works Study]; Volker Ralf Grassmuck, *A Copyright Exception for Monetizing File-Sharing: A Proposal for Balancing User Freedom and Author Remuneration in the Brazilian Copyright Law Reform* (2010), [https://cyber.law.harvard.edu/sites/cyber.law.harvard.edu/files/Rethinking\\_Music\\_Copyright\\_Exception\\_Monetizing\\_File-Sharing.pdf](https://cyber.law.harvard.edu/sites/cyber.law.harvard.edu/files/Rethinking_Music_Copyright_Exception_Monetizing_File-Sharing.pdf).

22. See generally LOKE-KHOON TAN, *PIRATES IN THE MIDDLE KINGDOM: THE ENSUING TRADEMARK BATTLE* 30 (2007) (explaining why piracy and counterfeiting are rampant in China).

praised for diminishing transaction costs and facilitating large-scale uses of copyright works while providing authors with equitable compensation, which is believed to reflect a middle ground between technology providers and copyright owners.<sup>23</sup> However, empirical evidence suggests that private parties continue to negotiate with each other in the wake of compulsory licenses.<sup>24</sup> A widely celebrated example is the Harry Fox Agency, which handles the majority of U.S. mechanical licenses despite the compulsory licenses under 17 U.S.C. § 115.<sup>25</sup> In many cases, not only do compulsory licenses fall short of eliminating transaction costs, but they also set in motion wasteful rent seeking to lobby the government for favorable terms.<sup>26</sup> The aggregation of transaction costs and rent-seeking costs could render compulsory licenses more burdensome than private transactions in the marketplace.

More importantly, governmental rate-setting procedures are unlikely to produce equitable remuneration for authors in proportion to the market values of their works.<sup>27</sup> Digital technology has lowered the market entry barriers of copyright industries and bred an increasing variety of business models for authors. Taking the music industry as an example, some musicians distribute their music in à-la-carte stores like iTunes, some license to subscription-based services like Spotify (a music buffet offering unlimited access to a large repertoire), and others provide music for free on YouTube or even at a negative price (i.e., paying broadcasters to perform their works) to obtain advertising revenues and promote their record or concert sales.<sup>28</sup> It is unclear how a uniform price imposed on all relevant authors by the government or another centralized organization could

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23. See *infra* note 170 and accompanying text.

24. See generally Mark A. Lemley, *Contracting around Liability Rules*, 100 CALIF. L. REV. 463 (2012) (discussing examples of mechanical license, cable retransmission, and fair use).

25. See 17 U.S.C. § 115(c)(3)(H)(5) (2012); Lydia Pallas Loren, *Untangling the Web of Music Copyrights*, 53 CASE W. RES. L. REV. 673, 682 n.38 (2003) (“The preference for obtaining licenses from Harry Fox instead of utilizing the statutory license is largely due to the reduction of transaction costs offered by Harry Fox.”); HARRY FOX AGENCY, *Licensing General FAQ*, <https://secure.harryfox.com/public/Licensing-GeneralFAQ.jsp> (describing the business scope of the Harry Fox Agency).

26. See *infra* text accompanying note 177.

27. See *infra* note 210 and accompanying text.

28. For discussions of nonmonetary motivations, see, for example, Molly Shaffer Van Houweling, *Making Copyright Work for Authors Who Write to Be Read*, 38 COLUM. J.L. & ARTS 381, 383 (2015); Bernard Lang, *Orphan Works and the Google Book Search Settlement: An International Perspective*, 55 N.Y.L.S. L. REV. 111, 131 (2010); David Throsby, *A Work-Preference Model of Artist Behaviour*, in CULTURAL ECONOMICS AND CULTURAL POLICIES 69 (Alan T. Peacock & Ilde Rizzo eds., 1994).

possibly capture the richness of business models that the copyright market would otherwise cultivate. Transforming exclusive rights to rights of remuneration would override the freedom of authors with different aspirations to exploit their works in different ways. Furthermore, absolving copyright liabilities towards authors with a tariff channeled to a government agency or a collective unrelated to the actual authors breaks the connections between authors and their works and between authors and their audiences.<sup>29</sup> The collectivism approach rendering works of authorship faceless may significantly affect the public respect for copyright protection in the long run.

In particular, Nordic countries originally designed ECLs, which allow an agreement between a collecting society and its users to be binding on nonmember authors, as an alternative to compulsory licenses in the narrow areas stipulated under the Berne Convention<sup>30</sup> and the TRIPS Agreement.<sup>31</sup> Theoretically, ECLs may have minimal distorting effect on the copyright market where the collecting society is highly representative and efficient.<sup>32</sup> There is an obvious irony however: in reality, the strongest proponents of ECLs are more often than not nascent collecting societies that have yet to accumulate sufficient memberships in a market dominated by a large number of foreign or otherwise nonmember works.<sup>33</sup> Currently, various market solutions to large-scale uses of copyrighted works have evolved in lieu of ECL regimes to diminish transaction costs and promote dynamic competition. In the United States, prospective users can obtain virtually

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29. See Paul Goldstein, *Copyright*, 55 LAW & CONTEMP. PROBS. 79, 79-80 (1992) (indicating copyright sustains the very heart and essence of authorship by enabling direct communication between authors and audiences).

30. Berne Convention for the Protection of Literary and Artistic Works, Sept. 9, 1886, 1161 U.N.T.S. 30, as amended on Sept. 28, 1979, S. TREATY DOC. NO. 99-27 [hereinafter Berne Convention].

31. Agreement on Trade-Related Aspects of Intellectual Property Rights, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, 1869 U.N.T.S. 299, 33 I.L.M. 1197 [hereinafter TRIPS Agreement].

32. See Stanley M. Besen, Sheila N. Kirby & Steven C. Salop, *An Economic Analysis of Copyright Collectives*, 78 VA. L. REV. 383, 383 (1992) (praising the fact that “copyright collectives lower collection costs and permit more transactions to occur”).

33. See Tarja Koskinen-Olsson, *Collective Management in Nordic Countries*, in COLLECTIVE MANAGEMENT OF COPYRIGHT AND RELATED RIGHTS 283, 306 (Daniel J. Gervais ed., 2010) (“[The system of ECLs in Nordic countries] presupposes in other words that the ‘copyright market’ is well organized and disciplined.”); Johan Axhamn & Lucie Guibault, *Cross-Border Extended Collective Licensing: A Solution to Online Dissemination of Europe’s Cultural Heritage?* (Instituut Voor Informatierecht, 2011), at viii, [http://www.ivir.nl/publicaties/guibault/ECL\\_Europeana\\_final\\_report092011.pdf](http://www.ivir.nl/publicaties/guibault/ECL_Europeana_final_report092011.pdf) (“[The ECL] presupposes the existence of a representative CMO with a sound culture of good governance and transparency.”).

total freedom to use any musical work by purchasing blanket licenses in a competitive market of collecting societies that include ASCAP, BMI, and SESAC.<sup>34</sup> In China, certain collecting societies offer an indemnification clause in their licenses, defending and holding their users harmless from copyright claims by nonmembers.<sup>35</sup> Hence, the fundamental concern about ECLs is that collecting societies who strive to increase membership may be incentivized to lobby the government for more powers rather than to attract more members by providing better services and increasing operational efficiency.

A compulsory license has also been introduced in several countries as a legislative solution to the problem of orphan works for which copyright owners may not be identified or located with a diligent search.<sup>36</sup> A user may apply to a government agency for the compulsory license to use an orphan work upon payment to a collecting society designed by the government agency. However, the “compulsory license” approach is clearly less efficient than the “limitation on liability” approach proposed by the U.S. Copyright Office, which would allow users to use orphan works without payment until copyright owners emerge.<sup>37</sup> First, the compulsory license is rarely used in the countries where it has been enacted<sup>38</sup> because it would require substantial administrative costs to certify the legal status of orphan works case-by-case, determine the royalty rates for the compulsory license, and process upfront payments by users to a collecting society. Second, it proves difficult for a government agency to efficiently set royalty rates for orphan works, which naturally do not have current market benchmarks.<sup>39</sup> Third, the compulsory license may create an incentive for the collecting society to sit on royalty payments rather than to diligently search for copyright owners if it permits the collecting society to retain the unallocated amount to defray administrative costs and support collective-purpose projects for existing members.<sup>40</sup> Fundamentally, copyright protection

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34. See U.S. COPYRIGHT OFFICE, COPYRIGHT AND THE MUSIC MARKETPLACE 19 (Feb. 2015), <http://copyright.gov/policy/musiclicensingstudy/copyright-and-the-music-marketplace.pdf> [hereinafter Music Marketplace Study].

35. Interviews with QJM & YDK, executives in Chinese collecting societies (Nov. 2, 2010) (on file with the author).

36. See, e.g., Copyright Act, R.S.C. 1985, c. C-42, s. 77 (Can.).

37. See U.S. COPYRIGHT OFFICE, REPORT ON ORPHAN WORKS (Jan. 2006), <http://copyright.gov/orphan/orphan-report-full.pdf> [hereinafter 2006 Orphan Works Study].

38. See *infra* note 248 and accompanying text.

39. See *infra* note 251 and accompanying text.

40. See *infra* note 255 and accompanying text.



reflects a trade-off between incentive and access.<sup>41</sup> However, orphan works by definition involve authors who may not be located with a diligent search. So chances are the authors will never reappear. If compulsory licenses are imposed in these cases, users would pay a higher price, but the real authors would not receive any financial incentives. This situation would be the worst of both worlds: limited access for consumers *and* no incentives for authors.

Notably, the clearance difficulties concerning mass digitization projects do not result entirely from orphan works. For instance, only a quarter of the Google Books Project corpus are potentially orphan works.<sup>42</sup> Neither does the sheer volume of copyrighted works involved in the Google Books Project by itself justify a statutory exemption. The increase in transaction costs has been approximately proportionate to the increased volume and increased value of the overall database. It does not make much sense to categorically argue that the more copyrighted works a database contains, the less reasonable it is to require a copyright license.

The key barrier to mass digitization appears to be that the incremental value of any individual work to the whole project is often lower than the transaction cost needed to obtain a license for such a work. However little it takes to locate a copyright owner (say one dollar), the user would still not reach out for a license if scanning the book adds even less (say three cents) to the project.<sup>43</sup> This issue is similar to the clearance hurdle for television/radio broadcasters who perform a significant number of musical works for their daily programs. If history is any indication, the best solution is not to bypass copyright transactions. Instead, we may pool different copyrighted works together through major publishers or collecting societies to facilitate the issuance of blanket licenses for mass digitization. Meanwhile, the ECL model does not appear to be necessary here. A project like Google Books does not need to include all books in the world to become a viable business, as the holdup problem rarely arises in the context of mass

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41. For detailed surveys of economic theories in connection with copyright law, see PAUL GOLDSTEIN, *GOLDSTEIN ON COPYRIGHT* §1 (2015); RICHARD POSNER & WILLIAM LANDES, *THE ECONOMIC STRUCTURE OF INTELLECTUAL PROPERTY LAW* 37 (2003); Gillian K. Hadfield, *The Economics of Copyright: An Historical Perspective*, 38 *COPYRIGHT L. SYMP. (ASCAP)* 1 (1992).

42. See, e.g., Michael Cairns, *580,388 Orphan Works—Give or Take*, PERSONANONDATA (Sept. 9, 2009), <http://personanondata.blogspot.com/2009/09/580388-orphan-works-give-or-take.html>.

43. See *infra* note 269 and accompanying text.

digitization.<sup>44</sup> If Google has obtained blanket licenses from collecting societies but a nonmember author refuses to grant her individual license, it may simply delete the infringing work from the database and continue the operation with other licensed works. A single party can scarcely have any veto power to block the entire project. As a matter of fact, Google has indicated that it only scanned one fourth of the books in the world even though a federal court has legalized the project as a fair use for book searching and non-display purposes.<sup>45</sup>

This Article does not aim to simply document ongoing copyright reform discourses in the United States and China, but rather to assess the rationality of compulsory licenses and ECLs vis-à-vis market mechanisms in modern copyright industries. Nevertheless, the discussions indeed shed light on the cultural contexts useful to understand why the Chinese public appears to be more conservative about compulsory licenses. Compulsory licenses and similar mechanisms are often proposed to decrease transaction costs. However, they also run the risk of depriving authors of pricing rights and replacing the copyright market with a small group of centralized decision makers. If lowering transaction costs is the most important goal for a copyright regime, the Chinese public has actually experienced first-hand a world without any transaction costs: all producers sold their products to the government and all consumers bought their products from the government. No one had the right to determine prices and terms except for a small group of government planners. This was what we call the central-planning economy. The Chinese people tried it once and didn't like it. Thus, they moved on to the market economy, which gave rise to the economic growth of China in the last three decades.<sup>46</sup> This experience teaches all of us a valuable lesson: we cannot, in the name of lowering transaction costs,

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44. See, e.g., Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1107 (1972). Similar issues are sometimes called the tragedy of "anticommons." See Michael A. Heller, *The Tragedy of the Anticommons: Property in the Transition from Marx to Markets*, 111 HARV. L. REV. 621, 623 (1998); Michael A. Heller & Rebecca S. Eisenberg, *Can Patents Deter Innovation? The Anticommons in Biomedical Research*, 280 SCIENCE 698, 700 (1998).

45. Leonid Taycher, *Inside Google Books: Books of the World, Stand Up and Be Counted! All 129,864,880 of You.*, GOOGLE: INSIDE SEARCH BLOG (Aug. 5, 2010, 8:26 AM), <http://booksearch.blogspot.com/2010/08/books-of-world-stand-up-and-be-counted.html>; Jennifer Howard, *Google Begins to Scale Back Its Scanning of Books from University Libraries*, THE CHRONICLE OF HIGHER ED. (Mar. 9, 2012), <http://chronicle.com/article/Google-Begins-to-Scale-Back/131109/>.

46. See *World Economic Outlook Database*, INT'L MONETARY FUND (July 2015), <https://www.imf.org/external/pubs/ft/weo/2015/01/weodata/index.aspx>.

completely sidestep transactions and sidestep the market as the principal mechanism to allocate social resources for intellectual creation.

Part II begins with an introduction of the ECL system in Nordic countries. It demonstrates that the Chinese proposal would likely transgress the traditional contours of the Nordic model, undermine incentives for collecting societies to improve their operational efficiency, and violate the three-step test under the Berne Convention and the TRIPS Agreement. Part III evaluates the rationality of compulsory licenses in the digital age. It contends that compulsory licensing is neither necessary to prevent monopoly nor effective in lowering transaction costs, and that it often results from a political compromise that unduly deflates the market values of copyrighted works. Part IV compares the “limitation on liability” and “compulsory license” approaches as possible solutions to orphan work and mass digitization issues. It explains why the former is economically superior. Part V concludes the article with a summary of the major points.

## II. EXTENDED COLLECTIVE LICENSE

### A. THE TRADITIONAL MODEL

The traditional extended collective license (“ECL”), as pioneered in Nordic countries since the 1960s, normally includes four features.<sup>47</sup> First, the ECL allows the agreement concluded by a collecting society and users to extend to and become binding on nonmembers by operation of law.<sup>48</sup> In other words, once the licensing agreement officially takes effect, the licensee would have the legal privilege to use the entirety of copyright works in the category that the collecting society administers, including those owned by nonmember authors. Members and non-members would have equal rights to request remuneration from the collecting society under the licensing agreement.

Second, a collecting society with the power to issue the ECL must obtain authorization from the government and represent a substantial

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47. See *supra* note 15 and accompanying text.

48. See Annette Dillely & Thomas Dyekjær, *The Danish Copyright System and Copying Within Libraries*, 31 INT’L J. LEGAL INFO. 445, 449 (2003); Thomas Riis & Jens Schovsbo, *Extended Collective Licenses and the Nordic Experience – It’s a Hybrid but Is It a Volvo or a Lemon?*, 33 COLUM. J.L. & ARTS 471, 496 (2010); Henry Olsson, *The Extended Collective License as Applied in the Nordic Countries*, KOPINOR (Mar. 10 2010), <http://www.kopinor.no/en/copyright/extended-collective-license/documents/the-extended-collective-license-as-applied-in-the-nordic-countries>.

number of right holders of the category involved.<sup>49</sup> Nordic countries usually do not provide for a clear definition or threshold for “a substantial number of right holders.” But it is generally understood that, although it may be difficult numerically to verify whether a collecting society represents the majority of right holders of a category, close to half is required.<sup>50</sup>

Third, the ECL is typically limited to special areas of usage, including: (i) retransmission by cable or satellite of television and radio programs;<sup>51</sup> (ii) use of published works by certain television and radio stations;<sup>52</sup> (iii) reproduction for research, educational and internal purposes;<sup>53</sup> (iv) preservation by libraries, archives, and museums;<sup>54</sup> (v) reproduction for the visually handicapped and the hearing impaired;<sup>55</sup> and (vi) use of works of fine art displayed in public.<sup>56</sup> It appears that the ECL principally applies to the areas where, due to exorbitant transaction costs, copyright owners may not be able to individually grant licenses to end users in an effective way.<sup>57</sup> Therefore, it is unsurprising that substantial overlap exists between the coverage of ECLs and coverage of compulsory licenses permitted in international conventions and implemented in domestic laws.<sup>58</sup>

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49. See Thomas Riis & Jens Schovsbo, *Extended Collective Licenses in Action*, 43 I.I.C. 930, 935 (2012).

50. See *id.* at 937.

51. Consolidated Act on Copyright § 35 (2010) (Den.); Copyright Act 1961 (as amended) § 25(f)(4) (Finland); Copyright Act 1961 (as amended) § 34 (Nor.).

52. Consolidated Act on Copyright §§ 30 & 30(a) (2010) (Den.); Copyright Act 1961 (as amended) §§ 25(f),(g) (Fin.); Copyright Act (as amended) §§ 30 & 32 (1961) (Nor.).

53. Consolidated Act on Copyright §§ 13 & 14, (2010) (Den.); Copyright Act §§ 13(a) & 14 (1961) (as amended) (Finland); Copyright Act (as amended) §§ 13(b) & 14 (1961) (Nor.).

54. Consolidated Act on Copyright § 16(b) (2010) (Den.); Copyright Act § 16(d) (1961) (as amended) (Fin.); Copyright Act (as amended) § 16(a) (1961) (Nor.).

55. Consolidated Act on Copyright § 17(4) (2010) (Den.); Copyright Act (as amended) § 17(b) (1961) (Nor.).

56. Consolidated Act on Copyright § 24(a) (2010) (Den.); Copyright Act § 25(a)(2) (1961) (as amended) (Fin.).

57. See Jane Ginsburg, *Reproduction of Protected Works for University Research or Teaching*, 39 J. COPYRIGHT SOC'Y U.S.A. 181, 198 (1992) (“[I]t is difficult to argue that ECL-statutes have deprived authors of a right that, practically speaking, was impossible to enforce prior to the existence of the ECL-statutes.”).

58. See Berne Convention, *supra* note 30, Article 11 bis(2) (rebroadcasting), 9(2) (reproduction); see also Christiansen, *supra* note 15, at 349 (arguing the ECL “is regarded as a compulsory license in the sense of the Berne Convention”).

Finally, nonmember right holders sometimes (but not always) may opt out of the ECL agreement by serving a notice to either the collecting society or the user.<sup>59</sup>

#### B. THE CHINESE PROPOSAL

The first draft of the 2012 Chinese Copyright Reform Bill included a proposal for the ECL system:

Collective management organizations that have obtained authorization from right holders and are capable of representing right holders' interests nationwide may apply to the Copyright Administration of the State Council for representing the entirety of right holders to exercise their copyrights and related rights, except those right holders who have declined collective management in a written declaration.<sup>60</sup>

While the ECL system has worked fairly well in Nordic countries for over sixty years without much controversy, the Chinese ECL proposal has been confronted with strong opposition. A number of high-profile Chinese musicians and publishers announced that, should the ECL system stay in the final legislation, they would withdraw from the Music Copyright Society of China—the collecting society that was one of the driving forces behind the ECL proposal.<sup>61</sup> They also threatened to establish a competing collecting society of their own.<sup>62</sup> The mounting pressure from musicians, publishers, and the general public resulted in a dramatic turn of events: The society was forced to issue a public statement that backpedaled its support for the ECL system and called its initial enthusiasm for the ECL proposal

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59. See Daniel J. Gervais & Alana Maurushat, *Fragmented Copyright, Fragmented Management: Proposals to Defrag Copyright Management*, 2 CAN. J. L. & TECH. 15, 31 (2003); Stef Van Gompel, *Unlocking the Potential of Pre-Existing Content: How to Address the Issue of Orphan Works in Europe?*, 38 I.I.C. 669, 688 (2007); U.K. INTELLECTUAL PROPERTY OFFICE, © THE WAY AHEAD: A STRATEGY FOR COPYRIGHT IN THE DIGITAL AGE 38 (2009), <http://webarchive.nationalarchives.gov.uk/20140603093549/http://www.ipo.gov.uk/c-strategy-digitalage.pdf>.

60. Article 60, First Draft, *supra* note 4.

61. See Xu Haiyang & Shen Can, *Musicians Collectively Published Their Comments on the Draft Copyright Law*, SINA (Apr. 13, 2012), <http://ent.sina.com.cn/c/2012-04-13/09473604126.shtml>.

62. Apparently, several influential musicians went ahead and established a competing society in 2015, called Hua Yue Music. See HUA YUE MUSIC (BEIJING) CO., [www.huayuemusic.com](http://www.huayuemusic.com) (last visited Apr. 2, 2017).

“too narrow-minded, short-sighted, geeky and insensitive to authors’ interests.”<sup>63</sup>

The controversy surrounding the ECL proposal is unsurprising given that the model suggested in the first draft of the 2012 Chinese Copyright Reform Bill is substantially different from the Nordic model. First, the proposed ECL is not confined to any special areas. Any collecting society may apply to the NCAC for the legal power to impose the ECL within its scope of business. Currently, there are five collecting societies operating in mainland China: (i) the Music Copyright Society of China (“MCSC”), established in 1992 to manage musical works;<sup>64</sup> (ii) China Audio-Video Copyright Association (“CAVCA”), established in 2008 to manage music videos used by karaoke bars;<sup>65</sup> (iii) China Written Works Copyright Society (“CWWCS”) established in 2008 to manage literary works;<sup>66</sup> (iv) the Images Copyright Society of China (“ICSC”), established in 2008 to manage photographic works;<sup>67</sup> and (v) China Film Copyright Association (“CFCA”), established in 2009 to manage motion pictures.<sup>68</sup> Their scopes of business in the aggregate cover almost all commercially significant uses for copyrighted works (except software), much broader than what the Nordic ECL encompasses. Accordingly, the potential impacts of the Chinese proposal on exclusive rights would be much more extensive.

Second, although the proposed ECL contains an opt-out option for nonmembers, the option is essentially superfluous. The first draft of the 2012 Chinese Copyright Reform Bill simultaneously introduces a limitation on liability that would totally negate any financial incentives for nonmembers to opt out of the ECL: a nonmember author would merely be entitled to the royalties collectable from a copyright society if the infringing

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63. See various comments posted online by the MCSC on the Draft Amendment: <http://www.mcsc.com.cn/imS-13-994.html> (Apr. 6, 2012); <http://www.mcsc.com.cn/imS-13-998.html> (Apr. 13, 2012); <http://www.mcsc.com.cn/imS-13-1003.html> (Apr. 19, 2012).

64. See MCSC, *Basic Information*, <http://www.mcsc.com.cn/mIL-5.html> (last visited Apr. 2, 2017).

65. See *Association History*, CHINESE AUDIO-VIDEO COPYRIGHT ASSOCIATION, <http://www.cavca.org/xhlc.php?page=28> (last visited Apr. 2, 2017).

66. See *Association Introduction*, CHINA WRITTEN WORKS COPYRIGHT SOCIETY, <http://www.prccopyright.org.cn/staticnews/2010-01-28/100128145635437/1.html> (last visited Apr. 2, 2017).

67. See *Association Introduction*, IMAGES COPYRIGHT SOCIETY OF CHINA, <http://www.icsc1839.org/html/zhuzuoquanxiehui/guanyuxiehui/index.html> (last visited Apr. 2, 2017).

68. See CHINA FILM COPYRIGHT ASSOCIATION (COLLECTIVE), <http://www.cfca-c.org/> (last visited Apr. 2, 2017).

user has obtained a license from the collecting society.<sup>69</sup> Most authors who prefer to opt out of the ECL presumably believe that they are capable of collecting more royalties by managing their works on their own, probably because they are more efficient in negotiating copyright licenses or they create more value for prospective users. However, the limitation on liability provision would impose a hard cap on how much an author could possibly collect. Even if she has opted out of the ECL, she could demand no more than what she would otherwise receive from the collecting society. In that case, who would bother to opt out?<sup>70</sup>

Third, the most important difference between the Chinese proposal and the Nordic ECL is not immediately obvious: all the existing Chinese collecting societies are far from the level of representativity envisioned by the Nordic tradition. As Figure 1 shows below, the MCSC, the largest and oldest collecting society in China, has only 6,500 members. It amounts to around 10% in scale of ASCAP and BMI in the United States and GEMA in Germany; and it appears even smaller compared to STIM of Sweden and PRS-music in the United Kingdom. This low level of representativity is highly disproportionate to the Chinese population,<sup>71</sup> which is more than a hundred times larger than the Swedish population.

The lack of representativity significantly aggravates the issues inherent in an ECL regime. The ECL may dilute exclusive rights granted by copyright law and undermine creative incentives for nonmember authors.<sup>72</sup> Several commentators observe that the ECL is not really different from a compulsory license in effect.<sup>73</sup> For instance, in Nordic countries, the ECLs

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69. Article 70, First Draft, *supra* note 4.

70. Notably, this provision is drastically different from the provision in some countries where an author would be entitled only to what would be available from a collecting society if she is a *member* of the collecting society. See Daniel J. Gervais, *The Purpose of Copyright Law in Canada*, 2 U. OTTAWA L. & TECH. J. 315, 351 (2005).

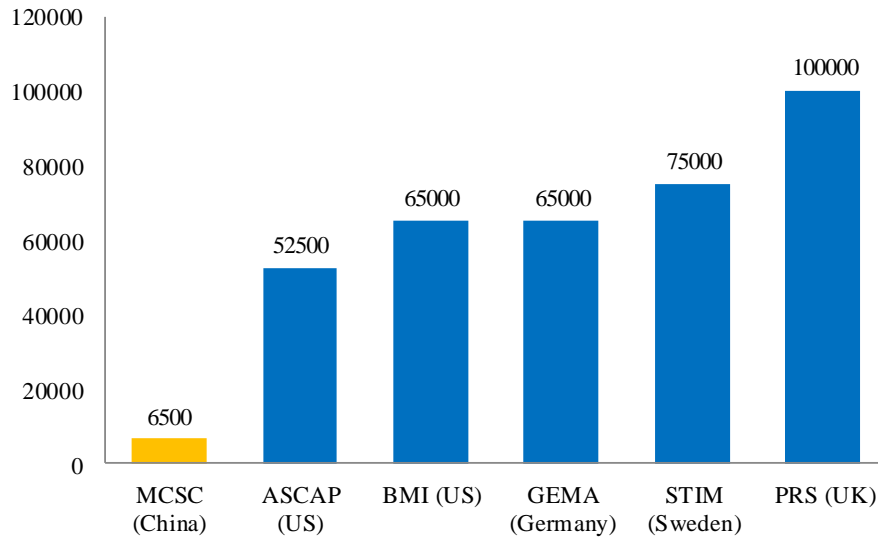
71. By comparison, China Musicians Association, which consists exclusively of established musicians recognized by the government, has 13,900 members. See *Info*, CHINESE MUSICIANS ASSOCIATION, <http://www.chnmusic.org/CmaInfo.html>.

72. See, e.g., Annette Kur & Jens Schovsbo, *Expropriation or Fair Game for All? The Gradual Dismantling of the IP Exclusivity Paradigm* (Max Planck Institute for Intellectual Property, Competition & Tax Law Research Paper No. 09-14, 2009), <http://ssrn.com/abstract=1508330>, at 13.

73. See, e.g., Maria Pallante, *Orphan Works, Extended Collective Licensing and Other Current Issues*, 34 COLUM. J.L. & ARTS 23, 31 (2010) (“Collective extending licensing is basically a form of statutory licensing.”); Riis & Schovsbo, *supra* note 48, at 476.

in areas such as cable transmission are entirely compulsory without an opt-out option for authors.<sup>74</sup>

**Figure 1: Memberships of Various Collecting Societies<sup>75</sup>**



Furthermore, nonmember authors, especially foreign authors, may not always be aware that their works are used under an ECL agreement. If an author does not join the domestic society or join a foreign society that has a reciprocal agreement with the domestic society, she is practically denied the right to opt out or to claim remuneration. The reason is that a collecting society typically does not have a legal obligation to seek out nonmembers whose works are used.<sup>76</sup> Neither does it have internal incentives to do so. If the royalties collected remain unclaimed for a certain amount of time (say three years), a collecting society would normally distribute the funds among

74. Council Directive of 27 September 1993 on the Coordination of Certain Rules Concerning Copyright and Rights Related to Copyright Applicable to Satellite Broadcasting and Cable Retransmission, Art. 9(1) 93/83/EEC, 1993 O.J. (L 248) 15 [hereinafter the E.U. Satellite and Cable Directive].

75. Membership data for Figure 1 was obtained from collecting society websites. See <http://www.mcsc.com.cn/imS-13-994.html> (MCSC); *About Us*, ASCAP, <http://www.ascap.com/about/> (last visited April 4, 2017); *About*, BMI, <http://www.bmi.com/about> (last visited April 4, 2017); *About Us*, GEMA, <https://www.gema.de/en/> (last visited April 4, 2017); STIM, <https://www.stim.se/en> (last visited April 4, 2017); *Our Members*, PRS FOR MUSIC, <https://www.prsformusic.com/aboutus/ourorganisation/ourmembers/Pages/default.aspx> (last visited April 4, 2017).

76. See Riis & Schovsbo, *supra* note 48, at 483.



existing members or use them to cover administrative costs.<sup>77</sup> This windfall suggests that the ECL may financially benefit those collecting societies that sit on the royalties collected for unidentified authors. The prejudice against foreign authors appears more severe when a collecting society decides to withhold certain funds (e.g., 10% of the royalties collected) for social, cultural, and other collective purposes in the forms of stipends and scholarships.<sup>78</sup> Although the royalties are derived from both domestic and foreign works, typically only domestic authors are provided access to such stipends, a result akin to economic protectionism and thus in violation of the spirit (if not mandates) of national treatment under the Berne Convention and the TRIPS Agreement.<sup>79</sup>

The ECL, by extending the licensed repertoire to all works in a category, also strengthens the monopolistic positions of existing collecting societies against both users and authors. Anecdotes illustrate how monopolistic societies have wielded their market power to squeeze exorbitant royalties from their users. For example, in 1989 the French collecting society SACEM was sued for unfair trading and price fixing because it charged discotheques at a royalty rate fifteen times higher than sister societies, including GEMA, normally charged.<sup>80</sup> The Canadian collecting society Access Copyright faced vociferous opposition from universities in 2012 when it increased the annual license fee per student to \$26, significantly higher than the \$3.56 per student fee that its sister society Copyright Clearance Center (“CCC”) charged in the United States.<sup>81</sup> In 1992, MTV Europe filed a complaint alleging price fixing by VPL, a collecting society established by IFPI to manage music videos for major music labels in Europe. The labels, through VPL, jointly demanded that MTV Europe pay

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77. For methodologies to distribute unclaimed funds, see, for example, *General FAQ*, SOUNDEXCHANGE, <http://www.soundexchange.com/generalfaq/> (last visited Apr. 4, 2017).

78. See Ginsburg, *supra* note 57, at 195 (“The use of collected money for collective purposes is not unique to the Nordic [countries] . . . CISAC have a long tradition of deducting up to 10% of their revenue for various collective purposes.”); Riis & Schovsbo, *supra* note 48, at 492 (“[T]he practice is widespread and generally accepted due to the prevalence of the practice (at least in continental Europe).”); Ferdinand Melichar, *Deductions Made by Collecting Societies for Social and Cultural Purposes in the Light of International Copyright Law*, 22 I.I.C. 47, 49 (1991).

79. PAUL GOLDSTEIN, *COPYRIGHT’S HIGHWAY: FROM GUTENBERG TO THE CELESTIAL JUKEBOX* 159 (2003).

80. See Joined Cases 110/88, 241/88 & 242/88, *Lucazeau v. SACEM*, 1989 E.C.R. 2811.

81. See Howard Knopf, *AUCC Settlement with Access Copyright—Questions and Answers—or Still More Questions?*, EXCESS COPYRIGHT (May 2, 2012, 7:34 PM), <http://excesscopyright.blogspot.ca/2012/05/aucc-settlement-with-access-copyright.html>.

15% of its gross revenue, while they offered music videos essentially for free in the United States.<sup>82</sup> The zero-price offered in the United States could indeed reflect the market rate because music companies in a competitive environment would be more open to sacrificing performance royalties, taking into account the obvious effect of television broadcasting to promote record sales.

In theory, the royalty rate without the coordination by a collecting society may even settle at a negative level, as evidenced by the long-term practice of payola, a reverse payment from individual music labels (sometimes music publishers) to radio/television broadcasters in exchange for more airtime of their own works.<sup>83</sup> Collecting societies typically grant blanket licenses that charge users uniform prices based on business scales of sales revenue or square footage, regardless of which and how many songs are actually performed. This business model functions in a way similar to a price-fixing cartel that limits price competition between songs and music companies.<sup>84</sup> However, game theory suggests that, as could happen to any price collusion among oligopolists, individual music companies have an inherent incentive to “cheat,” in other words, to *compete secretly* by offering broadcasters payola under the table to boost music sales and obtain a bigger share of the performance royalty pie. In this sense, payola may be regarded as one piece of evidence that the rates offered by collecting societies are too high and that persistent lobbying efforts by the music industry to outlaw payola actually aim to reinforce price collusion and discipline violators.<sup>85</sup>

Several countries have imposed price control mechanisms, such as governmental agencies in charge of rate-setting proceedings, on collecting societies to protect users from potential supra-competitive pricing. Typical examples include the Copyright Licensing Tribunal in Denmark,<sup>86</sup> the Copyright Tribunal in the United Kingdom,<sup>87</sup> and the rate courts at the

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82. See Hamish Porter, *European Union Competition Policy: Should the Role of Collecting Societies Be Legitimised?* 18 E.I.P.R. 672, 676 (1996).

83. See KERRY SEGRAVE, *PAYOLA IN THE MUSIC INDUSTRY: A HISTORY, 1880–1991* 36 (1993) (indicating payola payments to radio stations sometimes exceeded the royalties collected by ASCAP).

84. See RICHARD A. POSNER, *ANTITRUST LAW* 30 (2d ed. 2001) (collecting societies are examples of the “benign cartel”); William M. Landes, *Harm to Competition: Cartels, Mergers and Joint Ventures*, 52 *ANTITRUST L. J.* 625, 632 (1983) (calling collecting societies “one of the hallmarks of a successful cartel”).

85. See Ronald H. Coase, *Payola in Radio and Television Broadcasting*, 22 *J.L. & ECON.* 269, 315 (1979).

86. See Riis & Schovsbo, *supra* note 48, at 476.

87. See *About Us*, COPYRIGHT TRIBUNAL, <https://www.gov.uk/government/organizations/copyright-tribunal/about>.

United States District Court for the Southern District of New York.<sup>88</sup> Governmental rate-setting is notorious for giving rise to wasteful rent seeking, being susceptible to regulatory capture, and systematically underestimating the market values of intellectual products. These drawbacks will be further discussed in the context of various compulsory licenses, but it suffices to point out here, that the widespread imposition of governmental rate-setting in Nordic countries stands in dramatic contrast to the conventional wisdom that ECL regimes can achieve the best of both worlds—decreasing transaction costs *and* safeguarding market transactions.<sup>89</sup>

While the ECL may increase the market power of collecting societies, ample evidence exists indicating that collecting societies with monopolistic positions tend to have less incentive to improve their productive efficiency than those faced with fierce competition in the marketplace. Competitive American collecting societies ASCAP and BMI respectively spent 11.3%<sup>90</sup> and 11.7%<sup>91</sup> of their royalty revenues to offset administrative costs. By contrast, European collecting societies, most of which traditionally retained de jure monopoly within their respective territories, had pocketed 30% to 40% of royalties as administrative fees until market pressure intensified in the mid-1990s and resulted in a sizable decrease of overhead to 15%.<sup>92</sup> The European Union has recently stipulated a directive on collective rights management for the very purpose of further rejuvenating Europe-wide competition between collecting societies from different member countries.<sup>93</sup> Similarly, all of the Chinese collecting societies have monopolistic positions in their respective areas by operation of law.<sup>94</sup> Their operating

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88. Currently, Judge Denise Cote oversees rate-setting proceedings regarding ASCAP, and Judge Louis L. Stanton oversees rate-setting proceedings regarding BMI. *See* Music Marketplace Study, *supra* note 34, at 41.

89. *See* Riis & Schovsbo, *supra* note 48, at 473 (“ECLs have the effectiveness of compulsory licenses but at the same time leave right holders in control of the use of their works.”).

90. *See* ASCAP, <http://www.ascap.com/licensing/licensingfaq.aspx#general>.

91. *See* BMI Tops \$900 Million Mark in Revenues, BMI NEWS (Aug. 25, 2008), [http://www.bmi.com/news/entry/bmi\\_tops\\_900\\_million\\_mark\\_in\\_revenues](http://www.bmi.com/news/entry/bmi_tops_900_million_mark_in_revenues).

92. *See* Jeff Clark-Meads, *U2 Settles Royalty Suit with U.K.’s PRS*, BILLBOARD, Apr. 18, 1998, at 4.

93. Directive 2014/26, of the European Parliament and of the Council of 26 February 2014 on Collective Management of Copyright and Related Rights and Multi-Territorial Licensing of Rights in Musical Works for Online Use in the Internet Market, 2014 O.J. (L 84/72).

94. *See* Article 7, The Regulations of Copyright Collective Management (effective on Mar. 1, 2005), [http://www.gov.cn/gongbao/content/2011/content\\_1860740.htm](http://www.gov.cn/gongbao/content/2011/content_1860740.htm) (allowing no overlapping between the business scopes of different collecting societies).

efficiency is frequently called into question. For instance, collecting societies are semi-governmental organizations in China and their employees actually receive substantial stipends from the Chinese government.<sup>95</sup> Despite that, CAVCA, the collecting society that manages music videos used by karaoke parlors, was reported to distribute only 46% of the royalties collected to copyright owners (including all composers, performers, and producers), retaining the rest as administrative costs.<sup>96</sup>

In addition, the proposed ECL in China likely runs a higher risk than the Nordic model of violating the three-step test under the TRIPS Agreement: “Members shall confine limitations or exceptions to exclusive rights to certain special cases which do not conflict with a normal exploitation of the work and do not unreasonably prejudice the legitimate interests of the right holder.”<sup>97</sup> As a WTO panel sensibly explained, the first step of the three-step test, “certain special cases,” requires that limitations or exceptions be well-defined and limited in scope and reach.<sup>98</sup> The WTO panel went on to find that the business exemption under the U.S. Copyright Act<sup>99</sup> clearly violates the first step by *not* being limited to “certain special cases” because it effectively exempts 70% of all eating and drinking establishments and 45% of all retail establishments in the United States.<sup>100</sup> In the same vein, if a Chinese collecting society like MCSC has recruited less than 10% of Chinese musicians as its members,<sup>101</sup> extending their licenses to the entirety of Chinese musicians would prejudice the exclusive rights of the unassociated 90%, a vast majority that can hardly be reconciled with the requirement of “certain special cases.”

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95. See Ye Jiang, *Changing Tides of Collective Licensing in China*, 21 MICH. ST. INT'L L. REV. 729, 744 (2013).

96. See Yifei Tan, *Zhongwenfa Profits from the Karaoke Supervision Platform – Discovering the Distribution Scheme of KTV Revenues*, INFZM.COM (Mar. 25, 2010), <http://www.infzm.com/content/42972/0>.

97. TRIPS Agreement, *supra* note 31, Article 13. The ECL is likely to constitute “exceptions or limitations” under the TRIPS Agreement and the Berne Convention. See *id.*; Berne Convention, *supra* note 30, Article 9(2); Alain Strowel, *Symposium: Collective Management of Copyrights: Solution or Sacrifice? The European “Extended Collective Licensing” Model*, 34 COLUM. J.L. & ARTS 665, 669 (2011) (stating an ECL works in practice as an exception); cf. Séverine Dusollier & Caroline Colin, *Symposium: Collective Management of Copyrights: Solution or Sacrifice? Peer-to-Peer File Sharing and Copyright: What Could Be the Role of Collective Management?*, 34 COLUM. J.L. & ARTS 809, 826 (2011).

98. See Report of the Panel, *United States—Section 110(5) of the U.S. Copyright Act*, ¶ 6.31, WTO Doc. WT/DS160/R (June 15, 2000).

99. See 17 U.S.C. § 110(5) (2012).

100. See Report of the Panel, *supra* note 98, ¶ 6.237.

101. See *supra* note 71 and accompanying text.

C. MARKET ALTERNATIVES

Admittedly, the proposed ECL offers advantages. First, the ECL, similar to any other form of collective management, is designed to minimize transaction costs.<sup>102</sup> By pooling a large number of copyrighted works, collecting societies may theoretically generate economies of scale for authors in negotiating, auditing, and enforcing copyright licenses.<sup>103</sup>

Second, the ECL system would establish a one-stop shop that particularly benefits prospective users who desire to clear all necessary licenses for a large repertoire of copyrighted works in a cost-effective way.

Third, the ECL could immediately and substantially strengthen the bargaining power of collecting societies against large market players.<sup>104</sup> A high-level official at the NCAC once told a story that vividly illustrates this point: In 2010, the Chinese collecting society CWWCS discovered that Google had scanned 210,000 books written by 80,000 Chinese authors. It approached Google and claimed, “We are the only collecting society that manages literary works in China, and you need a license from us to scan

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102. See Besen et al., *supra* note 32, at 383.

103. See *Broadcast Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1, 20 (1979):

ASCAP and the blanket license developed together out of the practical situation in the marketplace: thousands of users, thousands of copyright owners, and millions of compositions. Most users want unplanned, rapid, and indemnified access to any and all of the repertory of compositions, and the owners want a reliable method of collecting for the use of their copyrights. Individual sales transactions in this industry are quite expensive, as would be individual monitoring and enforcement, especially in light of the resources of single composers. Indeed, as both the Court of Appeals and CBS recognize, the costs are prohibitive for licenses with individual radio stations, nightclubs, and restaurants . . . and it was in that milieu that the blanket license arose.

See also WORLD INTELLECTUAL PROPERTY ORGANIZATION, COLLECTIVE MANAGEMENT OF COPYRIGHT AND RELATED RIGHTS 130 (2002):

In the case of “performing rights,” reprographic reproduction rights and the rights in respect of simultaneous and unchanged retransmission of broadcast programs, collective administration is an indispensable means of the exercise of the exclusive rights to authorize the uses concerned. . . . The number and circumstances of uses and the number and variety of works used make it practically impossible for the users to identify the right owners in due time, ask for their authorization, negotiate their remuneration and other conditions of the use and to pay the fees on an individual basis.

104. See, e.g., Gervais, *supra* note 70, at 344 (“CMOs offer rightsholders the possibility of carrying a greater weight when negotiating with the larger users.”).

Chinese books for the Google Books Project.”<sup>105</sup> However, Google subsequently found out that CWWCS only had about 6000 members, representing less than 10% of all Chinese authors.<sup>106</sup> In other words, Google could still face liability from the other 90% of Chinese authors after paying the collecting society. Google quickly walked away, as any rational business would do. This story explains why the less representative a collecting society is, the more likely it is to desire an ECL. However, there is an obvious irony: the ECL system presupposes a highly representative and efficient collecting society that operates in a well-functioning copyright market;<sup>107</sup> in reality, the strongest proponents of the ECL system are oftentimes nascent collecting societies that have yet to accumulate sufficient memberships in a market dominated by a large number of foreign or otherwise nonmember works.<sup>108</sup>

Nevertheless, the proposed ECL is by no means the only way to increase representation. Another method is for collecting societies to improve their services and attract more members. In this sense, the fundamental concern about the proposed ECL is its potential effect on the incentives for collecting societies to offer authors better services by implementing new technologies and increasing operational efficiency.

Currently, without the benefits the proposed ECL provides, Chinese collecting societies sometimes provide an indemnification clause as part of their license agreements. Accordingly, collecting societies would defend and hold their users harmless from all copyright claims including those from non-members.<sup>109</sup> These collecting societies essentially operate in a way

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105. See Ziqiang Wang, *Media Interaction Conference for the Third Amendment to Copyright Law (manuscript)*, SINA (Apr. 25, 2012), [http://ent.sina.com.cn/y/2012-04-25/17063615203\\_7.shtml](http://ent.sina.com.cn/y/2012-04-25/17063615203_7.shtml).

106. See NCAC, *RMB 170 Million Was Distributed in 2011*, GOV.CN (Dec. 4, 2010), [http://www.gov.cn/gzdt/2012-12/04/content\\_2282411.htm](http://www.gov.cn/gzdt/2012-12/04/content_2282411.htm).

107. See *supra* note 33 and accompanying text.

108. See, e.g., Riis & Schovsbo, *supra* note 49, at 937 (noting Norwaco, the Norwegian collecting society that manages cable retransmission rights, requested the ECL power even though of the two hundred broadcasting channels in Norway, only fourteen were actually Norwegian); see also Jiang, *supra* note 95, at 732 (2013) (noting the ECL was proposed in China, a country “[w]ith nascent collective societies and a vulnerable copyright regime”); Gervais, *supra* note 15, at 4 (“The advantage of the extended collective license system in Canada would be to place small collective management organizations (CMOs) on the same footing as large CMOs.”).

109. The indemnification clause appears to be common practice in the United States and in Europe. See Koskinen-Olsson, *supra* note 33, at 292; cf. *Columbia Broad. Sys., Inc. v. American Soc. of Composers*, 562 F.2d 130, 140 (2d Cir. 1977):

There is not enough evidence in the present record to compel a finding that the blanket license does not serve a market need for those who wish

similar to liability insurance companies.<sup>110</sup> In the United States, prospective users could obtain virtually total freedom to use any musical works by purchasing blanket licenses in a competitive market of collecting societies that includes ASCAP, BMI, and SESAC.<sup>111</sup> These successful examples demonstrate how market forces may both diminish transaction costs and give rise to dynamic competition toward efficiency.

In response to overwhelming opposition from the Chinese public, the second draft of the Chinese Copyright Reform Bill narrowed the scope of the proposed ECL to two areas: use of musical and audiovisual works in karaoke parlors; and use of literary, musical, artistic, and photographic works by broadcasting organizations.<sup>112</sup> This proposal also makes little sense. Both karaoke parlors and music companies constitute commercial undertakings that operate in a highly organized and competitive marketplace. One would be hard-pressed to identify another pair of willing buyers and willing sellers that are more prepared to engage in market negotiations. These sectors arguably need the ECL the least. The ECL power would also be redundant for broadcasters should they continue to receive a compulsory license for uses of copyrighted works in their programs.<sup>113</sup>

On a related note, Nordic countries originally designed the ECL not as a mechanism to encroach extensively on the exclusive rights of copyright owners but as a favored alternative to compulsory licenses.<sup>114</sup> Should Chinese policymakers be determined to implement the Nordic approach faithfully, they should start by transforming existing compulsory licenses into the ECL regime. First, it would alleviate the rigidity and insensitivity to market reality inherent in existing compulsory licenses because authors

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full protection against infringement suits or who, for some other business reason, deem the blanket license desirable. The blanket license includes a practical covenant not to sue for infringement of any ASCAP copyright as well as an indemnification against suits by others.

110. This contractual design is one of the reasons why Chinese collecting societies called for a new limitation on liability provision under copyright law for collecting society licensees. See Article 70, First Draft, *supra* note 4; see also Jichao Ma, *The Necessity and Urgency of Implementing Extended Collective Licenses in Our Country*, SINA (Nov. 30, 2011), [http://blog.sina.com.cn/s/blog\\_593badd10100xdbv.html](http://blog.sina.com.cn/s/blog_593badd10100xdbv.html) (describing how CAVCA assisted karaoke parlors in handling lawsuits authors filed).

111. See Music Marketplace Study, *supra* note 34, at 19.

112. Article 60, Second Draft, *supra* note 4.

113. Article 43, Copyright Law of the People's Republic of China of 2010 (effective on Apr. 1, 2010), <http://www.ncac.gov.cn/chinacopyright/contents/479/17542.html> [hereinafter "Chinese Copyright Law"].

114. See Riis & Schovsbo, *supra* note 48, at 473.

would have a choice to opt out of the ECL and instead license their works directly. Second, for authors who prefer to stay within the ECL system, in most cases their copyright royalties would be decided through arms-length negotiations between collecting societies and prospective users. Third, the Chinese government would have a limited number of pilot projects to examine the long-term dynamics of the ECL regime first without unduly disturbing the status quo and vested interests.<sup>115</sup>

### III. COMPULSORY LICENSE

The mechanical license under 17 U.S.C. § 115 originates from the first compulsory license in U.S. history that Congress established in 1909.<sup>116</sup> It allows anyone to make and distribute phonorecords of a musical work after the work has been distributed to the public in the United States in phonorecords with permission, provided that the user serves a notice of intention, presents statements of account, and pays government-set royalties on a monthly basis.<sup>117</sup> Mechanical licenses have opened the gate for other compulsory licenses to proliferate. Today, compulsory licenses cover usages ranging from non-interactive digital public performances of sound recordings<sup>118</sup> and related ephemeral recordings<sup>119</sup> to retransmission by satellite and cable of broadcast programs,<sup>120</sup> over-the-air transmission of musical works by public broadcasting entities,<sup>121</sup> and a public levy imposed on digital audio recording devices and media.<sup>122</sup> ASCAP and BMI, which are collecting societies that manage public performance rights of musical works, are also subject to price control by the Southern District of New

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115. The U.S. government appears to follow this cautious approach regarding the online music market. See Music Marketplace Study, *supra* note 34, at 1.

116. See Howard B. Abrams, *Copyright's First Compulsory License*, 26 SANTA CLARA COMPUT. & HIGH TECH. L.J. 215, 216 (2010).

117. 17 U.S.C. § 115(b)(1) (2012).

118. § 114(f).

119. § 112(e).

120. §§ 111, 119, 122.

121. § 118(b).

122. § 1003.



York rate courts.<sup>123</sup> The provisions on compulsory licenses account for approximately 40% of the 280-page U.S. Copyright Act as it stands.<sup>124</sup>

The Chinese Copyright Law currently includes a provision similar to § 115 of the U.S. Copyright Act:

A producer of sound recording may use a musical work that has been legally recorded in a sound recording to produce another sound recording without permission of the copyright owner, provided that she pays statutorily set royalties. Nevertheless, such a use is not permitted for any work for which the copyright owner has declared that the use is prohibited.<sup>125</sup>

The key difference between U.S. and Chinese mechanical licenses is that copyright owners are permitted to opt out of the compulsory license under the Chinese regime. In this sense, the Chinese provision is more analogous to the ECL system than a typical compulsory license. In any event, the provision has not drawn much public attention before the copyright reform because Chinese musicians and music companies routinely opt out.

The first draft of the Chinese Copyright Reform Bill proposed to transform the mechanical license into a compulsory license by removing the opt-out option in the current provision.<sup>126</sup> The proposed change sparked an outcry in the Chinese music industry. A number of top Chinese musicians publicly voiced their concerns that the compulsory license would be tantamount to an endorsement of piracy and a disincentive to invest in original music compositions.<sup>127</sup> The Record Industry Commission of the China Audio-Video Association, which mostly represents potential users of the compulsory license, issued a public statement lamenting that the

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123. ASCAP and BMI are governed by consent decrees imposed as a result of antitrust complaints filed by the Antitrust Division of the U.S. Department of Justice. It brought a civil action in 1941 which led to the first consent decree (U.S. v. ASCAP, 1940-1943 Trade Cas. (CCH) ¶ 56, 104 (S.D.N.Y. 1941)); it was then modified in 1950 (U.S. v. ASCAP, 1950-1951 Trade Cas. (CCH) ¶ 62, 595 (S.D.N.Y. 1950)), again in 1960 (U.S. v. ASCAP, 1960 Trade Cas. (CCH) ¶ 69, 612 (S.D.N.Y. 1960)), and most recently in 2001 (U.S. v. ASCAP, 2001 WL 1589999 (S.D.N.Y.)). The first consent order regarding BMI was issued in 1941 (U.S. v. BMI, 1940-1943 Trade Cas. (CCH) ¶ 56, 096 (E.D. Wisc. 1941)), and was modified twice: in 1966 (U.S. v. BMI, 1966 Trade Cas. (CCH) ¶ 71, 941 (S.D.N.Y. 1966)) and 1994 (U.S. v. BMI, 1996-1 Trade Cas. (CCH) ¶ 71, 378 (S.D.N.Y. 1994)).

124. The full text of the U.S. Copyright Act is available at <http://copyright.gov/title17/>.

125. Article 40, Chinese Copyright law, *supra* note 113.

126. Article 46, First Draft, *supra* note 4.

127. See Tang Yue, *Songwriters Say Copyright Draft Doesn't Protect*, CHINA DAILY (Apr. 6, 2012), [http://www.chinadaily.com.cn/china/2012-04/06/content\\_14986887.html](http://www.chinadaily.com.cn/china/2012-04/06/content_14986887.html) (quoting Gao Xiaosong and Li Guangping).

proposal would deprive copyright owners of their licensing rights, destroy the business models of the music industry, and exacerbate the difficulties of musicians who have been fighting an uphill battle with widespread copyright piracy.<sup>128</sup>

The NCAC explained that the compulsory license would be useful for preventing musical composition monopolies.<sup>129</sup> This explanation, according to musicians, showed how much the government officials had lost touch with the reality in the music industry.<sup>130</sup> Musicians contended that, facing widespread piracy and competing with free illegal copies, most of them struggle to make ends meet. At present, none of the Chinese music companies is even financially strong enough to go public, let alone create a monopoly.<sup>131</sup> By contrast, some downstream users like Baidu, Alibaba, and Tencent, which Chinese policymakers intend to protect from any monopoly, are among the most powerful companies in the world with dominant market positions and multi-billion dollar assets.<sup>132</sup> A compulsory license that deprives musicians of their exclusive rights would amplify the already massive bargaining imbalance between technology providers and content providers.

The concerns of Chinese musicians and music companies are not unfounded, especially in light of their previous experience with another compulsory license for broadcasting organizations. Under the Chinese Copyright Law of 1990, radio and television stations that broadcast published sound recordings for non-commercial purposes enjoyed a total exemption from any claims of copyright owners, performers, or sound

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128. See *Singing Work: Copyright Office Representatives to Ignore the Voice of the Artist Published Appeal Dissatisfied*, CAIJING (Apr. 26, 2012), <http://industry.caijing.com.cn/2012-04-26/111829501.html> (full text of appeal of Record Industry Commission of the Chinese Audio-Video Association).

129. See *Record: The Third Revision of Copyright Law Press Conference*, SINA (Apr. 25, 2012), <http://ent.sina.com.cn/y/2012-04-25/17063615203.shtml> (transcripts of the presentation by Wang Ziqiang, Department of Law and Treaties, NCAC).

130. See Li Yi, *Chinese Musicians Association Convened an Emergency Conference to Discuss the Controversial Clauses of Copyright Law Amendment*, SINA (Apr. 10, 2012), <http://ent.sina.com.cn/c/2012-04-10/11173601191.shtml> (quoting Song Ke); Liu Ren & Jiang Xu, *The Public Enquiries of the Draft Copyright Law Aroused Controversies*, STATE INTELLECTUAL PROPERTY OFFICE OF THE P.R.C. (Apr. 13, 2012), [http://www.sipo.gov.cn/mtjj/2012/201310/t20131023\\_830773.html](http://www.sipo.gov.cn/mtjj/2012/201310/t20131023_830773.html) (quoting Zang Yanbin).

131. Ren & Xu, *supra* note 130.

132. See *Market Capitalization of the Largest Internet Companies Worldwide as of May 2015 (in Billion U.S. Dollars)*, STATISTA (June 2016), <http://www.statista.com/statistics/277483/market-value-of-the-largest-internet-companies-worldwide/>.

recording producers.<sup>133</sup> This provision was arguably inconsistent with the Berne Convention<sup>134</sup> and the three-step test under the TRIPS Agreement.<sup>135</sup> Therefore, right before China joined the WTO on December 11, 2001,<sup>136</sup> the Chinese Copyright Law of 2001 turned the exemption into a compulsory license: “Radio and television stations may broadcast published sound recordings without the permission of copyright owners but shall pay remunerations, unless the relevant parties have agreed otherwise. Detailed measures shall be formulated by the State Council.”<sup>137</sup> However, for the first eight years after the enactment of the compulsory license, Chinese broadcasting organizations, which are mostly resourceful state-owned enterprises, had wielded their lobbying powers to effectively block any initiatives to stipulate the detailed measures.<sup>138</sup> During that period, they continued to use all musical works for free. It was not until 2010 that radio and television stations gradually started negotiating with the MCSC, the collecting society responsible for managing the compulsory license.<sup>139</sup> This experience taught the music industry how vulnerable compulsory licenses were to regulatory capture by lobbying groups.

As a result of strong opposition from Chinese musicians and music companies, the third draft of the Chinese Copyright Reform Bill totally removed the compulsory license for mechanical reproductions together with the pre-existing provision.<sup>140</sup> In recent years, compulsory licensing has actually returned to the spotlight in copyright scholarship. It has been proffered as a solution to orphan works and mass digitization.<sup>141</sup> Several commentators suggest legalizing peer-to-peer file sharing in exchange for a levy imposed on information technologies including Internet access.<sup>142</sup> The

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133. Article 43, Copyright Law of People’s Republic of China of 1990 (effective on Jun. 1, 1991), <http://www.people.com.cn/zixun/flfgk/item/dwjff/falv/7/7-2-01.html>.

134. Berne Convention, *supra* note 30, Article 11 bis(1).

135. TRIPS Agreement, *supra* note 31, Article 13.

136. *See Member Information: China and the WTO*, WORLD TRADE ORG., [https://www.wto.org/english/thewto\\_e/countries\\_e/china\\_e.htm](https://www.wto.org/english/thewto_e/countries_e/china_e.htm).

137. Article 44, Chinese Copyright Law, *supra* note 113.

138. *See Interim Measures for the Payment of Remuneration for Sound Recordings Played by Radio and Television Stations* (effective on Jan. 1, 2010), [http://www.gov.cn/zwjk/2009-11/17/content\\_1466687.htm](http://www.gov.cn/zwjk/2009-11/17/content_1466687.htm).

139. MCSC, 2010 ANNUAL REPORT 3, <http://www.mcsc.com.cn/pdf/phpIK0X7C.pdf>.

140. Third Draft, *supra* note 4.

141. *See, e.g.*, Robert Kirk Walker, *Negotiating the Unknown: A Compulsory Licensing Solution to the Orphan Works Problem*, 35 CARDOZO L. REV. 983, 986 (2014).

142. *See* WILLIAM W. FISHER III, PROMISES TO KEEP: TECHNOLOGY, LAW, AND THE FUTURE OF ENTERTAINMENT 199–258 (2004); Peter Eckersley, *Virtual Markets for Virtual Goods: The Mirror Image of Digital Copyright?*, 18 HARV. J.L. & TECH. 85, 100 (2004);

U.S. Supreme Court in *eBay v. MercExchange* reinforces the discretionary powers of federal courts to withhold injunctive relief in intellectual property cases, which is arguably equivalent to a judiciary-imposed compulsory license.<sup>143</sup> The rejection of mechanical compulsory licenses in Chinese law serves as a reminder to reevaluate the efficacy and efficiency of compulsory licenses in the digital age. This Part focuses on three traditional rationales for compulsory licenses: monopoly prevention, transaction costs, and political compromise.

#### A. COPYRIGHT AND MONOPOLY

When the 1909 Copyright Act first introduced the compulsory license in the United States, Congress indeed intended to prevent the emergence of a monopoly power.<sup>144</sup> In the early 1900s, when piano rolls became one of the most popular ways for families to enjoy music in private,<sup>145</sup> federal courts faced the thorny question of whether mechanical renderings of musical compositions without authorization constituted copyright infringement.<sup>146</sup> The Supreme Court held in *White-Smith Music Publishing v. Apollo* that a piano roll was not a “copy” within the meaning of the Copyright Act because humans normally were unable to “see and read” the musical composition reproduced on a piano roll.<sup>147</sup>

Although the majority decision in the *Apollo* case found piano rolls not liable for copyright infringement, it was accompanied by a powerful concurrence from Justice Holmes pleading for legislative recognition of mechanical rights.<sup>148</sup> Music publishers had been lobbying Congress for a legislative intervention even prior to the *Apollo* decision.<sup>149</sup> Against this

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Neil Weinstock Netanel, *Impose a Noncommercial Use Levy to Allow Free Peer-to-Peer File Sharing*, 17 HARV. J.L. & TECH. 1, 35 (2003).

143. See *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 392 (2006). For empirical evidence of the overall influences of the eBay decision, see Jiarui Liu, *Copyright Injunctions After eBay: An Empirical Study*, 16 LEWIS & CLARK L. REV. 216, 231 (2012).

144. H.R. REP. NO. 60-2222, at 8 (1909).

145. See GOLDSTEIN, *supra* note 79, at 53; RUSSELL SANJEK, AMERICAN POPULAR MUSIC AND ITS BUSINESS: THE FIRST FOUR HUNDRED YEARS VOLUME II: FROM 1790 TO 1909 383 (1988); BRIAN DOLAN, INVENTING ENTERTAINMENT: THE PLAYER PIANO AND THE ORIGINS OF AN AMERICAN MUSICAL INDUSTRY 53 (2009).

146. See *White-Smith Music Publ'g Co. v. Apollo Co.*, 209 U.S. 1 (1908).

147. *Id.* at 17.

148. *Id.* at 19.

149. See, e.g., S. 6330, 59th Cong. § 1(g) (1906); H.R. 19853, 59th Cong. § 1(g) (1906); see Harry G. Henn, *The Compulsory License Provisions of the U.S. Copyright Law*, COPYRIGHT LAW REVISION, SENATE COMM. ON THE JUDICIARY, 86TH CONG., 1ST SESS., STUDIES PREPARED FOR THE SUBCOMM. ON PATENTS, TRADEMARKS, AND COPYRIGHTS OF THE COMM. ON THE JUDICIARY 3 (COMM. PRINT 1960) (STUDY No. 5).

backdrop, the Aeolian Company set out to actively acquire the not-yet-existing mechanical rights in musical compositions speculating that Congress would soon pass a bill to totally reverse the *Apollo* holding.<sup>150</sup> The Aeolian Company was a leading manufacturer of piano rolls and received a patent on its player piano, the Pianola.<sup>151</sup> Due to the legal uncertainty surrounding mechanical rights, the Aeolian Company managed to quickly accumulate a significant share in the music market on relatively favorable terms and conditions: Eighty-seven members of the Music Publishers Association granted exclusive mechanical licenses, which in the aggregate represented 381,598 compositions and accounted for 43% of the total market.<sup>152</sup>

The anticompetitive implications of the above practice deeply concerned Congress in 1909, which warned that, if mechanical rights were formally enacted, “not only would there be a possibility of a great music trust in this country and abroad, but arrangements are being actively made to bring it about.”<sup>153</sup> As a result, the 1909 Copyright Act on the one hand overruled the *Apollo* decision by, for the first time, granting authors exclusive rights to reproduce musical works in phonorecords; on the other hand though, the Act created a compulsory license for subsequent mechanical reproductions of musical works to address the antitrust concern.<sup>154</sup>

No matter how realistic the threat of a music cartel was in light of the actions taken by the Aeolian Company (which ceased to exist decades ago), the antitrust rationale for compulsory licenses finds little support in modern

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150. See SANJEK, *supra* note 145, at 23, 400.

151. *Id.*; U.S. Patent No. 765,645 (filed Nov. 16, 1899).

152. See SANJEK, *supra* note 145, at 23. The Aeolian Company agreed to pay 10% of the retail prices of piano rolls sold. The other 117 music publishers in the Music Publishers Association controlled 503,597 compositions. Remarkably, iHeart Media—the largest broadcaster in the United States—used the same strategy in 2013 when it entered into licensing agreements with Warner Music Group and a number of independent labels (including Big Machine Records, which represents Taylor Swift) covering both digital performance rights and not-yet-existing terrestrial performance rights of sound recordings. See Ed Christman, *Here’s Why Warner Music’s Deal with Clear Channel Could be Groundbreaking for the Future of the U.S. Music Biz (Analysis)*, BILLBOARD (Sept. 12, 2013), <http://www.billboard.com/biz/articles/news/5694973/heres-why-warner-musics-deal-with-clearchannel-could-be-groundbreaking>. In doing so, iHeartMedia was able to obtain favorable percentage-based rates, unlike the current per-play rates set by Copyright Royalty Judges. See Ben Sisario, *Clear Channel Warner Music Deal Rewrites the Rules on Royalties*, N.Y. TIMES (Sept. 12, 2013), <http://www.nytimes.com/2013/09/13/business/media/clear-channelwarner-music-deal-rewrites-the-rules-on-royalties.html>.

153. H.R. REP. NO. 60-2222, at 8 (1909); S. REP. NO. 60-1108, at 8 (1909).

154. Copyright Act of 1909, Pub. L. No. 60-349, §1(e), 35 Stat. 1075, 1075–76 (1909).

copyright regimes.<sup>155</sup> Copyrights rarely confer market power in the same manner patents do because different copyrighted works are often good (albeit not perfect) substitutes for each other.<sup>156</sup> The high degree of substitutability lies primarily in several legal doctrines in copyright law. First, the idea/expression dichotomy mandates that copyright protection only extend to expressions rather than to ideas in a work of authorship.<sup>157</sup> This principle suggests that a subsequent author could intentionally imitate a pre-existing work as closely as possible, provided the borrowing is limited to unprotected ideas. Second, in accordance with the copying requirement,<sup>158</sup> the exclusive rights of a copyright owner only cover actual copying of her expression. A work of authorship created independently, however similar to a pre-existing one, does not constitute copyright infringement.<sup>159</sup> Indeed, such a work would likely be considered original and entitled to a copyright separate from the pre-existing one.<sup>160</sup> As a result, similar works of authorship abound in the marketplace due to either deliberate imitation or coincidental repetitiveness.

Additionally, the overall concentration in the music market does not reach a level that would generate real market powers for any firms to restrict music production and inflate music prices, at least according to the Federal Trade Commission, which approved the acquisition of EMI by its direct

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155. As mentioned above, the majority of music market at the time was controlled by music publishers unrelated to the Aeolian Company. *See supra* note 152 and accompanying text.

156. *See* Edmund W. Kitch, *Elementary and Persistent Errors in the Economic Analysis of Intellectual Property*, 53 VAND. L. REV. 1727, 1730 (2000) (arguing that “copyrights do not prevent competitors from creating works with the same functional characteristics”); GOLDSTEIN, *supra* note 29, at 86 (“Although we would prefer not to admit it, one author’s expression will always be substitutable for another’s.”).

157. 17 U.S.C. § 102(a)–(b) (2012). It is not an overstatement that most countries recognize the idea/expression dichotomy since the TRIPS Agreement includes such a provision. *See* TRIPS Agreement, *supra* note 31, Article 9(2) (“Copyright protection shall extend to expressions and not to ideas, procedures, methods of operation or mathematical concepts as such.”).

158. In other words, the social costs of copyrights are limited access to a work created by the author, while the social costs of patents are limited access to certain inventions created either by the patentee or by any third party.

159. *See, e.g.*, *Sheldon v. Metro-Goldwyn Pictures Corp.*, 81 F.2d 49, 54 (2d Cir. 1936) (“[B]ut if by some magic a man who had never known it were to compose anew Keats’s Ode on a Grecian Urn, he would be an ‘author,’ and, if he copyrighted it, others might not copy that poem, though they might of course copy Keats’s.”).

160. To this extent, copyright law drastically differs from patent law, under which the exclusivity of patent rights is relatively strong, covering not only unscrupulous copying but also independent creation of the same invention.

competitors in 2012.<sup>161</sup> In terms of music publishing, three major firms, Sony/ATV Music Publishing (“Sony/ATV”), Universal Music Publishing Group (“UMPG”), and Warner/Chappell Music respectively control 22.4%, 28.9%, and 17.4% of the music publishing market.<sup>162</sup> Because digital technology has lowered the market entry barriers regarding music production and distribution costs, the majors are faced with increasing competition from thousands of independent music publishers including Kobalt Music Group and BMG Chrysalis, which have in the aggregate grown from 31.6% of the market in 2007 to 35% in 2014.<sup>163</sup>

The recording sector, mostly downstream users of mechanical licenses, features a market structure similar to the publishing sector. There are three major labels, Universal Music Group (“UMG”), Sony Music Entertainment, Inc. (“SME”), and Warner Music Group (“WMG”) that respectively hold 27.5%, 22%, and 14.6% market shares.<sup>164</sup> Hundreds of independent labels combined account for 35.1% of record industry revenues. Furthermore, major music labels and major music publishers are subject to common corporate ownership. UMPG is owned by UMG, the Sony Corporation owns SME and half of Sony/ATV, and Warner/Chappell Music is a division of WMG.<sup>165</sup> These factors suggest that music publishers would rarely be able to leverage their bargaining powers against music labels in negotiating mechanical licenses, regardless of any constraints created by a compulsory license.

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161. See *FTC Closes Its Investigation into Vivendi, S.A.’s Proposed Acquisition of EMI Recorded Music*, FTC (Sept. 21, 2012), <https://www.ftc.gov/news-events/press-releases/2012/09/ftc-closes-its-investigation-vivendi-sas-proposed-acquisition-emi>; (FTC press release); *FTC Closes Its Investigation Into Sony/ATV Music Publishing’s Proposed Acquisition of EMI Music Publishing*, FTC (June 29, 2012), <https://www.ftc.gov/news-events/press-releases/2012/06/ftc-closes-its-investigation-sonyatv-music-publishings-proposed> (FTC press release).

162. See *Revenue Market Share of the Largest Music Publishers Worldwide from 2007 to 2016*, STATISTA (Feb. 2017), <http://www.statista.com/statistics/272520/market-share-of-the-largest-music-publishers-worldwide/>.

163. See *id.*

164. See Ed Christman, *Music in 2014: Taylor Takes the Year, Republic Records on Top, Streaming to the Rescue*, BILLBOARD (Jan. 9, 2015), <http://www.billboard.com/articles/business/6436399/nielsen-music-soundscape-2014-taylor-swift-republic-records-streaming?page=0%2C2>.

165. See Sebastian Torrelio, *Jody Gerson Appointed Chairman and CEO of Universal Music Publishing Group*, VARIETY (Aug. 1, 2014), <http://variety.com/2014/biz/news/jody-gerson-appointed-chairman-and-ceo-of-universal-music-publishing-group-1201273829>; *Profile: Sony Corp*, REUTERS, <http://www.reuters.com/finance/stocks/companyProfile?symbol=SNE.N>; *About Us*, WARNER/CHAPPELL MUSIC, <http://www.warnerchappell.com/about>.

Music publishers also have to deal with even more formidable market players of the caliber of Apple, Amazon, and Google in the digital environment. The digital music market is clearly more concentrated than the music publishing market. For instance, iTunes (64%) and Amazon MP3 (16%) combined control 80% of the music download market,<sup>166</sup> and YouTube alone accounts for 77.6% of Internet video visits.<sup>167</sup> Artificially limiting the bargaining powers of music publishers would effectively reinforce the dominant positions of Internet service providers.<sup>168</sup>

There is no guarantee that anticompetitive behaviors would not emerge in any copyright industry. However, antitrust statutes incorporate more comprehensive and sophisticated mechanisms than does the Copyright Act to handle anticompetitive concerns, allowing for both specialized government agency and private enforcement.<sup>169</sup> It appears grossly disproportionate to subject a whole industry to a compulsory license for the purpose of redressing a limited number of wrongdoings.

#### B. TRANSACTION COSTS AND RENT SEEKING COSTS

Another conventional justification for compulsory licenses is minimal transaction costs because prospective users may unilaterally decide to use copyrighted works upon payment of statutory royalties without negotiation with copyright owners.<sup>170</sup> However, recent empirical studies present strong

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166. See *Paid Digital Music Download Market in the United States as of September 2012*, STATISTA (Sept. 2012), <http://www.statista.com/statistics/248995/us-paid-music-download-market-distribution/>.

167. See *Leading Multimedia Websites in the United States in October 2016, Based on Market Share of Visits*, STATISTA (Nov. 2016), <http://www.statista.com/statistics/266201/us-market-share-of-leading-internet-video-portals/>.

168. One may argue that a compulsory license could help alleviate the problem of double marginalization resulting from monopolistic complementary markets in information products and information technologies. But this would still not explain why the government should impose a price control on music publishers rather than Internet service providers if the price control is needed at all.

169. See, e.g., *Radio Music License Comm., Inc. v. SESAC*, 29 F. Supp. 3d 487 (E.D. Pa. 2014); *Meredith Corp. v. SESAC, L.L.C.*, 87 F. Supp. 3d 650, 2015 WL 728026 (S.D.N.Y. 2015).

170. See, e.g., H.R. REP. NO. 94-1476, at 89 (1976), *reprinted in* 1976 U.S.C.C.A.N. 5659, 5703 (“[I]t would be impractical and unduly burdensome to require every cable system to negotiate with every copyright owner whose work was retransmitted by a cable system.”); *NBC v. Copyright Royalty Tribunal*, 848 F.2d 1289, 1291 (D.C. Cir. 1988) (“The purpose of this regulatory structure is to facilitate the exploitation of copyrighted materials by removing the prohibitive transaction costs that would attend direct negotiations between cable operators and copyright holders, while at the same time assuring copyright holders compensation for the use of their property.”); AL KOHN & BOB KOHN, *KOHN ON MUSIC LICENSING* 772 (2010) (“[T]he compulsory license has served to



evidence demonstrating that private parties continue to actively bargain in the shadow of compulsory licenses and other liability rules.<sup>171</sup>

Ironically, a typical example is precisely the first compulsory license. Although the U.S. government has regularly set royalty rates for various mechanical licenses, a majority of music labels approach private clearinghouses, such as the Harry Fox Agency, to negotiate for mechanical licenses.<sup>172</sup> The music labels apparently find the monthly accounting obligations under § 115 too cumbersome and prefer to directly negotiate with the Harry Fox Agency, which offers quarterly accounting as a standard practice.<sup>173</sup> In other words, the administrative costs incurred for compulsory licenses outweigh the transaction costs involved in private negotiations.

Not only do private parties routinely contract around compulsory license terms, but the U.S. Copyright Act also contains built-in mechanisms to encourage private negotiations prior to, and during the course of, governmental rate-setting proceedings. For instance, Congress requires that voluntary licenses negotiated between copyright owners and prospective users take precedence over the rates and terms set by government agencies.<sup>174</sup> Congress also provides antitrust exemptions for both parties to compulsory licenses so that they could respectively designate common agents to negotiate royalty rates.<sup>175</sup> The rate-setting proceedings specifically set aside a three-week period for settlement negotiations.<sup>176</sup>

While compulsory licenses have limited effects in minimizing transaction costs, they usually generate additional administrative costs unseen in private transactions. Both copyright owners and prospective users have strong incentives to invest substantial resources in lobbying

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simplify the process of obtaining mechanical licenses and has reduced a significant amount of unnecessary transaction costs.”).

171. See Lemley, *supra* note 24, at 463.

172. See, e.g., *Music Licensing Reform Before the Subcomm. on Intellectual Property of the S. Comm. on the Judiciary*, 109th Cong., 1st Sess. (2005) (statement of Marybeth Peters, Register of Copyrights), <http://www.copyright.gov/docs/regstat071205.html> (“[T]he use of the [compulsory] license appears to have again become almost non-existent; up to this day, the Copyright Office receives very few notices of intention.”); *Mechanical and Digital Phonorecord Delivery Rate Determination Proceeding*, 74 Fed. Reg. 4509, 4510, 4511, 4520 n.32 (Jan. 26, 2009) (codified at 37 C.F.R. pt. 385) (citing testimony of RIAA expert economist Dr. Steven Wildman) (“As witnesses for both record companies and music publishers have explained, essentially no one uses the compulsory license process—licenses for mechanical royalties . . . are negotiated in the market on a voluntary basis.”).

173. See Loren, *supra* note 25, at 682 n.38.

174. See 17 U.S.C. §§ 112(e)(5), 114(f)(3), 115(c)(3)(E)(i) (2012).

175. See §§ 112(e)(2), 114(e)(1), 115(c)(3)(B).

176. § 803(b)(6)(C)(x).

government agencies<sup>177</sup> for favorable royalty rates (often referred to as rent-seeking costs or influence costs).<sup>178</sup> The legislative history of the 1976 Copyright Act pointed to the sheer magnitude of expenditures by lobbyists trying to influence the licensing rates. In the first comprehensive amendment of the U.S. Copyright Act in sixty years, over 32% of the 1976 hearings record was devoted to rates.<sup>179</sup> ASCAP, which is subject to rate-setting proceedings by rate courts, more recently admitted, “ASCAP and applicants have collectively expended well in excess of one hundred million dollars on litigation expenses related to rate court proceedings, much of that incurred since only 2009.”<sup>180</sup>

The proceedings regarding webcaster royalties provide another dramatic illustration.<sup>181</sup> While the Digital Performance Right in Sound Recordings Act of 1995 recognizes “the exclusive right to perform the copyrighted work publicly by means of a digital audio transmission,” it simultaneously provides for a compulsory license covering non-interactive webcasting services.<sup>182</sup> However, no royalty negotiations for such services started until the passage of the Digital Millennium Copyright Act of 1998,<sup>183</sup> which further clarified the rate-setting standards. A large number of webcasters had emerged operating practically in a royalty-free environment by the time the Copyright Arbitration Royalty Panel (“CARP”) proceedings officially concluded in 2002.<sup>184</sup> The Library of

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177. Congress created the Copyright Royalty Tribunal (“CRT”), with five commissioners appointed by the President, to adjust the royalty rate. *See* Copyright Act of 1976, Pub. L. No. 94-553, §§ 801–802, 90 Stat. 2541, 2594–96 (1976). The CRT was replaced in 1993 by the Copyright Arbitration Royalty Panel (“CARP”) system; rather than permanent appointees, the CARP arbitrators were convened for specific rate proceedings. *See* Copyright Royalty Tribunal Reform Act of 1993, Pub. No. 103-198, §802, 107 Stat. 2304, 2305 (1993). The CARP system, in turn, was replaced in 2004 by the current system, the Copyright Royalty Board (“CRB”), which is composed of three administrative judges (“Copyright Royalty Judges”) appointed by the Librarian of Congress. *See* 17 U.S.C. § 801 (2012); Copyright Royalty and Distribution Reform Act of 2004, Pub. L. No. 108-419, 118 Stat. 2341 (2004).

178. *See* Paul Milgrom & D. J. Roberts, *Bargaining Costs, Influence Costs, and the Organization of Economic Activity*, in PERSPECTIVES ON POSITIVE POLITICAL ECONOMY 57–89 (James E. Alt & Kenneth A. Shepsle eds., 1990).

179. *Copyright Law Revision: Hearings on H.R. 2223 Before the Subcomm. on Courts, Civil Liberties and the Administration of Justice of the House Comm. on the Judiciary*, 94th Cong., 1st Sess., pts. 1–3 (1976).

180. *See* Music Marketplace Study, *supra* note 34, at 93.

181. 17 U.S.C. § 114(f) (2012).

182. Pub. L. No. 104-39, §4, 109 Stat. 336 (1995).

183. Pub. L. No. 105-304, tit. IV, 112 Stat. 2860 (1998).

184. Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings and Ephemeral Recordings, 67 Fed. Reg. 45,240, 45,272 (July 8, 2002).

Congress (“LOC”) affirmed the CARP decision to set per-performance rates, including \$0.0007 per performance for commercial webcasters and \$0.0002 per performance for non-commercial webcasters.<sup>185</sup> Webcasters who felt the CARP rates overly burdensome acted immediately to lobby for an amendment in Congress, which passed the Small Webcasters Settlement Act of 2002 to suspend the implementation of the CARP decision and encourage SoundExchange to negotiate directly with webcasters for alternative royalty structures.<sup>186</sup> Both parties eventually reached agreements (effective through 2005), under which small webcasters would pay a graduated percentage-of-revenue rate and non-commercial webcasters would pay a flat rate.<sup>187</sup> In essence, the CARP proceedings, which reportedly incurred \$25 million in legal fees and witness costs, were completely superseded by private negotiations.<sup>188</sup>

The drama repeated itself five years later despite Congress attempted to streamline rate-setting procedures by replacing the ad hoc CARP with the Copyright Royalty Board (CRB), consisting of three standing Copyright Royalty Judges.<sup>189</sup> In 2007, the CRB similarly ruled in favor of a per-performance structure for commercial webcasters, establishing a graduated rate starting from \$0.0008 for 2006.<sup>190</sup> Several webcasters expectedly objected to the CRB rates and filed appeals in the D.C. Circuit.<sup>191</sup> Meanwhile, they quickly returned to Congress, which again enacted legislative solutions following the exact pattern of the Small Webcaster Settlement Act of 2002.<sup>192</sup> With the authority from Congress to engage in private negotiations for alternative licensing rates, SoundExchange reached another round of agreements with a wide variety of webcasters (effective through 2015). As a result, commercial pureplay internet radio services

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185. *See id.*

186. *See generally* Pub. L. No. 107-321, 116 Stat. 2780 (2002).

187. Notification of Agreements under the Small Webcaster Settlement Act of 2002, 67 Fed. Reg. 78510 (Dec. 24, 2002); Notification of Agreements under the Webcaster Settlement Act of 2002, 68 Fed. Reg. 35008 (June 11, 2003).

188. *Copyright Royalty and Distribution Reform Act of 2003: Hearing Before the Subcomm. on Courts, The Internet, and Intellectual Property of the House Comm. on the Judiciary*, 108th Cong., 1st Sess. 28, 31 (2003) (statement of Michael J. Remington, former staff counsel, IP Subcommittee, House Committee on the Judiciary).

189. *See* Copyright Royalty and Distribution Reform Act of 2004, Pub. L. No. 108-419, 118 Stat. 2341 (2004).

190. 37 C.F.R. § 380.3(a)(1) (2012).

191. *See* Terry Hart, *A Brief History of Webcaster Royalties*, COPYHYPE (Nov. 28, 2012), <http://www.copyhype.com/2012/11/a-brief-history-of-webcaster-royalties/>.

192. *See* Webcaster Settlement Act of 2008, Pub. L. No. 110-435, 122 Stat. 4974 (2008); Webcaster Settlement Act of 2009, Pub. L. No. 111-36, 123 Stat. 1926 (2009) (extending the timeframe for negotiation).

agreed to pay 25% of gross revenues or a per-performance rate lower than the CRB rate, whichever greater.<sup>193</sup> The clock for the next round of CRB proceedings has started ticking as the rate-setting under Section 114 takes place every five years by operation of law.<sup>194</sup>

The above examples reveal that private negotiation and government lobbying are normally intertwined in the context of compulsory licenses. Contrary to the conventional wisdom that compulsory licenses simplify licensing processes, they essentially add rent-seeking costs on top of transaction costs.

### C. POLITICAL COMPROMISE

Monopoly concerns and transaction costs are not the whole story for traditional compulsory licenses. In cases involving new information technologies, Congress has sometimes enacted a compulsory license to broker a compromise between dueling stakeholder groups of technology providers who demanded unabridged access to copyrighted works and of copyright owners who asserted exclusive rights over new uses of their works.

Take the *Apollo* case as an example. Piano rolls, a technological innovation back then, produced new uses of musical compositions, and so music publishers approached the judiciary for legal remedies by suing the technology manufacturer.<sup>195</sup> The district court in *Apollo* ruled in favor of the defendant due to the lack of clear guidance in the Copyright Act.<sup>196</sup> By the time the case was finally before the Supreme Court several years later, the new uses had become sufficiently widespread that the Supreme Court had to reluctantly affirm the district court's decision and call upon Congress to reform the outdated statute in response to new technologies.<sup>197</sup> Faced with forceful lobbying by a thriving new technology industry and the potential public relations nightmare of outlawing everyday activities by millions of consumers, Congress was compelled to mediate a political compromise through a compulsory license:<sup>198</sup> Technology providers could continue their business models without the constraints of exclusive rights;

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193. Notification of Agreements under the Webcaster Settlement Act of 2009, 74 Fed. Reg. 34,796, 34,799–800 (July 17, 2009).

194. 17 U.S.C. § 804(b)(3) (2012).

195. *White-Smith Music Publishing Co. v. Apollo Co.*, 209 U.S. 1, 8 (1908).

196. *Id.* at 8.

197. *Id.* at 9 (indicating millions of piano rolls and player pianos were manufactured).

198. 17 U.S.C. § 115 (2012).

in exchange, copyright owners received presumably equitable remuneration to maintain creative incentive.<sup>199</sup>

Such political dynamics became a recurrent theme for other compulsory licenses. In the 1960s and 70s, when copyright owners brought actions against cable operators for augmenting local signals and importing distant signals, the Supreme Court twice affirmed district court decisions in favor of the defendants, holding that cable systems did not involve public performance because they were more aligned with a viewer function than a broadcaster function.<sup>200</sup> Two years later, in the 1976 Copyright Act, Congress responded by carving out a compulsory license for cable retransmission.<sup>201</sup> In the 1980s, while movie studios sought injunctive relief to enjoin the distribution of analog video recorders, the Supreme Court again sided with the district court, which found no indirect liabilities for a manufacturer whose machines facilitated time shifting by television viewers.<sup>202</sup> Seven years later, the advent of digital audio recorders (which could generate unlimited copies without quality degradation) started to push the envelope of the *Sony* holding.<sup>203</sup> Congress consequently enacted the Audio Home Recording Act of 1992 to impose a levy on digital audio recording devices and media, and prohibited any copyright actions against the providers and their consumers.<sup>204</sup>

By contrast, the market landscape would have been dramatically different if a court initially did not hesitate to uphold the exclusive rights of copyright owners over new uses of copyrighted works. Taking peer-to-peer file sharing as an example, when a district court issued a preliminary injunction against Napster in 1999,<sup>205</sup> which was essentially affirmed by the Ninth Circuit in 2002,<sup>206</sup> music labels and technology providers actively engaged in private negotiations for voluntary licenses, both inside and

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199. See, e.g., Jane C. Ginsburg, *Fair Use for Free, or Permitted-but-Paid?*, 29 BERKELEY TECH. L. J. 1383, 1386 (2014); Robert P. Merges, *Compulsory Licensing vs. the Three "Golden Oldies": Property Rights, Contracts, and Markets*, POL'Y ANALYSIS NO. 508 (Cato Inst., Wash., D.C.), Jan. 15, 2004, at 1; Tim Wu, *Copyright's Communications Policy*, 103 MICH. L. REV. 278, 290, 311 (2004).

200. *Teleprompter Corp. v. CBS*, 415 U.S. 394, 408–10 (1974); *Fortnightly Corp. v. United Artists Television, Inc.*, 392 U.S. 390, 399–401 (1968).

201. 17 U.S.C. § 111 (2012).

202. *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417, 420–21 (1984).

203. *Cahn v. Sony Corp.*, No. 90 Civ. 4537 (S.D.N.Y. July 11, 1991).

204. Pub. L. No. 102-563, 106 Stat. 4237 (1992) (codified as amended at 17 U.S.C. §§ 1001–1010).

205. *A&M Records, Inc. v. Napster, Inc.*, 114 F. Supp. 2d 896, 901 (N.D. Cal. 2001), *aff'd in part and rev'd in part*, 239 F.3d 1004 (9th Cir. 2001).

206. *A&M Records, Inc. v. Napster, Inc.*, 239 F.3d 1004 (9th Cir. 2001).

outside of the legal proceedings.<sup>207</sup> A robust digital music market has quickly emerged, starting from the launch of the iTunes store in 2003, which not only changed the fate of then-ailing Apple but also permanently changed the way people purchase music.<sup>208</sup> Unsurprisingly, Congress has not issued any compulsory license for file sharing despite the pleadings from several high-profile scholars.<sup>209</sup>

A compulsory license that substitutes reasonable remuneration for exclusive rights might not obstruct a copyright market if the government-set rates could accurately reflect the market values that would otherwise be revealed through private transactions. However, empirical evidence from several natural experiments appears to suggest that the government has an inherent tendency to underestimate the value of copyrighted works in rate-setting proceedings. For instance, no matter how closely the two-cent rate for mechanical licenses imitated the market rates in 1909, it would be hard to justify that the rate stayed two cents for almost seventy years from 1909 to 1978.<sup>210</sup> During the same period of time, overall inflation increased by 500%, suggesting the real value of the two-cent rate decreased by 500%.<sup>211</sup> Likewise, the current 9.1-cent rate in 2015 remains significantly lower than the two-cent rate in 1909, which amounts to over fifty cents in 2015 after adjustment for inflation.

The rapid depreciation of statutory royalties dramatically contrasts the growing importance of musical works in the digital age.<sup>212</sup> In 2004, several music publishers and music labels, uncertain whether ringtones fell into the definition of Digital Phonorecord Delivery under the compulsory license,

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207. See Jeff Leeds, *Bertelsmann Reaches Deal with EMI over Napster*, N.Y. TIMES (Mar. 27, 2007), [http://www.nytimes.com/2007/03/27/business/media/27music.html?\\_r=0](http://www.nytimes.com/2007/03/27/business/media/27music.html?_r=0) (reporting Bertelsmann reached an agreement to invest in Napster).

208. See Press Release, Apple, *iTunes Store Tops 10 Billion Songs Sold* (Feb. 25, 2010), <http://www.apple.com/pr/library/2010/02/25itunes.html>.

209. See *supra* note 142 and accompanying text.

210. See U.S. BUREAU OF LABOR STATISTICS, *Consumer Price Index*, <http://www.bls.gov/cpi/> (documenting the general inflation during the same period of time).

211. See U.S. COPYRIGHT OFFICE, *Mechanical License Royalty Rates*, <http://www.copyright.gov/licensing/m200a.pdf>. Congress raised the rate in the 1976 Copyright Act, which became effective in 1978.

212. It has been reported that, in 2014, there were 434,695,663,626 total music streams across Spotify, YouTube, Vevo, Soundcloud, Vimeo, and Rdio. This reflects a 95% increase from 2013 and a 363% increase from 2012. See Zach O'Malley Greenburg, *Truth in Numbers: Six Music Industry Takeaways from Year-End Data*, FORBES (Jan. 22, 2015), <http://www.forbes.com/sites/zackomalleygreenburg/2015/01/22/truth-in-numbers-six-music-industry-takeaways-from-year-end-data/>; NEXT BIG SOUND, *The State of The Industry*, <http://www.nextbigsound.com/industryreport/2014>.

entered into voluntary licensing agreements.<sup>213</sup> These market transactions established a royalty rate for ringtones at twenty-four cents per use,<sup>214</sup> drastically higher than the 9.1-cent rate set by the government. Remarkably, ringtones usually use short excerpts of musical works, which highlights how much the government-set rate undervalues full-length works.<sup>215</sup> Similarly, several music publishers sought in 2013 to withdraw new media rights from ASCAP and BMI to bypass the rate-setting proceedings at rate courts and negotiate directly with service providers for higher royalties.<sup>216</sup> As a result, EMI received a rate equivalent to the ASCAP rate of 1.85% for non-interactive streaming services but without a deduction for ASCAP surcharges; Sony/ATV obtained a prorated share of 5% (equivalent to a 2.28% implied rate for ASCAP); and UMG negotiated a prorated share of 7.5% (equivalent to a 3.42% implied rate for ASCAP).<sup>217</sup>

Several phenomena in the copyright market explain why compulsory licenses may systematically undercompensate authors for the market values of copyright licenses. First, the unauthorized version of a copyrighted work, if distributed to the public in a poor quality, inflicts a reputational harm to the author, which may scarcely be quantifiable in any compulsory licenses.<sup>218</sup> Such reputational harms are actually as relevant to financial

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213. Mechanical and Digital Phonorecord Delivery Rate Adjustment Proceeding, 71 Fed. Reg. 64,303, 64,308–09 (Nov. 1, 2006).

214. 37 C.F.R. § 385.3(b) (2015).

215. Mechanical and Digital Phonorecord Delivery Rate Determination Proceeding, 74 Fed. Reg. 4509, 4522 (Jan. 26, 2009) (Music publishers introduced the negotiated agreements as marketplace benchmarks and secured a much higher rate for ringtones than the rate for full songs.).

216. Pandora Media, Inc. v. Am. Soc’y of Composers, Authors, & Publishers, 6 F. Supp. 3d 317, 330, 339 – 40, 355 (S.D.N.Y. 2014).

217. These negotiated rates were later overruled by the rate courts. *See In re* Petition of Pandora Media Inc., No. 12 Civ. 8035(DLC), 2013 WL 5211927, at \*11 (S.D.N.Y. Sept. 17, 2013); Broadcast Music, Inc. v. Pandora Media, Inc., No. 13 Civ. 4037(LLS), 2013 WL 6697788, at \*5 (S.D.N.Y. Dec. 19, 2013).

218. *See, e.g.,* Nintendo of Am. Inc. v. Lewis Galoob Toys, Inc., No. 90-15936, 1991 WL 5171, at \*3 (9th Cir. Jan. 24, 1991) (“A large portion of the harm to Galoob and Nintendo from either granting or denying the preliminary injunction would be financially compensable. However, Nintendo introduced evidence in the court below that the sale of Game Genie could cause irreparable harm to its design strategy, reputation, and its right to create derivative works.”); Columbus Rose Ltd. v. New Millennium Press, No. 02 CIV. 2634(JGK), 2002 WL 1033560, at \*11 (S.D.N.Y. May 20, 2002) (holding that plaintiff’s “name and artistic reputation are his major assets,” which “cannot be remedied by a monetary award”) (internal quotation marks omitted); Art Line, Inc. v. Universal Design Collections, Inc., 966 F. Supp. 737, 744–45 (N.D. Ill. 1997); Clifford Ross Co. v. Nelvana, Ltd., 710 F. Supp. 517, 520–21 (S.D.N.Y. 1989) (“[I]t is well established that loss to artistic reputation . . . cannot be compensated for in money damages.”), *aff’d*, 883 F.2d 1022 (2d Cir. 1989).

interests as to moral rights because “the ultimate commercial success of an ‘artist’ often depends on name recognition and reputation with the value and popularity of each succeeding work depending upon the ‘name’ established through commercial exploitation of preceding works.”<sup>219</sup> In voluntary agreements, copyright owners may insist on extensive involvement in the editing process, request a prior approval for every proposed change, or otherwise wield quality control over the licensed versions. It is unclear whether such quality control is practical, or even possible, in compulsory licenses. Second, creative industries involve a notoriously high degree of uncertainty in consumer preferences. Therefore, copyright owners traditionally maintain a large portfolio of different works that they use to cross-subsidize experimental or pioneer works with lucrative revenues from bestsellers.<sup>220</sup> Uniform reasonable royalties set for compulsory licenses would likely undercompensate copyright owners for their business risks in producing a variety of works. Third, copyright owners would lose the ability to grant an exclusive license in the shadow of a compulsory license. The total royalties from several nonexclusive licenses would probably still be less than those from a single exclusive license due to the erosion of market power by multiple competitors. Fourth, unlike private negotiations, the rate-setting proceedings are susceptible to lobbying pressures in a political environment where lower royalty rates are understandably more popular among potential voters and powerful technology sectors.<sup>221</sup> Fifth, compulsory licenses may result in uneven bargaining positions between copyright owners and prospective users. Where the government-set rate is too high, a licensee could always ask for a discounted rate from a copyright owner or simply cease using her work.<sup>222</sup> By contrast, if the government-set rate is too low, a copyright owner would be unable to stop the other party from using her work and therefore have much less leverage to bargain for a higher rate.<sup>223</sup> In most cases, the compulsory license creates a ceiling for the

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219. *Concrete Mach. Co. v. Classic Lawn Ornaments, Inc.*, 843 F.2d 600, 611 (1st Cir. 1988); *see also* *Ty, Inc. v. GMA Accessories, Inc.*, 132 F.3d 1167, 1173 (7th Cir. 1997); *Gilliam v. Am. Broad. Cos.*, 538 F.2d 14 (2d Cir. 1976).

220. *See* GOLDSTEIN, *supra* note 29, at 83; Barry W. Tyerman, *The Economic Rationale for Copyright Protection for Published Books: A Reply to Professor Breyer*, 18 UCLA L. REV. 1100, 1121 (1971).

221. *See supra* note 184 and accompanying text.

222. The dramas surrounding webcasting royalty rates somewhat illustrate the bargaining power of copyright users to demand lower rates under compulsory licenses. *See supra* text accompanying note 181.

223. However, it does not follow that a copyright owner would never have any chance to bargain for higher royalties in the context of a compulsory license. For narrow exceptions, *see* Lemley, *supra* note 24, at 463.



amount copyright owners may realistically bargain for in private negotiations.<sup>224</sup> This explains why both parties often incur substantial expenses to litigate and lobby for a compulsory license they rarely use in practice.<sup>225</sup>

#### IV. ORPHAN WORKS AND MASS DIGITIZATION

“Orphan works” refer to the situations where a prospective user who wishes to obtain a license for a copyrighted work cannot identify or locate the copyright owner with a reasonably diligent search.<sup>226</sup> Faced with the possibility of expensive copyright litigation and ensuing statutory damages, risk-averse users such as libraries, museums, and archives would often shy away from a projected use that could otherwise generate substantial social value. Meanwhile, the copyright owner, if located, might be more than happy to grant the user a license. As a result, excessive transaction costs involved in locating relevant parties in effect prevent a mutually beneficial transaction from taking place.

The increased attention to orphan works stems from a number of modern developments in international copyright regimes. First, many countries, including the United States and most European nations, have extended the duration of copyright protection to life plus seventy years.<sup>227</sup> Generally, the longer the time having elapsed since a copyrighted work was created and published, the more difficult it is to ascertain its current ownership. Second, the Berne Convention<sup>228</sup> requires member countries to remove registration,

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224. See Music Marketplace Study, *supra* note 34, at 93.

225. Mechanical and Digital Phonorecord Delivery Rate Determination Proceeding, 74 Fed. Reg. 4509, 4513 (Jan. 26, 2009) (citation omitted):

The complexity of compliance, and the associated transactions costs, create a curious anomaly: virtually no one uses section 115 to license reproductions of musical works, yet the parties in this proceeding are willing to expend considerable time and expense to litigate its royalty rates and terms. The Judges are, therefore, seemingly tasked with setting rates and terms for a useless license. The testimony in this proceeding makes clear, however, that despite its disuse, the section 115 license exerts a ghost-in-the-attic like effect on all those who live below it. Thus, the rates and terms that we set today will have considerable impact on the private agreements that enable copyright users to clear the rights for reproduction and distribution of musical works.

226. See 2006 Orphan Works Study, *supra* note 37, at 16.

227. See, e.g., Sonny Bono Copyright Term Extension Act of 1998, Pub. L. No. 105-298, 112 Stat. 2827 (codified as amended in 17 U.S.C. §§ 301–304); Council Directive of 29 October 1993 on Harmonizing the Terms of Protection of Copyright and Certain Related Rights, 93/98/EEC, 1993 O.J. (L 290) 9.

228. Berne Convention, *supra* note 30, Article 5.

notice, and any other formalities as preconditions for the enjoyment and exercise of copyright.<sup>229</sup> This requirement practically decreases the incentives for authors to provide sufficient ownership information. Third, digital technology has made it possible to copy and distribute a vast volume of copyrighted works, which quickly multiplies transaction costs required to locate relevant copyright owners.<sup>230</sup>

Recent studies demonstrated that orphan work problems are prevalent and have significant effects on public interests.<sup>231</sup> For instance, a 2012 survey conducted in the United Kingdom estimated staggering percentages of orphan works:<sup>232</sup> (i) National History Museum, London – 25% of its 500,000 item collection; (ii) European Film Archives – 4% to 7% of its 3.2 million titles; (iii) Imperial War Archive – 20% of its 11 million item collection; (iv) National History Museum, London – 20% of its one million book collection; and (v) National Library of Scotland – around 20% of its 1.5 million book collection. Similarly, several U.S. projects discovered significant shares of orphan works among various library collections, usually in the range of 25% to 50%.<sup>233</sup>

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229. See, e.g., Copyright Act of 1976, Pub. L. No. 94-553, § 408(a), 90 Stat. 2541, 2580 (codified as amended at 17 U.S.C. § 408(a)) (registration optional); Berne Convention Implementation Act of 1988, Pub. L. No. 100-568, § 7(a)–(b), 102 Stat. 2853, 2857-58 (codified at 17 U.S.C. §§ 401(a), 402(a)) (notice optional); Copyright Amendments Act of 1992, Pub. L. No. 102-307, § 102(a), 106 Stat. 264, 264 (codified as amended at 17 U.S.C. § 304(a)) (renewal automatic).

230. For cases involving millions of works distributed online, see, for example, *Kelly v. Arriba Soft Corp.*, 336 F.3d 811 (9th Cir. 2003); *Authors Guild, Inc. v. HathiTrust*, 755 F.3d 87 (2d Cir. 2014); *Authors Guild v. Google, Inc.*, 804 F.3d 202 (2d Cir. 2015).

231. See, e.g., JISC, *In from the Cold: An Assessment of the Scope of “Orphan Works” and Its Impact on the Delivery of Services to the Public* (Apr. 2009), <http://webarchive.nationalarchives.gov.uk/20140702233839/http://www.jisc.ac.uk/media/documents/publications/infromthecoldv1.pdf> (inter-organizational report on orphan works in the United Kingdom); Anna Vuopala, *Assessment of the Orphan Works Issue and Costs for Rights Clearance* (May 2010), [http://www.ace-film.eu/wp-content/uploads/2010/09/Copyright\\_anna\\_report-1.pdf](http://www.ace-film.eu/wp-content/uploads/2010/09/Copyright_anna_report-1.pdf) (report to the European Commission on the Digital Libraries initiative).

232. See Department of Business, Innovations and Skills (U.K. Intellectual Property Office), *Impact Assessment Report on Orphan Works* (June 2012), at 11, <http://webarchive.nationalarchives.gov.uk/20140603093549/http://www.ipo.gov.uk/consult-ia-bis1063-20120702.pdf>.

233. See 2006 Orphan Works Study, *supra* note 37, at 36–39 (over 50% in selected university libraries); Cairns, *supra* note 42 (25% in the Google Books Project); John P. Wilkin, *Bibliographic Indeterminacy and the Scale of Problems and Opportunities of “Rights” in Digital Collection Building*, RUMINATIONS (Feb. 2011), <http://www.clir.org/pubs/ruminations/01wilkin/wilkin.html> (50% in the HathiTrust corpus).

Many countries in the world have introduced creative legal mechanisms to resolve orphan work problems.<sup>234</sup> This Part is focused on two proposals that may be loosely called the “limitation on liability” approach and the “compulsory license” approach. Additionally, this Part will briefly evaluate various proposals regarding the related but slightly different issue of mass digitization using the Google Books Project as an example.<sup>235</sup>

#### A. LIMITATION ON LIABILITY VERSUS COMPULSORY LICENSE

The U.S. Copyright Office initially deliberated on the “limitation on liability” approach in its well-known 2006 Report on Orphan Works.<sup>236</sup> The report drew inspiration from a 2003 book suggesting that copyright law establish a mechanism similar to marketable title under property law to provide incentives for authors to regularly update ownership information and facilitate copyright transactions.<sup>237</sup> Following these recommendations, Congress introduced multiple bills for orphan works in 2006 and 2008 (none of which have passed).<sup>238</sup> This approach includes the following elements:

(i) A copyrighted work is considered an orphan work where the user is unable to identify and locate the copyright owner with a good faith diligent search;

(ii) A user can start to use the orphan work after filing a notice of use with a government authority;

(iii) If the copyright owner emerges and alleges copyright liabilities, retrospective monetary relief would be limited to reasonable compensation, i.e., the amount that a willing buyer and a willing seller would have agreed upon before the use began;

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234. See, e.g., Axhamn & Guibault, *supra* note 33; Pamela Samuelson, *Legislative Alternatives to the Google Book Settlement*, 34 COLUM. J.L. & ARTS 697, 705 (2011); Commission of the European Communities, *Creative Content in a European Digital Single Market: Challenges for the Future* (Oct. 2009), [http://ec.europa.eu/internal\\_market/consultations/docs/2009/content\\_online/reflection\\_paper%20web\\_en.pdf](http://ec.europa.eu/internal_market/consultations/docs/2009/content_online/reflection_paper%20web_en.pdf), at 4.

235. See *Authors Guild v. Google, Inc.*, 804 F.3d 202, 213 (2d Cir. 2015).

236. See 2006 Orphan Works Study, *supra* note 37, at 16. Those recommendations are restated in 2015 Orphan Works Study, *supra* note 21, at 3. The “limitation on liability” approach is different from the argument that the orphan status of a copyrighted work automatically weighs in favor of fair use. The moment that the user is sued for copyright infringement, the works ceases to be an orphan. Therefore, a denial of all remedies, particularly injunctive relief and future royalties, are not justified in many cases.

237. See GOLDSTEIN, *supra* note 79, at 203 (confirmed by a drafter of the report who worked at the U.S. Copyright Office at the time).

238. Shawn Bentley Orphan Works Act of 2008, S. 2913, 110th Cong. (2008); Orphan Works Act of 2008, H.R. 5889, 110th Cong. (2008); Orphan Works Act of 2006, H.R. 5439, 109th Cong. (2006).

(iv) Eligible nonprofit institutions including certain schools, museums, libraries, archives, and public broadcasters would not be subject to any monetary relief for noncommercial uses of orphan works unless they do not promptly cease their uses after receiving notice from the copyright owner; and

(v) A court has the authority to impose injunctive relief upon request of the copyright owner to enjoin further uses of the orphan work accounting for the reliance interests of, and the original expressions added by, the user.

One may argue that the U.S. Copyright Act already contains a watered-down version of the “limitation on liability” approach in the context of mechanical licenses where, if the copyright owner is not locatable in public records, the user may file a notice of intention with the U.S. Copyright Office and then use the work royalty-free until the owner emerges.<sup>239</sup> In 2012, the European Union issued the Directive on Certain Permitted Uses of Orphan Works, which builds on another watered-down version of the U.S. model by providing an exemption for public interest missions of “libraries, educational establishments and museums . . . archives, film or audio heritage institutions and public-service broadcasting organizations.”<sup>240</sup>

By contrast, Canada<sup>241</sup> is a celebrated example that has implemented the “compulsory license” approach to tackle orphan work problems, joined by a handful of other countries including the United Kingdom,<sup>242</sup> Hungary,<sup>243</sup>

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239. 17 U.S.C. § 115(b)–(c) (2012).

240. Directive 2012/28 of the European Parliament and of the Council of 25 October 2012 on Certain Permitted Uses of Orphan Works, art. 1(1), 2012 O.J. (L 299) 8 (EU) [hereinafter the E.U. Orphan Works Directive]; see also Australian L. Reform Comm’n, *Copyright and the Digital Economy* (Discussion Paper 79, June 5, 2013), Proposals 12–1, 12–2, 12–3, 12.60, [http://www.alrc.gov.au/sites/default/files/pdfs/publications/12\\_orphan\\_works\\_.pdf](http://www.alrc.gov.au/sites/default/files/pdfs/publications/12_orphan_works_.pdf).

241. Copyright Act, R.S.C. 1985, c. C-42, s. 77.

242. Copyright and Rights in Performances (Licensing of Orphan Works) Regulations 2014, S.I. 2014/2863 (U.K.).

243. See Mihály Ficsor, *How to Deal with Orphan Works in the Digital World? An Introduction to the New Hungarian Legislation on Orphan Works*, EUROPEAN PARLIAMENT DIRECTORATE GENERAL FOR INTERNAL POLICIES (2009), <http://www.europarl.europa.eu/document/activities/cont/200911/20091113ATT64497/20091113ATT64497EN.pdf>.

India,<sup>244</sup> Japan,<sup>245</sup> and Korea.<sup>246</sup> Although slight variations exist among these countries, their approach may be summarized based loosely on the Canadian model:

(i) A published work is considered an orphan work where the user is unable to identify and locate the copyright owner with a reasonable effort;

(ii) A user may apply to the Copyright Board (or counterpart authorities in other countries) for a compulsory license to use the orphan work;

(iii) The Copyright Board would grant the compulsory license, usually nonexclusive and nontransferable in nature, if the user sufficiently proves her reasonable effort in searching for the copyright owner;

(iv) The Copyright Board is responsible for establishing the royalty rates and usage conditions for the compulsory license;

(v) The user shall pay her royalties to a collecting society designated by the Copyright Board (or directly to a government agency in several other countries); and

(vi) The collecting society will retain the royalties in escrow while trying to locate the copyright owner for a certain period of time. If the copyright owner does not emerge after the period, the collecting society may allocate the royalties for other purposes, e.g., defraying its administrative costs or funding social and cultural activities.

#### B. THE INCENTIVE ANALYSIS

The 2012 Chinese Copyright Reform Bill expectedly follows the “compulsory license” approach largely because it would result in rent-seeking opportunities for interest groups like collecting societies:

If the user is unable to identify and locate, with a diligent search, the copyright owner of a published work which copyright has not expired, the user may use the work in a digitalized form after filing an application with, and deposit a royalty at, the organization designated by the copyright administrative authority of the State Council.<sup>247</sup>

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244. The Copyright (Amendment) Act, No. 27 of 2012, Gazette of India (June 7, 2012), [http://copyright.gov.in/Documents/CRACT\\_AMNDMNT\\_2012.pdf](http://copyright.gov.in/Documents/CRACT_AMNDMNT_2012.pdf).

245. Copyright Act, Law No. 48 of 1970, as amended up to Law No. 35 of 2014, art. 67, [http://www.cric.or.jp/english/clj/doc/20150227\\_October,2014\\_Copyright\\_Law\\_of\\_Japan.pdf](http://www.cric.or.jp/english/clj/doc/20150227_October,2014_Copyright_Law_of_Japan.pdf) (Japan) (unofficial translation).

246. Copyright Act of 1957, Act No. 432, Jan. 28, 1957, as amended up to Act No. 12137, Dec. 30, 2013, art. 50(1), *translated at* [http://elaw.klri.re.kr/eng\\_service/lawView.do?hseq=32626&lang=ENG](http://elaw.klri.re.kr/eng_service/lawView.do?hseq=32626&lang=ENG) (S. Kor.) (unofficial translation).

247. Article 51, Third Draft, *supra* note 4.

Notably, evidence from countries already implementing this approach demonstrates that prospective users of orphan works rarely utilize such compulsory licenses. For example, for the twenty-seven-year period from 1988 to 2015, the Copyright Board of Canada has issued only 283 compulsory licenses, which amounts to approximately ten licenses per year.<sup>248</sup> This number is drastically dwarfed by the millions of existing orphan works.<sup>249</sup>

It is easy to understand why the “compulsory license” approach is not popular among potential users, especially compared to the “limitation on liability” approach. First, each time a user wishes to obtain a compulsory license to use an orphan work, she must prove to the satisfaction of the government authority that the copyright owner is not locatable with a good faith diligent search.<sup>250</sup> By contrast, with the “limitation on liability,” a user would have to establish her reasonable search in negotiation or in court only if the copyright owner emerges.<sup>251</sup> Therefore, the “limitation on liability” approach has the advantage of saving administrative costs for both users and adjudicators.

Second, the “compulsory license” approach requires orphan works users to pay copyright royalties upfront, while the “limitation on liability” approach only requires users to pay royalties if the copyright owner resurfaces. Also, it is difficult to imagine how the government authority could efficiently set royalty rates for the compulsory licenses to use orphan works. While governmental rate-setting is by no means easy for any compulsory license, orphan works would add an additional layer of complexity and uncertainty. The government usually strives to simulate the ordinary market value that a willing buyer and a willing seller would have agreed upon through arms-length negotiation.<sup>252</sup> Orphan works are by definition out-of-commerce works that do not have existing market benchmarks. The royalty rates for non-orphan works under normal

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248. See Copyright Board of Canada, *Decisions – Unlocatable Copyright Owners*, <http://www.cbcd.ca/unlocatable-introuvables/licences-e.html>. The situations appear similar in other countries following the “compulsory license” approach. See, e.g., Marcella Favale et al., *Copyright, and the Regulation of Orphan Works: A Comparative Review of Seven Jurisdictions and a Rights Clearance Simulation* (U.K. Intellectual Property Office, July 2013), <https://www.gov.uk/government/publications/copyright-and-the-regulation-of-orphan-works>, at 46 (eight-two compulsory licenses were granted from 1972 to 2010 in Japan); KOREAN COPYRIGHT OFFICE, <https://www.findcopyright.or.kr/statBord/statBo03List.do?bordCd=3> (ten compulsory licenses were granted by 2015).

249. See *supra* note 232 and accompanying text.

250. See *supra* note 241 and accompanying text.

251. See *supra* note 238 and accompanying text.

252. See, e.g., 17 U.S.C. §§ 112(e)(4), 114(f)(2)(B), 801(b)(1) (2012).

commercial exploitation may not serve as proxy for orphan works, which typically have less market value.<sup>253</sup> Many works become orphaned because copyright owners believe the costs for keeping the ownership information accessible and updated outweigh the benefits of exploiting the works.<sup>254</sup>

Third, a collecting society designated to manage the compulsory licenses may have enough incentives to collect royalties for orphan works but not enough to locate their copyright owners and distribute royalties. On the one hand, if the money collected is negligible and hardly covers searching costs, the collecting society would naturally be unwilling to search for copyright owners. On the other hand, if the royalties are substantial, the collecting society would have even less incentive to locate copyright owners because it may use the unallocated amount to defray administrative costs and support collective-purpose projects targeting existing members, including awards and scholarships.<sup>255</sup>

From an efficiency perspective, the “limitation on liability” approach is clearly preferable to the “compulsory license” approach. Copyright protection reflects a trade-off between incentive and access in accordance with the economic features of its subject matters.<sup>256</sup> Information products, including works of authorship, have certain characteristics of a public good, i.e., “non-excludability” (or “inappropriability”) and “non-rivalry” (or “indivisibility”).<sup>257</sup> “Non-excludability” means that, once information is

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253. See Randal C. Picker, *Private Digital Libraries and Orphan Works*, 27 BERKELEY TECH. L.J. 1259, 1283 (2012). To design a compulsory license that encourages users to apply, the government would need to at least ascertain the market values of orphan work licenses (i.e., reasonable damages if liable for infringement) and the probability of copyright owners eventually emerging. It may then set the royalty rates by multiplying the two factors. Above the level, prospective users may choose to proceed without a license.

254. Any financial return from orphan works hardly affects ex ante incentives for creation no matter how successful authors are, especially where the criteria for a diligent search are set sufficiently high and authors have the option to terminate the orphan status. If an author expects her work to be commercially valuable (say 10), she may also expect the probability of her work becoming orphan to be rather low (say 10%). Therefore, the expected value from orphan work licensing would be low (1). If an author otherwise expects the probability of her work becoming orphan is rather high (say 100%), she would rationally anticipate that her work has limited commercial value (1). The expected value is equally low (1).

255. Certain institutional designs may be useful to alleviate the incentive concern; for example, requiring the collecting society to distribute royalties to relevant copyright owners before allocating a percentage of the distributed royalties to defray administrative costs.

256. See *supra* note 41 and accompanying text.

257. See, e.g., ROBERT COOTER & THOMAS ULEN, *LAW AND ECONOMICS* 135 (1988); PAUL A. SAMUELSON & WILLIAM D. NORDHAUS, *ECONOMICS* 37 (17th ed. 2001); William

created and distributed, it is physically difficult to exclude others from enjoying it. The consumption of information is “non-rivalrous” where it may be enjoyed simultaneously by an infinite number of people without incidentally affecting the enjoyment by others. In economic terms, the marginal cost of extending the consumption to another person is near zero. Under such circumstances, it is extremely difficult for authors to recoup the fixed costs of creating their works in a market without property rights because competitors, who are free to copy the same works without incurring the fixed costs, will soon drive the prices towards the marginal costs of reproduction and distribution.<sup>258</sup> Therefore, the market tends to undersupply those valuable works absent sufficient incentive for intellectual creation. Copyright law is intended to solve the incentive problem by granting authors exclusive control, for a limited period of time, over the reproduction and distribution of their works, which in turn generates market opportunities for pricing their works above marginal costs. The markup allows authors to recoup their initial investment in creative works, although the increased price may inhibit access by certain consumers who are willing to pay for the marginal cost but not for the premium.

However, orphan works by definition involve authors who may not be located with a diligent search. Chances are that the authors will never reappear. If compulsory licenses are imposed in these cases, users would pay a higher price, but the real authors would not receive any financial incentives. This situation would be the worst of both worlds: limited access for consumers *and* no incentive for authors. By contrast, under the “limitation on liability” approach, consumers would enjoy virtually free access to orphan works, unless the authors reappear and copyright incentives resume functioning properly to signal the authors how much consumers value their works.<sup>259</sup> By conditioning certain monetary remedies

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M. Landers & Richard A. Posner, *An Economic Analysis of Copyright Law*, 28 J. LEGAL STUD. 325, 326 (1989).

258. From an ex post perspective, once a work is created, the author would be unable to internalize the fixed costs and therefore suffer a competitive disadvantage over free riders who do not bear the fixed costs. From an ex ante perspective, even if the author tries to negotiate a price with all potential users before the work is created, game theory suggests that many users may underbid the work attempting to free ride other consumers' contribution.

259. See GOLDSTEIN, *supra* note 79, at 200 (“[T]here is no better way for the public to indicate what they want than through the price they are willing to pay in the marketplace.”); Harold Demsetz, *Information and Efficiency: Another Viewpoint*, 12 J.L. & ECON. 1, 1 (1969) (arguing that production and consumption of information cannot be judged independently); ADAM SMITH, LECTURES ON JURISPRUDENCE 82–83 (R.L. Meek et al. eds., 1987) (1762) (“[Copyright] is perhaps as well adapted to the real value of the work as any



(e.g., statutory damages and attorneys' fees) on the accessibility of relevant copyright owners, the approach would generate powerful incentives for authors to provide updated ownership information and connect directly with consumers. A well-functioning market would eventually benefit the whole society including consumers and authors alike.

### C. MASS DIGITIZATION

The above discussions also suggest that compulsory license and ECL proposals may not be appropriate even for mass digitization projects that involve an astronomical number of copyrighted works and substantial transaction costs for copyright clearance.

Taking the Google Books Project as an example, since 2004 Google has scanned millions of books provided by publishers and libraries.<sup>260</sup> On the one hand, Google used the digital corpus to develop book search engines and data mining tools ("non-display uses"). On the other hand, it engaged in negotiation with major publishers and the Authors Guild to launch an online bookstore comparable to Amazon ("display uses"), which Google appeared to discontinue after Judge Chin had rejected the Google Books Settlement.<sup>261</sup>

The Google Books Project has tested the boundaries of copyright protection across the world, especially with regard to non-display uses. In the United States, the Second Circuit recently affirmed the district-court decision that the copying involved in Google's searching and data-mining functions was "transformative use," did not offer the public a meaningful substitute for purchasing copyrighted works, and hence satisfied the test for fair use.<sup>262</sup> However, in 2012, a Chinese court found Google liable for full-text book scanning but not for displaying limited snippets.<sup>263</sup> Although

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other, for if the book be a valuable one the demand for it in that time will probably be a considerable addition to his fortune. But if it is of no value the advantage he can reap from it will be very small.").

260. See *Authors Guild v. Google Inc.*, 954 F. Supp. 2d 282, 286 (S.D.N.Y. 2013).

261. See *Authors Guild v. Google Inc.*, 770 F. Supp. 2d 666, 679 (S.D.N.Y. 2011).

262. Cf. *Authors Guild v. Google, Inc.*, 804 F.3d 202, 230 (2d Cir. 2015); *Authors Guild, Inc. v. HathiTrust*, 755 F.3d 87, 105 (2d Cir. 2014). While a comprehensive evaluation of Second Circuit decisions regarding the Google Books Project entails a separate article (if not more), it suffices to say at the moment *Authors Guild v. Google* could theoretically arrive at a different outcome than *Authors Guild v. HathiTrust*. In the latter case, the library defendants have originally acquired the copies of relevant books through purchase or other legitimate means. In the former case, Google did not own any copies until it generated new copies through digital scanning. In other words, scanning books eliminates the need for Google but not for libraries to purchase books.

263. See *Wang Xin v. Google, Inc.* (Beijing Interm. People's Ct. Dec. 20, 2012), <http://bjgy.chinacourt.org/paper/detail/2013/10/id/1230596.shtml>.

Chinese law does not contain a four-factor fair use test, the court incorporated part of the three-step test into the reasoning.<sup>264</sup> It concluded that the book scanning conflicts with the normal exploitation of copyrighted works because granting licenses and collecting royalties for full-text reproduction is one of the most common exploitations by copyright owners. In addition, the court held that the book scanning unreasonably prejudiced the legitimate interests of copyright owners by creating a potential danger to the market of copyrighted books. Once Google is in possession of the scanned books without authorization, copyright owners would lose control over any subsequent uses of the copies by Google and, if the security system were compromised, the copies would become the breeding bed of countless infringing uses by third parties.<sup>265</sup> The Chinese decision appears to attach more importance than the U.S. decision to the market-formation purpose of copyright protection.<sup>266</sup>

Notably, the clearance difficulty in the Google Books Projects does not result mainly from orphan work issues where searching costs for locating relevant copyright owners are prohibitively high. It has been estimated that merely a fourth of the whole corpus consists of potentially orphan works.<sup>267</sup> Google, the largest search engine in the world, had no problem identifying the vast majority of the copyright owners and was actually in the process of negotiating possible licensing agreements with publishers even before the litigation commenced.<sup>268</sup> Neither does the sheer volume of copyrighted works involved in the Google Books Project by itself justify a statutory exemption. The increase in transaction costs has been approximately proportionate to the increased volume and increased value of the overall database. It makes little sense to categorically argue that the more copyrighted works a database contains, the less reasonable it is to request a copyright license.

The key barrier to mass digitization appears to be that the incremental value of any individual work to the whole project is often lower than the

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264. *See id.* The decision curiously omitted the first step of the three-step test, “limited to certain special cases.”

265. *See id.* The Second Circuit explicitly rejected the hacking scenario as speculative due to “impressive security measures” implemented by Google. *Authors Guild*, 804 F.3d at 228.

266. For the purposes of following sections, mass digitization refers to projects that involve both non-display and display uses. In other words, the discussions are premised on the Google Books Project envisioned in the proposed settlement rather than what Google has implemented so far. Fair use defenses are apparently less plausible for making copyrighted works available online. *See* 2015 Orphan Works Study, *supra* note 21, at 76.

267. *See supra* note 42 and accompanying text.

268. *See* *Authors Guild v. Google Inc.*, 954 F. Supp. 2d 282, 286–87 (S.D.N.Y. 2013).

transaction cost needed to obtain a license for the work.<sup>269</sup> For instance, assume that locating a copyright owner takes one dollar, a perfectly reasonable searching cost; the user would still not reach out for a license if scanning the book only added three cents to the whole project.<sup>270</sup> This issue is not really different in nature from that faced every day by television/radio broadcasters who use a large number of musical compositions for their programs. If history is any indication, the best solution is not to bypass copyright transactions. Instead, we may pool various copyrighted works together through major publishers or collecting societies to facilitate the issuance of blanket licenses for mass digitization. This approach takes advantage of economies of scale to decrease transaction costs as the formations of ASCAP, BMI, and SESAC do for music rights clearance.<sup>271</sup>

The ECL proposal warrants cautious evaluation as a possible solution to mass digitization for three reasons in particular. First, as discussed above, complicated institutional design would be needed to prevent the ECL from superseding the pricing powers of uninformed nonmember authors, to contain the de jure monopoly of the collecting society against both authors and users, and to create incentives for the collecting society to improve distributional efficiency instead of sitting on royalties collected for

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269. Therefore, the Google Books Project actually includes four categories of works: (i) public domain works; (ii) works whose owners opt in; (iii) works whose owners are searchable but searching costs exceed their marginal values; and (iv) orphan works whose owners are not locatable with a diligent search. Apparently, if we define a diligent search by using, as a benchmark, the marginal value of the captioned book, the third and fourth categories would merge into one. *See*, Lang, *supra* note 28, at 135–36.

270. Website search engines provide a familiar example. Although a comprehensive collection of web content is likely the foundation of a search engine, any individual webpage is simply a small portion that may easily be replaced or omitted without any meaningful impact to the overall function of the search engine. Because the search engine actually assists consumers in locating a website, in a competitive market, the website author may be willing to grant a license for free and even pay the search engine to include her website in its search results. Under these circumstances, the license fee is effectively zero or negative. Any search costs, if positive, could appear excessive to the search engine. It may not be efficient to establish a collecting society with the monopolistic power to charge positive prices that create a deadweight loss and substantial administrative costs for handling copyright royalties.

271. In the limited cases where transition costs remain insurmountable and hamper digitization projects, a court may apply a limitation on liability, which however would become unavailable the moment new mechanisms emerge to diminish the transaction costs. It would serve better than a compulsory license to unlock socially valuable utilization of existing works and incentivize future innovations in lowering transaction costs. *Compare* *Am. Geophysical Union v. Texaco, Inc.*, 60 F.3d 913, 917 (2d Cir. 1994) (denying fair use because of new mechanism to lower transaction costs), *with* *Williams & Wilkins Co. v. United States*, 487 F.2d 1345, 1361 (Ct. Cl. 1973) (finding fair use partially because of high transaction costs).

nonmembers.<sup>272</sup> The institutional design and its implementation entail substantial costs.<sup>273</sup> Second, the history of the music market demonstrates that competitive collecting societies offering blanket licenses are capable of giving users practically unlimited freedom to use an exhaustive repertoire of relevant works.<sup>274</sup> Third, it is unclear why it is even necessary for a project like Google Books to include all of the books in the world to become a viable business. Theoretically, the holdup problem may arise where a project involves a large number of copyright owners and every permission is essential for the whole project to function.<sup>275</sup> Under these circumstances, a copyright owner could strategically withhold her permission to increase her share of copyright royalties, which could potentially cause a negotiation breakdown. However, this is usually not the case for mass digitization projects.

Assume that the Google Books Project obtains blanket licenses from collecting societies but accidentally includes a book owned by a nonmember author. If the author claims copyright infringement, Google may remove the infringing work from the digital database and continue its operation with other licensed works (taking comfort in the indemnity provided by collecting societies).<sup>276</sup> A single party can hardly have any veto power to block the entire project, which renders the holdup problem remote.<sup>277</sup> As a matter of fact, Google has slowed down scanning books from libraries, almost to a complete halt, even though a federal court held that the existing project is exempt from copyright liability as fair use.<sup>278</sup> Apparently, the marginal benefit of scanning more books for the purposes of designing book search engines and training web search algorithms quickly diminishes after having scanned 30 million books, although Google

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272. See *supra* note 245 and accompanying text. See also David R. Hansen, Kathryn Hashimoto, Gwen Hinze, Pamela Samuelson, & Jennifer M. Urban, *Solving the Orphan Works Problem for the United States*, 37 COLUM. J. L. & ARTS 1, 46 (2013).

273. For example, the U.K. Intellectual Property Office has estimated the cost of establishing the supervising authority would be £2.5 million to £10 million and the costs of operating the supervising authority would be £0.5 million to £1.8 million annually. See Intellectual Property Office, *supra* note 232, at 6.

274. See Music Marketplace Study, *supra* note 34, at 19.

275. See *supra* note 44 and accompanying text.

276. See *supra* note 110 and accompanying text.

277. For recent articles that discuss the holdup problem, see John M. Golden, Commentary, "Patent Trolls" and Patent Remedies, 85 TEX. L. REV. 2111, 2139 (2007); Mark A. Lemley & Carl Shapiro, *Patent Holdup and Royalty Stacking*, 85 TEX. L. REV. 1991, 1993 (2007); J. Gregory Sidak, *Holdup, Royalty Stacking, and the Presumption of Injunctive Relief for Patent Infringement: A Reply to Lemley and Shapiro*, 92 MINN. L. REV. 714, 716 (2008).

278. See Howard, *supra* note 45.

announced in 2010 that there are a total of 130 million books in the world (129,864,880 to be precise).<sup>279</sup>

The ECL proposal for mass digitization is sometimes justified on the premises that an opt-out choice is available for nonmember authors, and transaction costs would be lower for *some* authors to opt out of a project than for a prospective user to approach *all* relevant authors.<sup>280</sup> It may appear to be no more than a small inconvenience for an author to opt out of the Google Books Project by approaching the proposed Book Rights Registry, a single collective society intended to manage a single project.<sup>281</sup> However, if the ECL system becomes widespread in numerous countries and mass digitization projects proliferate for various purposes, an author striving to exploit her exclusive rights worldwide would have to monitor multiple projects managed by multiple collecting societies around the world. If she wishes to opt out of the ECL regimes and instead manage some or all her works by herself, she must carefully comply with opt-out requirements set by different countries. These daunting tasks are exactly the kind of formalities that the drafters of the Berne Convention envisioned while determining to completely prohibit any formality as a precondition for the enjoyment and exercise of exclusive rights.<sup>282</sup>

## V. CONCLUSION

Digital technologies have significantly lowered the costs involved in producing, marketing, and distributing copyrighted content. Online service providers such as Amazon, YouTube, and Spotify have the necessary economic and technological capacities to make an enormous volume of multimedia content available to the general public. However, due to relatively limited innovation in the field of rights clearance,<sup>283</sup> these online service providers are still facing substantial transaction costs in tracking

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279. See Taycher, *supra* note 45.

280. See 2015 Orphan Works Study, *supra* note 21, at 93.

281. See, e.g., Daniel Gervais, *The Changing Role of Copyright Collectives*, in COLLECTIVE MANAGEMENT OF COPYRIGHT AND RELATED RIGHTS 26 (Daniel Gervais ed., 2006) (“If it is a restriction at all, [ECL] is a mild one. It guarantees an orderly exploitation of the repertoire that will be licensed but offers authors the option of going back to Level 0 by sending a simple notice, perhaps even as simple as an email.”).

282. Berne Convention, *supra* note 30, Article 13.

283. Notably, several projects have recently emerged to streamline copyright clearance in the digital environment. See, e.g., *Copyright Policy Practicum*, <https://law.stanford.edu/education/only-at-sls/law-policy-lab/practicums-2014-2015/copyright-policy-practicum/>; *Copyright Hub*, <http://www.copyrighthub.co.uk/>; *Google Content ID*, <https://support.google.com/youtube/answer/2797370?hl=en>.

down copyright owners, negotiating license terms, and acquiring proper authorizations for millions of different copyright works.<sup>284</sup> Policymakers around the world are working to unlock copyrighted works in the digital age. Copyright reform initiatives largely follow one of two directions: Policymakers may change copyright from an opt-in regime into an opt-out or all-in regime (e.g., ECLs and compulsory licenses) to eliminate the necessity of copyright transactions and allow downstream users to exploit copyrighted works without authorization. Alternatively, policymakers may streamline private transactions in the marketplace, create incentives for authors to provide licensing information, and eventually allow market players to innovate on efficient business models. In comparison to the market approach, compulsory licenses have a number of drawbacks, such as divesting authors of exclusive rights in copyrighted works, resulting in wasteful rent seeking and setting arbitrary prices for copyright royalties. However, the fundamental concern is that compulsory licenses would undermine the incentives for collecting societies and other market players to improve their services in order to decrease transaction costs. While the United States and the rest of the world are at a crossroads in copyright reform, the road taken (and the road not taken) by Chinese policymakers provides a valuable lesson: We cannot, in the name of lowering transaction costs, completely sidestep transactions and sidestep the market as the principal mechanism to allocate social resources for intellectual creation.

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284. See, e.g., James Duffett-Smith, *Comments OF Spotify USA Inc.*, [http://copyright.gov/docs/musiclicensingstudy/comments/Docket2014\\_3/Spotify\\_USA\\_Inc\\_MLS\\_2014.pdf](http://copyright.gov/docs/musiclicensingstudy/comments/Docket2014_3/Spotify_USA_Inc_MLS_2014.pdf). (Spotify spent almost three years for clearance in the United States.).