

**ECONOMICS OF COPYRIGHT COLLECTING SOCIETIES AND  
DIGITAL RIGHTS: IS THERE A CASE FOR A CENTRALISED  
DIGITAL COPYRIGHT EXCHANGE?**

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ABSTRACT. Copyright collecting societies have attracted economists' attention for over 30 years and the attention of government regulators for even longer. They have typically been accepted by economists and by courts of law as necessary for reducing transaction costs and enabling copyright to work. The advent of digitization has led to renewed interest in the topic and to the view that though new technologies offer the possibility of improved rights management, collecting societies are not responding sufficiently to these opportunities. That view was evident in recent enquiries into the role of copyright in the digital age in the UK, which proposed the formation of a Digital Copyright Exchange (DCE) that would promote online digital trade. This paper evaluates the case for the DCE in the light of what economists know about collective rights management.

1. INTRODUCTION

In a recent article in this journal, Nancy Gallini (2011) offered new insights into the economics of copyright collecting societies by comparing them to patent pools. She concluded that the case for collecting societies as transaction cost minimising natural monopolies was still sound. However, she suggested that her conclusion might be changed by the spread of digital rights in copyright works and that is what I consider in this paper. She argued that if new technologies lower the costs of licensing, monitoring and

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enforcement, there would be a tendency to more decentralised alternatives to collective administration.

In this paper, I take up the discussion in the context of the proposal that the UK government encourage the formation of a Digital Copyright Exchange (DCE), a centralised clearing house for digital management of rights. The proposal was first put forward in the Hargreaves Review (2010) on two grounds: one, that a central exchange could more efficiently handle cross media (and possibly cross national) licensing of digital rights of all types of works than is the case in the current situation in which a multiplicity of collecting societies manage a restricted bundles of works in particular media, making it necessary for multimedia firms, such as broadcasters, to obtain licences from several societies. The second ground was that the DCE could introduce competition into the ‘locked-in’ system of collecting societies, each with its specific bundle of rights, territories and administrative procedures, which are held to be anti-competitive, lacking transparency and inefficient and, more to the point for this paper, unable to handle the needs of new digital platforms. The proposal has now been followed up by the Hooper study on the feasibility of the DCE, which reported in two phases: *Rights and Wrongs* (2012a) and *Copyright Works* (2012b); in the latter the DCE morphed into the notion of a Copyright Hub incorporating a number of DCEs. These moves to centralize licensing, however, gainsay Gallini’s conclusion that new technologies could lead to greater decentralization.

The present paper uses the DCE proposal as the backdrop for discussing three basic questions it seems to me economists should ask in this context: has digitization fundamentally altered the economic case for collective rights management? Second, would a new system of licensing alter the accepted view of collecting societies as natural monopolies? Third, can effective competition or contestability be introduced by a centralised copyright exchange

into the world of collecting societies so as to reduce transaction costs, as envisaged in the UK reports?

## 2. THE DCE PROPOSAL

The DCE is conceived as an online electronic system that ‘allows licensors to offer their rights and licensees/rights users to license them’. Registration has to be voluntary because copyright/authors’ rights are viewed by the Berne Convention as automatic and copyright owners cannot be required to register. The DCE would have several functions for users: it would reduce search costs of content and rights holders across different media and enable transactions to take place electronically while providing rights holders with a full account of usage and royalties due (Hooper, 2012b). Digital methods are seen as facilitating ‘knowing exactly’ what uses are being made of works and so enable rights owners to be ‘correctly’ paid for their contribution. There is the suggestion that it would enable individual licensing though it is clear that the DCE needs to work with the collecting societies who hold significant databases. The proposal is based on the view that copyright licensing can be improved by digital rights management (DRM) and that digital rights and digital trade are somehow different.

A main focus of the proposed DCE is that the cost of obtaining the use of rights is ‘expensive’ and ‘high’ but there is little attempt to meaningfully define ‘expensive’. The Hargreaves Review suggested that they are high because there is insufficient competition in licensing services provided by the collecting societies. What is not considered at all is that if users are prepared to pay ‘expensive’ prices, the market would be economically efficient. The question that should be asked is: are the administrative costs of copyright licensing *unnecessarily* high and if so, why? A report by KEA (2012) provides ample evidence on the sources of transaction costs in music licensing (see below).

There is, however, a wider context to the UK proposal: the EU has been concerned for some time about the single market aspects of copyright licensing: though there is a common market for the use of copyright works, licensing is nationally based. There are in effect three issues in one – the impact of digitization, cross-border licensing and the governance and management of copyright collecting societies; they interact because it is held that some (many?) of the European collecting societies have not responded to the need for digital licensing nor are their accounting methods transparent or capable of being influenced by ‘foreign’ rights holders, such as composers whose music is being played throughout the EU but with licences issued each territory, possibly on differing terms. There is also concern about the power of collecting societies to hold-up legal access to digital copyright works thus exacerbating unauthorized use. These concerns were aired by Hargreaves and Hooper and also in EC (2012) – a proposed European Directive on multi-territorial licensing of rights in musical works for online uses.

### 3. DIGITAL RIGHTS, DIGITAL PRODUCTS AND DIGITAL SERVICES

**3.1. Digital rights.** With the emphasis in these reports on digital trade it is worth considering what is meant by digital rights since the term seems to be used to mean several things: there are rights to works that were created digitally or were digitized from analogue form and there are digital rights that attach to copyright works in tangible form (such as a book); there is digital rights management that could mean digital management of rights by electronic means (DRM) using technological protection measures (TPM) or management of digital rights, which could be done using ‘analogue’ age methods by existing collective licensing systems. Forms of DRM are used in various ways by collecting societies and by the producers of creative products, though the cherished ideal of technology solving all monitoring and enforcement problems has not been realised and firms that used them, for

instance record labels, have had to abandon some types of DRM for both legal reasons and its unpopularity with consumers; moreover standards do not yet exist for use on all platforms. Thus we need to distinguish the management of digital rights from the use of DRM as a management tool in collecting societies in order to ask if the nature of digital services and their markets calls for a new structure of rights management.

Electronic distribution of digital products has led to the introduction of new ‘digital’ rights into copyright law and its adaptation to new technologies. The right to make a work available on demand and the right to consent to electronic communication to the public were created to extend the existing bundle of copyright protection to internet trade; as with other rights in the copyright bundle, they may be licensed separately from other rights in the same work. Copyright law has also extended protection for online use to neighbouring rights for broadcasters, sound recording makers and performers. Some of these extensions, especially those mandating statutory licences, require remuneration to be administered by collecting societies, leading to the creation of new societies and boosting the status and revenues of older ones. Performers have been accorded individual rights in digital works which they may or may not choose to enforce via a collecting society. All in all therefore, copyright law has become more complex and broader in scope as a result of digitization, as well as having longer duration.

### **3.2. The effect of digitization on markets for copyright products.**

One of the biggest shifts caused by digitization and trade in digital services is that copyright products that were previously sold in tangible form for a price – books, CDs, videos – are licensed as a service when in digital form for a fee. Some features that apply to sales of goods do not extend to licensed services; the first sale doctrine that allows resale, lending or sharing

of a physical book or CD may not extend to the same book or CD in electronic form, depending upon national law. In tangible form, products that contain a bundle of works will have had all rights cleared for sale to the consumer but the same product in digital form involves further permissions and transactions. As is well known, digitization has made products that were rival and excludable into what are tantamount to public goods with only observance of copyright law and TPMs as means of exclusion to discourage ('prevent') free-riding. Different business models have developed for licensing rights than for outright sales. Two basic models used for the licence fee are a subscription that covers a bundle of items for a period of time and a per use model in which the user pays to use the item each time, say a book title or music track; especially the latter requires users to renew the licence frequently, increasing the number of transactions.

Two things follow from this: one, that far more licensing of products of the creative industries is going on in the digital than in the analogue world; second, revenues from licences now replace producers' sales revenues wholly or in part, depending on the product. Both these developments make the ease and cost of licensing arrangements more significant. The growth of digital products, growth of digital rights and growth of the number of transactions has put the administration of copyright licensing in the spotlight resulting in renewed interest in the pros and cons of collective licensing.

What is also the case, however, is that many copyright works are not in digital form, indeed the vast majority of works in copyright are no longer in publication since the copyright term by far exceeds the shelf life of the products that contain copyright works. Products currently on the market are not all digitized and even ones that are may well exist in both analogue and digital form, say a book or newspaper. Digital rights are only part of the whole bundle that needs clearance for use in those cases. Though little

is known about the age structure of collecting societies' portfolios, potential users may prefer to obtain a licence for all rights in one transaction rather than obtaining analogue and digital rights separately, which they may do through collecting societies.

### 3.3. The impact of digitization on the administration of rights.

Digital rights combined with effective DRM held out the promise of individual licensing for digital services by digital means; that was the scenario presented in Katz (2006/10). That scenario seemed at first sight to suggest that a competitive market for administering digital rights would emerge spontaneously, making collecting societies redundant or at least contestable. It suggested that creators would be better able to contract directly with users even to control secondary use. The DRM dream has faded but that has not meant no change at collecting societies.

Collecting societies have utilised the internet and electronic means to enable easy access to licensing arrangements making it trivially simple to obtain a standard blanket licence for a defined set of uses. That requires the user to know where to go for the licence, which however is easily searched for online. But collecting societies do not put users in touch with copyright holders. The chief merit of a Digital Copyright Exchange or Hub is that it would act as a clearing house for *information* on all rights holders and the agencies that license their rights across different media and it may also provide a gateway to contacting them; it would in effect provide a club good. Similar models already exist: for example, JSTOR supplies that service for academic publications; it can be seen as a club good serving academia and SSRN fulfils the role of a centralised information service. Club goods are typically financed by membership subscriptions and there is an issue as to how many members are admitted, for example to a tennis club, but the DCE presents the opposite case as its value as a network subsists in supplying a

comprehensive list, suggesting that there could be free-riding and hold-ups by rights owners who do not wish to join or pay for the maintenance of the service. The DCE could also operate as a platform for a two-sided market, financed by users and rights holders who would pay for the information.<sup>1</sup> Any such payments would likely add to transaction costs, however. A potential weakness of the DCE would be that if it does not have comprehensive information, for example if rights holders do not wish to take part, it could leave users with an even more difficult task of searching to contact them. That is also a problem with rights management by collecting societies identified in by KEA (2012).

**3.4. Digital services in music.** The main thrust of a lot of the issues discussed above has to do with music licensing for online use; that is no doubt because setting up legal facilities is considered vital to the future of the sound recording industry, which was in the forefront of the impact of digitization, as well as to achieving greater respect for copyright law. The KEA (2012) study looked in detail at basically two problems that have held up the development of online music services in Europe, namely, the difficulties and expense of multi-territorial and multi-repertoire licensing. Online music services have been slow to develop and that is no surprise as it is estimated that a service aiming to offer over a million titles in several countries could face transaction costs of up to 260,000 euros (KEA, 2012; 46). In this context, licensing costs are *ex ante* costs of searching and negotiating a licence: the study did not deal with *ex post* enforcement and other such costs. The costs are estimated on the basis of the time and effort needed for finding rights owners and agreeing terms: for the figure just quoted, negotiations could take up to two years. Even if (as is usual) these figures are to be treated with caution, they indicate the extent of the problem that the DCE seeks to overcome.

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<sup>1</sup>Thanks to Richard Watt for suggesting the two-sided market model. Further work on this subject should certainly consider that in detail.

The main problems identified are the multiplicity of rights that are owned and/or managed by different agents (which would have been aggregated and cleared for the sale of a CD by the sound recording producer), the absence of complete information on rights ownership (especially an issue in sound recordings where there are multiple authors and performers), the territoriality of rights that make it necessary to deal with collecting societies in all the territories in which the online service is to operate and above all, the bargaining power of the major labels and publishers who control 75 per cent of the market, with whom negotiations are longer; in addition, they demand advances to be paid, which is a disincentive to start-ups and smaller online music service enterprises. Perhaps the problems with recorded music are greater than for other creative content but multimedia services also are held to face similar costs according to Hooper (2012b). *Soundexchange* in the US, however, offers an interesting contrast: it is a non-profit rights management organisation approved by the Copyright Board for collecting royalties from digital music services operating under statutory licences.<sup>2</sup>

To sum up this section: from the economic point of view, digitization has led to digital rights on both new and older copyright works and to more rentals and licensing; the volume of transactions and licensing has increased and while online administration by collecting societies have reduced the cost of obtaining the licences, new online music services face considerable costs of negotiation and finding information. The case for the DCE is that it improves that information. To evaluate its role beyond that function by extending into licensing itself, though, and to discuss the merits of individual versus collective licensing, we need to consider the economics of collecting societies.

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<sup>2</sup><http://www.soundexchange.com>

**3.5. The economics of collecting societies.** There is a small literature on the economics of copyright collecting societies: Weir and Peacock (1975) produced what seems to have been the first empirical study of collective rights management - on the UK's Performing Rights Society; the issue at that time was how to set the rate in the bilateral monopoly between the PRS and the BBC which was a monopsony user of recorded music and a major supplier of live broadcast music. Hollander (1984) provided the first analytical study, followed by Besen and Kirkby (1989) and Besen et al (1992). The subject has been periodically revisited by economists with very similar conclusions, namely, that collecting societies are natural monopolies and that blanket licensing is generally efficient.<sup>3</sup> It is these conclusions that digitization might change.

**3.6. What makes collecting societies natural monopolies?** Collecting societies perform several functions as a bundled service: administering rights for their members, licensing those rights to users, monitoring use and enforcing copyright for their members' works. This bundling is the basis of economies of scale and scope for the collecting society. They supply joint products for the rights holder and offer a service to users of access via a bundled licence to all works in the repertoire held by the national society and, through agreements with comparable collecting societies in other territories, they effectively offer a licence to world repertoire of the type of work they administer (music, literature, etc). It costs very little to offer these services to additional members and works once the initial investment in the structure of licensing, fee setting and monitoring is in place - hence the natural monopoly - and the cost of licensing to rights holders and users is thereby vastly reduced.

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<sup>3</sup>For a survey, see Handke and Towse (2007).

In most cases, anyone with a published copyright work may join the appropriate collecting society,<sup>4</sup> whose portfolio is determined by the medium and the scope of the rights, and in so doing he or she ‘registers’ their work(s) with the title and the author’s name(s) and provides contact and bank details. That yields two databases: one of works and names of the rights holders and one of rights holders’ details for the distribution of royalties and other payments, both of which the rights holders themselves have the incentive to keep up to date.<sup>5</sup> It is worth noting that the cost of registering works is largely borne by the rights holders not the society as once the template for the required information is on the society’s website, registration is done by the rights holder online and that can be time consuming even for a small rights owner as detailed information must be provided. The collecting society has a third database of licensees and some details about them, such as the type of user and extent of their use since that determines the rate for the licence, and it incurs costs of maintaining that database and administering licences; online licensing has simplified these processes, however. The terms of the licence in some cases require the licensee to provide information about the use made of individual works, such as a song title, which adds compliance costs to the licence fee for users.

Since the fixed costs of setting up these databases can be spread over very large numbers of works and rights holders and the bundled services are offered collectively, collective licensing has falling average costs and low marginal costs. Existing members benefit from enlarging membership as the size of the repertoire offered increases. Though there are probably no economies of scale in creating each of the collecting societies’ databases of copyright

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<sup>4</sup>In some jurisdictions, open membership to qualifying creators is mandatory. This would be called ‘common carriage’ in other contexts.

<sup>5</sup>That is not always the case for heirs and indeed, one weakness of copyright is that heirs do not always know they own rights or perceive them to be of value. Many ‘orphan’ works belong to unknowing owners. The problem libraries and archives have in dealing with digitizing orphan works is expected to be in part solved by the DCE.

holders and works in the first place, replicating them would be inefficient; collective licensing is a network with similar characteristics to networks such as gas pipes and rail track. As with those utilities, a regulatory authority could enforce ‘open access’ to encourage competition but without it, duplication of the database information would increase administrative and other transaction costs for rights holders and the cost of setting up the databases would put new entrants to the business of managing licensing at a disadvantage. Of course the databases could easily be copied but the collecting society would have no incentive to allow that as they are its commercial assets and it knows that doing so would invite competition.<sup>6</sup> It is likely for this reason that the Hargreaves Review suggested the DCE should cooperate with the collecting societies. Indeed, in many jurisdictions, collecting societies are regulated by the state and the government could enforce open access and common carriage rules.<sup>7</sup>

In addition to being natural monopolies in the economic sense, collecting societies also acquire monopoly control of the rights they manage since they require the exclusive assignment of a specific bundle of rights as a condition of membership, thereby enabling them to offer a blanket licence. This requirement typically rules out individual licensing and the opportunity that gives for negotiating licences for particular uses (Hollander, 1984; Katz, 2006/10) and the blanket licence also rules out rewarding the owners of works exactly for the use made of their works, a topic that is discussed below.

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<sup>6</sup>British Equity Collecting Society that licenses performers’ rights has licensed access to some of the information held on its database to assist producers of new programmes with completing cast lists for new productions. ‘This ensures that existing data being reused where possible rather than data being retyped, possibly with minor errors, which in turn create rights verification issues for the future.’ BECS evidence to the Hargreaves Review (p.18).

<sup>7</sup>In the UK, however, there is minimal regulation via the Copyright Tribunal, which deals with conflict resolution for disputes over commercial licensing.

**3.7. Blanket and individual licensing.** Economies of scale and scope particularly come into play with the blanket licence that is the standard practice of collecting societies. The main economic argument for blanket licensing is that it reduces transaction costs to both rights holders and users. Blanket licences are typically negotiated with representative user organisations, for example, of broadcasters, discotheques and shops and rates set accordingly. Collecting societies' monopoly of licensing services for the bundles of rights they manage gives them power over pricing that is a cause for concern but it is also the case those organisations have some countervailing power, especially the big broadcasters.<sup>8</sup> Price discrimination in licence fees is common. There are economies of scale in the transaction costs of negotiating and agreeing terms between the collecting society and the trade organisation which then enables individual businesses to easily obtain a licence. These transaction costs are considered to be too great for any but the wealthiest individual rights holder and may be prohibitive even for them.

The blanket licence does not fully ensure that every available work is licensed for all uses that the collecting society covers at home and through its foreign partners. A point that is not often mentioned is that since not every rights holder wants to join a collecting society, collecting societies do not have the mandate to licence all works of a particular type. According to Katz (2005), however, the purchase of a licence from the appropriate collecting society is deemed by courts to be a defence against unauthorised use and so offers peace of mind to users. If licences are offered individually, there is a greater risk to users of not having that permission.

Collecting societies everywhere (except the US where there is a duopoly in music licensing) are monopoly providers of licensing services and typically only offer a blanket licence, seemingly ruling out individual licensing. Though individual licensing is held out as more accurately rewarding the

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<sup>8</sup>In the UK the BBC is still a leading broadcaster with considerable clout.

owners of works for the use made of those works than does the blanket licence, it would not necessarily increase the sum they command on the open market. According to Katz (2005, 2006/10), there is no requirement for collecting societies to offer a blanket licence for all the works in the repertoire of members: they could debundle rights and works and license them at discriminate prices. He points out that in principle collecting societies can offer a collectively determined price for individual works but that would have to be lower than the fee for the blanket licence to make it attractive to users; Liebowitz and Margolis (2009), however, disagree on the grounds debundling would be inefficient and Snow and Watt (2005) make the argument in terms of the risk-bearing aspect of blanket licensing: debundling transfers all risk to each member, thereby eliminating any benefits of risk sharing that collecting societies could offer (see later). Moreover, not all users want blanket permission: every user may not wish to obtain permission and pay, say, for copying articles from hundreds of newspapers; some business users may just want to copy articles from a top few national dailies, for example. Collecting societies have been unwilling or unable due to their articles of governance to deal with reduced repertoire or individual licensing.

**3.8. Setting the rate for licences.** The blanket licence is a flat fee for the whole range of works whose rights are owned by the membership. Though there are different rates for different uses and users based on the potential audience sizes or on users' revenues, the licence fee does not discriminate in pricing according to the quality, characteristics or popularity of members' works. What determines a member's royalty distribution is the volume and type of usage.

Setting the rate itself involves considerable costs of negotiation with multiple users in a market environment. Even in the analogue world, new technologies developed new uses and rates had to be set for unknown future

revenues. Especially where a copyright board or court is involved, that seems to be done by analogy to a similar existing medium or platform, for instance, treating digital replay devices like time shifting using a VHS device, and increments are set according to a rule of thumb, such as the rate of inflation, rather than according to the market conditions for the type of work. These rates then become accepted and path dependency sets in. This also can happen in ‘free’ bargaining and that currently applies to online uses because their value cannot be verified in advance; moreover, some ventures would become prohibitively expensive if payments had to be made in advance but, on the other hand, if creators or performers have to wait for their payments, they are effectively involved in financing the undertaking without any power of decision-making. It is widely accepted that ‘nobody knows’ in launching new works in the creative industries but that equally applies to new business models. There is also the risk that digital media and platforms ‘cannibalize’ existing products. Experience of the existing market may not be a guide but in a radically uncertain world of new products, previous experience of a similar market may be the best guide in setting the rate.

Individual licensing by the right owner herself would require exactly the same process of bargaining, rate setting, collecting licence fees and so on but the associated costs would be higher without the benefit of economies of scale that blanket licensing affords. A private agency could offer the services of rights administration, a move envisaged by Hargreaves (and also by Hollander, 1984; Besen et al, 1992) and Hooper (2012b) reports the presence of a number of private companies doing just that, but unless they are able to achieve comparable economies of scale and scope to those of a collecting society, their administration charges must be higher. For the user, the search costs would also be higher but there may be other advantages, such as a lower fee than a collecting society would offer in a blanket licence. Having

the DCE might encourage the development of such agencies by reducing the search costs to users. If it were to be involved in rate-setting itself, these are the issues it would also face. For the rights holder, the comparable service from the DCE would also have to include monitoring all uses and enforcing licences, vital and costly services that get no mention in the DCE proposal.

**3.9. Distribution of revenues.** The distribution of revenues by the collecting society requires a database of rights holders' contact details. Revenues from the sale of blanket licences and other forms of remuneration are distributed net of administration costs to every rights holder who earns more than the minimum annual sum. The distribution takes the use of individual works into account by rather indirect means such as playlists and top ten charts. Some societies have compensating preferential rates for distributions to particular groups of members, for example, classical composers, whose works do not figure in listings or in returns by large scale venues. This lack of accuracy on the value of the individual's work has been criticised on the grounds that the financial incentive of copyright is blunted: that may be but what needs to be recognised is that there is a trade-off between the costs of more detailed monitoring of use and administrative costs to rights holders. In European societies, their articles often mandate deductions of ten per cent or so for 'cultural purposes'. In general, the lack of accountability and transparency in the distributions of some of those collecting societies, especially from cross-national licensing, is likely to be regulated within the EU.<sup>9</sup>

Snow and Watt (2005), however, argue that by going to the lengths they do to distribute revenue according to use made of individual members' works, collecting societies miss the opportunity to act as a risk-pooling insurance

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<sup>9</sup>EC COM(2012) 372 final Proposal for a Directive on collective management of copyright and related rights and multi-territorial licensing of rights in musical works for online uses in the internal market.

mutual. Though they bundle works together in the blanket licence for the licensing purposes, they then incur transaction costs in effectively debundling them for distribution purposes. They demonstrate that this is economically inefficient and propose an alternative model for distribution that both rewards the creators of successful works, thus providing an incentive to create them, and distributes a share in the success of the whole repertoire of the collecting society, thereby pooling risk in the highly uncertain markets for copyright works. This combination is compatible with the basic assumptions that collective rights management is preferable to individual licensing and that the collecting society welcomes new members whose works will increase revenues and therefore shares for all. Open membership is anyway mostly required by regulators, probably for equity reasons and it is interesting that Snow and Watt also find it to be economically efficient.

**3.10. Administrative costs.** Much of the criticism of collecting societies has been aimed at their administration costs, which vary quite a lot, the lowest in the UK being around 8 per cent and the highest around 20 per cent. That criticism featured prominently in both Hargreaves (2012) and Hooper (2012a) for UK collecting societies, though in international terms the figures are low.<sup>10</sup> In fact, little effort is made by either report to put these costs into perspective; for example, the BBC's frequently quoted shock-horror £10 million licensing costs for clearing rights of archive programmes for its iPlayer needs to be set in the context of its nearly £5 billion revenue; the BBC is in the business of rights licensing and sales! Many societies in other countries have higher charges, and those are passed on through the system of international transfers that are made through agreements between national societies, including to the UK which, at least for music, is a net exporter. In fact, all businesses have transaction and administrative costs;

<sup>10</sup>Einhorn (2006) points out the 'competition' (a regulated duopoly) between ASCAP and BMI in the US results in higher charges than those of the UK's PRS for musical performing rights.

for example, administrative expenses for insurers of small health plans in the US constitute 25 to 27 per cent of premiums.<sup>11</sup> That said, it is clear from the research by KEA (2012) that transaction costs of music licensing are sufficiently high as to deter start-up online music services so that only big players, such as iTunes, enter the market.

It is assumed in the Hargreaves and Hooper reports that DRM can considerably reduce or avoid such administrative costs though there is no evidence on this point. Nor are there any estimates of the costs associated with the DCE; the ‘impact’ estimates of the (considerable) net benefits of the DCE assume only benefits from it, no costs!<sup>12</sup> The full cost would also have to take into account switching costs, the costs of displacement of the existing licensing system and any reduction to creators’ earnings.

#### 4. OTHER ARGUMENTS FOR BLANKET LICENSING

In addition to the transaction cost minimization rationale for blanket licensing, other arguments have been advanced in favour of blanket licensing and they also offer a critique of individual licensing.

A variation on the transaction cost argument is presented by Parisi and Depoorter (2003) who argue that if the works in the repertoire of the collecting society are complementary, the blanket licence is efficient because it prevents the ‘tragedy of anti-commons pricing’, meaning that excessive diversity of rights owners and works results in no trade being feasible due to the high cost or impossibility of tracing owners. If the repertoire consists of substitutes, though, blanket licensing simply reinforces the monopoly and prevents competition. The case can be made either way, it seems: in one sense all works within a genre are substitutes – several plays cannot be put

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<sup>11</sup>Small Business Research Summary (ISSN 1076-8904) of the U.S. Small Business Administration’s Office of Advocacy.

<sup>12</sup>It is claimed that UK GDP would increase by £2.2bn due to the DCE (Hargreaves, 2012: Annexe EE), a figure that was believed by only a tiny proportion of the few respondents who replied to that point in the Hooper questionnaire (Hooper, 2012a:64)!

on in one theatre simultaneously – but users wanting a broad repertoire of works seem to view individual works as complements in a diverse service, such as a radio programme. The point is how users behave when faced with changes in relative prices for which, however, there need to be alternatives to blanket licences. One situation in which that exists is per programme or per use licensing for cable and satellite broadcasting in the US where the attempt was made to introduce competition into licensing enforced by decree (Einhorn, 2006).

Liebowitz and Margolis (2009) have commented on the US court decisions on per programme licensing. They adapt economic analysis on bundling and tie-ins to information goods such as broadcasting, pointing out that as they are non-rival and can have zero reproduction costs there is no social benefit from excluding users for already created works - the ‘eat all you can’ pricing model is preferable to ‘a la carte’. Individual pricing is therefore inefficient and since the collecting societies use price discrimination in a detailed way in setting the licence fee (for example, setting the rate according to the size of the premises or putative number of listeners), most users’ willingness to pay is accommodated. They argue that ‘carve-outs’ from the blanket licence are necessarily inefficient, not least because there is no efficient pricing rule for the extracted works. They also point out that bundling is normal in many goods; a CD is a bundle of songs, a book bundles the underlying authorial work with paper and binding.<sup>13</sup> Though digital works can easily be debundled and their use restricted either by DRM or by contract that does not make individual pricing efficient; moreover, the public goods features of information goods anyway imply that scarcity pricing is economically inefficient.

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<sup>13</sup>In fact most goods are bundled though we do not think of it like that. New technologies innovate by rebundling in product and process innovation – ‘old wine in new bottles’. Digitization is not the first technology to achieve that!

A different line of argument in favour of blanket licensing on equity grounds is offered by Kretschmer (2002) who pointed out some time ago that collecting societies offer solidarity to their members through collective bargaining for the licence fee. For many individual creators that is their best means of obtaining a reasonable reward for secondary usage. Collective bargaining has always been particularly well established for stage and audiovisual performers in the UK, though not in other European countries.<sup>14</sup> Professional associations exist in most creative areas of work and recommend rates for primary work; even so few seem to be set in stone and the individual is often forced to accept a lower rate on a ‘take it or leave it’ basis.<sup>15</sup> Therefore, the collectively bargained remuneration for secondary use is valued by collecting society members in addition to the fact that for most, individual bargaining for secondary uses would be prohibitively expensive in terms of time and transaction costs.

Thus both efficiency and equity arguments have been advanced in favour of collective administration of copyright using blanket licensing and applied to both analogue and digital technologies. The obverse is that individual licensing is inefficient.

## 5. IS THERE A CASE FOR A DCE?

What would economists want to know in order to evaluate the case for a centralised digital copyright exchange? If assembling data were a costless process, there would be an open and shut case on economic grounds for

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<sup>14</sup>That seems to explain the greater emphasis in EU Directives on statutory remuneration for rights such as the rental right that has to be paid to collecting societies: collective bargaining for freelancers seems not to exist on the Continent. It is worth noting that in the UK, Equity which represents stage, TV and film performers used to work on a repeat fee basis for TV programmes. With the rights usually cleared for only one or two performances, the repeat fee for a greater number of performances was based on the payment for the performance with allowance for inflation over the intervening period. In the 1990s, Equity renegotiated its agreements on to a royalty basis, thus reducing the upfront cost of making a programme. GEMA in Germany still uses the initial payment rule as the basis for distributing revenues to authors and composers.

<sup>15</sup>See <http://www.cippm.org.uk/symposia/symposium-2009.html>.

a centralised register of copyright works and rights holders because that alone is likely to reduce search and information costs. But it is not. Both the Hargreaves and Hooper reports envisage that the industries concerned will finance it but all the net benefit calculations omit any estimate of the set up and running costs. An off the cuff figure given to this author by one of the big collecting societies for initial set-up costs is £0.5 million – not very much in the scheme of things: the twelve largest UK collecting societies between them have revenues of nearly £100 million, according to the Hargreaves Review.

Apart from the register, what does a centralised exchange for digital rights offer by way of benefits? Electronic management of rights by collecting societies has already reduced costs of licensing for right holders and users. Both digital and ‘pre-digital’ rights can be administered with one comprehensive licence and many users would presumably like to clear all available rights in a work, not just the electronic ones, to save time and trouble and to avoid risk of unauthorised use. If a rights holder preferred to debundle the digital rights in a work with the objective of maximising revenue outside the collecting society that would increase administration costs and presumably the price of the licence - why else would it be desirable? That would benefit the rights holder but increase the cost to the user. In principle DRM encrypted in a product can handle debundling but it has so far not overcome the problem of the lack of standardization on all platforms. DRM embodied in a product such as a sound recording or an e-book can log use but without standardised databases of rights holders’ contact details, cannot distribute revenues from licence fees to rights holders. For that the databases of the collecting societies are needed; as argued above, duplication of these would be inefficient. It is not clear how the DCE could assist with these matters without becoming a full scale collecting society.

Standardization of content description, rights holders details and other data relating to copyright works are crucial to operating a DCE or hub. Evidence to the Hargreaves and Hooper reviews show that various industry based ‘meta’ database schemes are already underway, though experiencing problems. Among them are the International Standard Name Identifier (ISNI) which will produce a database of unique names of authors and performers and the Global Repertoire Database (GRD) of musical works and eventually of sound recordings. These standardized electronic listings might enable further developments in rights management; it remains to be seen if they then encourage individual licensing. One problem, though, is that publishers themselves do not have all the necessary information on the works they own (KEA, 2012). Of course, as mentioned earlier, they are only able to include data about rights holders who choose to enter their works with an agency or collecting society and refusal would restrict the ‘meta’ listing.

The Hargreaves Review and the Hooper study state that ‘transaction costs’ of the existing collecting society regime are ‘very high’. Why would they not be ‘high’ for a system topped by the DCE too? It is hard to see how it could avoid adding yet another layer of transaction costs to those already in place - yet without offering the full bundle of services that collecting societies provide.

## 6. CONTESTABILITY

Hargreaves’ advocacy of the DCE is tied with the view that it would encourage competition by putting pressure on the collecting societies to improve their service to their members and licensees. It is argued here that this view misunderstands the economics of natural monopolies and the complexities of the copyright system.

Though private agencies are likely to have higher average administrative costs than collecting societies, the view is that they could offer a large rights

holder a discounted price. That undoubtedly means they would cherry-pick top earners. What collecting societies fear most from such competition is that default of high revenue members would leave them with smaller rights holders for whom unit licensing costs are greater, thus imposing higher administrative costs on the remaining members. Eventually those costs would be passed on to licensees who might then prefer to buy a limited bundle of works that are cheaper, setting off a downward spiral for the collecting society. That may be good for intermediary firms in the creative industries but it would reduce the reward and incentive to the creators whom copyright is supposed to benefit. Yet collecting societies are often required by their articles of government or by law to accept any and all qualifying members however small the number and value of their works. Those requirements would become unsupportable with cherry-picking.

So far, the development of new licensing services and individual digital rights does not seem to have been a threat to collecting societies. There could be several reasons for that: licensing and monitoring secondary use is too expensive for individual creators and businesses; creators and rights holders believe that they can get a better rate collectively than individually; a great deal of repertoire is not in digital form; digital and 'analogue rights are bundled together; collecting societies have a track record of offering a reasonable service; and legislation requires equitable remuneration for works subject to statutory licences to be paid to collecting societies for distribution. For one reason or another, incumbent organisations have considerable organisational and reputational advantages over an unknown entity in a very complex area where mistakes could be costly to users and rights holders. Collecting societies do not compete with each other mainly because they specialise in a particular grouping of rights determined by copyright law. There is nothing to stop rights holders from joining foreign societies if they think they will

get better service and some do. There have been some mergers of collecting societies, for instance, the PRS and MCPS in the UK merged; in that case, however, the scope of their rights and rights owners overlapped significantly and in other countries both performance and mechanical rights were anyway managed jointly.

Having gone through every possible argument in law and economics for and against the development of competition in licensing services, Katz (2006) concluded that the problem lies not in competition in the marketplace but in the exclusive assignment of rights that collecting societies typically require for the works they license. Furthermore, that is required by legislation in some countries or is written into the constitution of the collecting society. In addition, some collecting societies require assignment of the creator's whole repertoire, probably to save the costs of sorting through a huge bundle of works to see which rights are included and to ensure to a licensee that the whole lot is covered by the blanket licence. In other words, reform must come through regulation of collecting societies not from competition.<sup>16</sup>

## 7. GOVERNANCE OF COLLECTING SOCIETIES

Space does not permit a discussion of wider issues in the governance of collecting societies. Preliminary work by Rochelandet (2003) on the impact of governance arrangements on the administrative efficiency of collecting societies is worth noting, however. He found that the greater strength of regulation by the state in Germany yielded a better performance in terms of administration charges than the internal governance system in the UK and the looser state regulation in French, comparing the similar repertoires of the authors' rights societies for musical performance rights. An overhaul of the regulation of collecting societies and their governance could likely

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<sup>16</sup>The conclusion reached by Einhorn (2006) in the case of per programme licences.

achieve a considerable improvement in their services without any change to the law or setting up new institutions.

## 8. CONCLUSION

There is a strong case for a register of copyrights, logging who owns what and how they may be contacted. The scope of the DCE (or similar facility) was left open by Hargreaves but the Hooper study clearly states that the idea goes far beyond a mere central register and that the Copyright Hub would also perform the functions of selling licences, collecting revenues and distributing revenues to licensors, who, it is envisaged may well be collecting societies themselves (though there is undoubtedly a sub plot to encourage individual licensing). But it is precisely those activities that are so ‘expensive’ (to use Hooper’s word) in existing collecting societies and the costly job of monitoring uses and enforcing rights is nowhere mentioned. To economists it is the bundling of all these services combined with blanket licensing that is the basis of the natural monopoly of the collecting societies. The natural monopoly argument predicts that splitting them up would raise unit costs.

So far, both law and economics support the view analysed in Gallini (2011) that the collecting societies’ monopoly is a natural monopoly that reduces transaction costs for both rights holders and users. Belief that DRM raises the possibility of greater flexibility in pricing and contestability seems to have foundered with DRM itself. Moreover, if there are strong tendencies to natural monopoly, would they not show up in a DCE that took on pricing and licensing? There would seem to be nothing to stop the DCE becoming a huge monopoly itself.

What shines out from all contemporary studies of copyright licensing is that it is excessively complex and that that is because of the complexity of copyright law itself. In some cases it is the law that inhibits markets from

developing, not the administration of rights; the law itself is a barrier to contestability. What needs to be decided is whether the perceived problems of licensing are due to the inability of the law to adjust to new technologies and uses or to the reluctance of rights owners and collecting societies to adapt to them. Without that it is not clear what can effectively be achieved by reorganising licensing services without changes to the law and governance practices.

What emerges from reading the evidence to the Hargreaves Review and Hooper (2012b) is that most creative industry businesses have adapted to the existing regime of collective licensing including that of digital rights – not very surprising. They have made it work and there would be considerable switching costs to changing the system (the typical reason for ‘lock-in’). Path dependency is often the rule of human behaviour especially for risk averse small time creators; moreover, evidence from other fields where there is choice shows that consumers do not switch – in the UK 60 per cent of households have not switched energy suppliers since privatisation over 20 years ago, mainly because tariffs are so complex that people cannot understand them.<sup>17</sup> The same argument could well apply to copyright.

What is clear is that some form of collective licensing is essential for the working of copyright law. Copyright requires a system of charging for use via the market and remitting rewards to creators and rights holders. Intermediaries do it for primary rights and collecting societies do it for secondary rights. It is worth remembering that the development of collecting societies was a spontaneous *market* response to the problem of licensing copyright, not (at least in the UK) the result of state intervention. New collectives have emerged as new technologies and uses developed. So one might well

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<sup>17</sup>See [http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/IpsosMori\\_switching\\_omnibus\\_2011.pdf](http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/IpsosMori_switching_omnibus_2011.pdf)

ask: if the case for a DCE is so strong, why it has not developed spontaneously? There could be two explanations for this: one, that competition authorities have been demonstrably suspicious of any such moves that appear to strengthen the ‘monopoly hold’ of collecting societies and that has discouraged any such moves being made privately and secondly, that the legal situation is just too complex.

It has always been understood that natural monopolies require state regulation and for copyright this is done in several ways – by direct control over licence fees, by oversight by a board or tribunal or court and through competition law. It seems therefore that improved governance may achieve more efficiency than contestability. Ultimately, though, copyright law has to be reformed to make it appropriate to the digital age; it needs to be less complex and shorter term.

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