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AN ECONOMIC ANALYSIS OF COMPULSORY LICENSING IN COPYRIGHT LAW

ROBERT STEPHEN LEE

The economic philosophy behind the clause empowering Congress to grant patents and copyrights is the conviction that encouragement of individual effort by personal gain is the best way to advance public welfare through the talents of authors and inventors in “Science and useful Arts.”

I. INTRODUCTION

In order to encourage the development of the arts and sciences, the framers of the United States Constitution granted Congress the authority to enact copyright legislation. The framers intended to give authors and inventors exclusive property rights to their writings and discoveries for limited periods of time. This protection has been justified as an obligation society owes to the creator of a protected object and as a means of promoting the general well-being of society. Granting creators exclusive rights to their works is viewed as desirable because it is believed that artistic production cannot be expected to go forward, or public consumption of artistic works enjoyed, unless creative resources first are distributed to the separate, authoritative governance of the creators themselves.

Traditionally, it also has been argued that creators have a natu-
ural right to the fruits of their labors.\textsuperscript{5} The creation and protection of a property right in an author's work is viewed as desirable because under such a regime, creators are able to obtain and keep what is due them.\textsuperscript{6} Further, it is contended that artists have a moral right to have their creations protected as extensions of their personalities.\textsuperscript{7} Finally, it is believed that authors have a right to be compensated for their contributions to society.\textsuperscript{8}

Despite these justifications for exclusive property rights, both the Copyright Act of 1909 (1909 Act)\textsuperscript{9} and the current Copyright Act of 1976 (1976 Act)\textsuperscript{10} contain compulsory licensing provisions. These provisions not only deny creators the exclusive right to use their
works as they wish, but also require them to do business with persons not of their own choosing and to accept statutorily established rates at statutorily mandated intervals for the use of their works. Consequently, while the 1976 Act grants creators exclusive property rights in their works, these rights are limited by the compulsory licensing provisions.

This article will trace the development of the compulsory licensing provisions in copyright law. It will analyze the current status of this concept in light of economic notions of contract and property law. It also will examine the government policy of encouraging use of copyrighted works through reliance on compulsory licensing arrangements. Finally, it will be contended that compulsory licensing is an inefficient method of allocating the right to use a creator's work, and that the concept's continued presence in modern copyright legislation is justified only through historical reasoning.

II. DEVELOPMENT OF COMPULSORY LICENSING PROVISIONS

Congress first extended federal copyright protection to original musical compositions in 1831. Anyone possessing such a copyright had the exclusive right to sell copies of the musical score. Individuals purchasing copies of the composition usually did so in order to play the work at home on the piano or other musical instrument. Between 1831 and 1909, however, numerous machines were invented that allowed the musical work to be mechanically reproduced. Mounting sales of these new machines detracted from the value of the copyright granted for the musical composition because individuals having such devices had little need for sheet music.

The problems created by this new technology eventually reached the Supreme Court of the United States in White-Smith Music Publishing Co. v. Apollo Co. In White-Smith, defendant Apollo manufactured piano rolls capable of mechanically reproducing two copyrighted songs, "Little Cotton Dolly" and "Kentucky Babe Schottische," which had been published previously in the form of

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11. Id. §§ 111, 115, 116, 118.
14. Id.
15. Id.
16. 209 U.S. 1 (1908). The White-Smith Court applied a visual test of a copy of a musical composition within the meaning of the 1909 Act. The Court defined a copy as "a written or printed record of [the composition] in intelligible notation." Id. at 17.
sheet music. In hope of a decision recognizing mechanical reproduction rights, several music publishers granted the Aeolian Company exclusive, long term licenses to manufacture perforated music rolls in consideration for Aeolian's pursuing the *White-Smith* infringement action as far as the Supreme Court. These contracts were to become effective upon the recognition of mechanical reproduction rights by Court decision or congressional enactment. The *White-Smith* Court, however, held that the piano rolls were not copies of the copyrighted music under the then existing federal copyright law, but were merely components of a machine that played the musical works. As a result, Congress was confronted with a dilemma. Congress either could give exclusive rights to musical copyright owners for the mechanical reproduction of their works, thereby allowing the creation of what was referred to as a great music trust, or it could withhold these rights, causing great injustice to creators. Despite these fears of monopolization, the 1909 Act, for the first time, recognized recording and mechanical reproduction rights as part of the bundle of exclusive rights secured by copyright law. The 1909 Act, however, did not ignore the potential for monopoly in the event that the Aeolian Company's contracts became effective. It

17. *Id.* at 8.


20. 209 U.S. at 18.


22. Some of the exclusive rights granted by the 1909 Act were the rights to "print, reprint, publish, copy and vend the copyrighted work;" translate or arrange the copyrighted work; "deliver, authorize the delivery of, read or present the copyrighted work in public for profit;" "perform or represent the copyrighted work publicly;" and to "make any arrangement or setting of [a musical composition] or of the melody of it in any system of notation or any form of record in which the thought of an author may be recorded and from which it may be read or reproduced." Ch. 1, § 1(e), 35 Stat. 1075 (repealed 1976).

The recognition of recording and mechanical reproduction rights, however, was only partial. Instead of deciding whether phonograph records and piano rolls should be considered copies of the composition recorded, the House Committee stated that: "It is not the intention of the Committee to extend the right of copyright to the mechanical reproduction themselves, but only to give the composer or copyright proprietor the control, in accordance with the provisions of the bill, of the manufacture and use of such devices." 1909 House Report, *supra* note 18, at 9. It was not until February 15, 1972, that sound
resolved this problem by devising a special provision to allow any manufacturer of recordings or mechanical reproductions to use a musical composition as long as the manufacturer paid a royalty to the copyright owner for use of the work.\textsuperscript{23}

In this way, compulsory licensing in copyright law was introduced and, with it, a continuing controversy arose over its validity.\textsuperscript{24}


In contrast to the 1909 Act, the exclusive rights guaranteed by the 1976 Copyright Act are as follows:

Subject to sections 107 through 118, the owner of copyright under this title has the exclusive rights to do and to authorize any of the following:

(1) to reproduce the copyrighted work in copies or phonorecords;
(2) to prepare derivative works based upon the copyrighted work;
(3) to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending;
(4) in the case of literary, musical, dramatic, and choreographic works, to perform the copyrighted work publicly; and
(5) in the case of literary, musical, dramatic, and choreographic works, pantomimes, and pictorial, graphic, or sculptural works, including the individual images of a motion picture or other audiovisual work, to display the copyrighted work publicly.


23. Ch. I, § 1(e), 35 Stat. 1075 (repealed 1976); Ringer, \textit{supra} note 21, at 304. Although the compulsory license provision of section 1(e) was the first of two instances of a compulsory license in federal copyright and patent enactments, it was not entirely without precedent. Congress had no power over copyright under the Articles of Confederation. Congress, therefore, recommended in 1783 that the states enact their own copyright legislation. Of the 12 original states which did so between 1783 and 1786 (Delaware being the exception), four states (Connecticut, Georgia, New York, and South Carolina) passed statutes containing compulsory license provisions which were applicable when copies of a copyrighted book were not supplied in reasonable quantities and at reasonable prices. \textit{Copyright Enactments of the United States}, 1783-1906, at 11-31 (2d ed. 1906); Fenning, \textit{Copyright Before the Constitution}, 17 J. PAT. OFF. SOC'Y 379-83 (1935); Seltzer, \textit{Exemptions and Fair Use in Copyright; The "Exclusive Rights" Tensions in the New Copyright Act}, 24 BULL. COPYRIGHT SOC'Y 215, 224-25 (1977).


The great weight of opinion, however, is the other way. It is true that Congress could not legislate a man's existing rights out of existence, for thereby it would impair the obligation of contract; but in this case Congress is creating a new property right, and in creating new rights Congress has the power to annex to them such conditions as it deems wise and expedient.
The Copyright Office itself has recommended that the compulsory licensing concept in copyright be abandoned.\textsuperscript{25} During the development of the 1976 Act, music publishers echoed many of the basic arguments against compulsory licensing. They contended that compulsory licensing no longer is needed to meet the special antitrust

\textbf{1909 House Report, \textit{supra} note 18, at 9.}

Nathan Burkan, former general counsel of the American Society of Composers, Authors and Publishers (ASCAP), during testimony on one bill that would have eliminated the compulsory licensing provision of \$ 1(e) altogether, \textit{Copyrights: Hearings on H.R. 11258 before the House Comm. on Patents}, 68th Cong., 2d Sess. 148-68 (1925) (statement of Nathan Burkan), contended that compulsory licensing was arbitrary and discriminatory class legislation which forced authors to do business with persons not of their own choosing, \textit{id.} at 149, 164, at terms contrary to those specified in section 1(e) (since the statutory rate, being considered a ceiling price, was not reached in many contract negotiations), and without any means of enforcing their claims against unknown record producers. \textit{id.} at 158. During later Congressional hearings in which Mr. Burkan questioned the constitutionality of compulsory licensing, he explained the failure of anyone to make an attack on section 1(e) in the courts as follows:

\begin{quote}
Unquestionably this act was so artfully drawn, that if an attack was made upon the compulsory provisions of the act and the court declared them unconstitutional, the whole act would have to fall. That would have left the authors in the same plight they were in from 1888 to July 1909.
\end{quote}

\textit{Bill to Amend the Copyright Act, Hearings on S. 2328 and H.R. 10353 before the Joint Committee on Patents}, 69th Cong., 1st Sess. 314 (1926) (statement of Nathan Burkan).

\textbf{25.} The 1961 \textit{Register of Copyrights Report} recommended that the provision be retained for one year and then be eliminated.

Removal of the compulsory license would be likely to result in a royalty rate, fixed by free negotiation, of more than the present statutory ceiling of 2 cents. The record companies would, of course, lose the advantage of the lower rate. The price of records to the public might be increased by a few cents, though this is not certain since many factors enter into the pricing of records. If it is true that a freely negotiated rate would exceed 2 cents, we would conclude that the 2-cent ceiling denies authors and publishers the compensation due them for the use of their works.

We have previously mentioned the fundamental principle of copyright that the author should have the exclusive right to exploit the market for his work, except where this would conflict with the public interest. In the situation prevailing in 1909, the public interest was thought to require the compulsory license to forestall the danger of a monopoly in musical recordings. The compulsory license is no longer needed for that purpose, and we see no other public interest that now requires its retention.

problems that existed in 1909.\textsuperscript{26} They also questioned the rationale that singled out certain intellectual property, such as music, for compulsory licensing in opposition to fundamental concepts of property.\textsuperscript{27} Finally, they argued that music publishing is not a public utility and that establishment of a statutory fee for a product wholly produced and distributed within the private sector of our economy is an incongruity.\textsuperscript{28} Nevertheless, through the whole range of national and international regimes since 1950, the compulsory licensing concept consistently recurs.\textsuperscript{29}

Compulsory licensing usually is adopted as a compromise measure in revising and developing copyright legislation.\textsuperscript{30} Superficially, the compulsory licensing system looks fair. The author and copyright owner get paid for their work. The user, however, who has a strong argument that what he is doing represents the public interest, cannot be prevented from using the work.\textsuperscript{31} Consequently, compulsory licensing normally is offered as a compromise to copyright controversies in two situations. First, compulsory licensing is offered when technology has created new uses for which the author's exclusive rights have not been clearly established.\textsuperscript{32} It also is used when technology has made old licensing methods for established rights ponderous or inefficient.\textsuperscript{33} Under the 1976 Act, such compromises have resulted in four compulsory licensing provisions concerning: Secondary transmissions by cable television systems;\textsuperscript{34} mechanical royalties;\textsuperscript{35} jukeboxes;\textsuperscript{36} and public broadcasting.\textsuperscript{37} This expansion

\begin{enumerate}
\item \textsuperscript{26} 1967 House Report, \textit{supra} note 24, at 66.
\item \textsuperscript{27} Id.
\item \textsuperscript{28} Id. at 67.
\item \textsuperscript{29} Ringer, \textit{supra} note 21, at 306.
\item \textsuperscript{30} See 1976 House Report, \textit{supra} note 24, at 107, where it is stated that the system of compulsory licensing "represented a compromise of the most controversial issue of the 1909 Act ... ." Id.
\item \textsuperscript{31} Id.
\item \textsuperscript{32} Id. at 303.
\item \textsuperscript{33} Id.
\item \textsuperscript{34} 17 U.S.C. § 111 (1976). Section 111 establishes a compulsory license for secondary transmissions by cable systems. Under this provision, the secondary transmission to the public of distant, copyrighted, non-network programs by a cable system is subject to compulsory licensing. Before the cable system may make such secondary transmissions, however, section 111(d)(1) requires that at least one month before the commencement of operations, the cable system must record in the Copyright Office a notice including a statement giving the identity and address of the cable system owner along with the name and location of the primary transmitter whose signals are regularly carried. Subsection (d)(2) directs cable systems whose secondary transmissions have been subject to compulsory licensing to deposit with the Register of Copyrights a semi-annual statement of account specifying the number of channels on which the cable system made secondary transmissions to its subscribers, the names and locations of all primary transmitters.
led Barbara Ringer, the former Register of Copyrights, to predict that as we enter the 1980's, copyright will become less the exclusive right of an author and more a system under which the author is guaranteed some remuneration for his work but is deprived of any

whose transmissions were carried by the system, the total number of subscribers to the system, and the gross amounts paid to the system for the basic service of providing secondary transmissions. Cable systems are also required to deposit royalty fee payments for the period covered by the statements of account computed on the basis of specified percentages of gross receipts from cable subscribers. During the month of July of every year, anyone claiming to be entitled to compulsory license fees must file a claim with the Copyright Royalty Tribunal. After the first day of August of each year, if the Tribunal determines that there is no controversy as to the payment of royalties, it may distribute these fees after deducting reasonable administrative costs. Royalties are paid only for the retransmission of distant, non-network programming. No royalty fees may be claimed or distributed to copyright owners for the retransmission of either local or network programs. 1976 HOUSE REPORT, supra note 24, at 88-101.

35. 17 U.S.C. § 115 (1976), establishes a compulsory license for phonorecords. It basically follows the provisions of sections 1(e) and 101(e) of the former copyright statute. Under this provision, a musical composition that has been reproduced in phonorecords with the permission of the copyright owner may generally be reproduced in phonorecords by another person, if he notifies the copyright owner and pays the specified royalty. 1976 HOUSE REPORT, supra note 24, at 107-11.

36. The compulsory licensing provisions in section 116 were patterned after those in section 115. In contrast to section 115, however, section 116 not only provides “the operator of the coin-operated phonorecord player” with the opportunity to obtain “a compulsory license to perform the work publicly on that phonorecord player,” but also specifically exempts under certain conditions “the proprietor of the establishment in which the public performance takes place.” The owner-operator of the jukebox is required to file in the Copyright Office an application containing certain information and must also deposit with the Register of Copyrights an eight dollar royalty fee for each machine. Individuals who believe they are entitled to royalties because their works have been played on jukeboxes, must file a claim with the Copyright Royalty Tribunal in January. The royalties may be distributed after the first of October and after reasonable administrative costs have been deducted, if the Tribunal determines that there is no controversy concerning the distribution of the royalty fees. 17 U.S.C. § 116 (1976); 1976 HOUSE REPORT, supra note 24 at 111-15.


During its consideration of revision legislation in 1975, the Senate Judiciary Committee adopted an amendment offered by Senator Charles McC. Mathias. The amendment, now section 118 of the Senate bill, grants to public broadcasting a compulsory license for use of nondramatic literary and musical works, as well as pictorial, graphic, and sculptural works, subject to payment of reasonable royalty fees to be set by the Copyright Royalty Tribunal established by that bill. The Mathias amendment requires that public broadcasters, at periodic intervals, file a notice with the Copyright Office containing information required by the Register of Copyrights and deposit a statement of account and the total royalty fees for the period covered by the statement. In July of each year all persons having a claim to such fees are to file their claims with the Register of Copyrights. If no controversy exists, the Register would distribute the royalties to the various copyright owners and their agents after deducting reasonable administrative costs; controversies are to be settled by the Tribunal. 1976 HOUSE REPORT, supra note 24, at 116.
control over the use to which the works are being put. Ringer also suggested that we have reached the point where any new rights under copyright law that may develop because of future technological advances cannot be exclusive.

III. Basic Economic Concepts

Whatever the force of these criticisms, several economic questions remain concerning the continued use of compulsory licensing. First among these is whether compulsory licensing is efficient. This efficiency criterion has been described as a means of "exploiting economic resources in such a way that 'value'—human satisfaction as measured by aggregate consumer willingness to pay for goods and services—is maximized." When resources shift in a voluntary transaction, it may be presumed that the shift involves a net increase in efficiency because the transaction would not have occurred if both parties did not expect to gain. With involuntary transfers, however, that may occur as the result of compulsory licensing, the question of efficiency is not so easily resolved. It must be asked whether, and in what circumstances, an involuntary exchange may be said to increase efficiency.

38. Ringer, supra note 21, at 303. Indeed, Thomas C. Brennan, Chief Counsel of the U.S. Senate Subcommittee on Patents, Trademark and Copyright has stated that the dominant trend in copyright legislation in Congress is reliance on the compulsory license to facilitate access to copyrighted materials by potential users. Brennan, Some Observations on the Revision of the Copyright Law from the Legislative Point of View, 24 BULL. COPYRIGHT SOC'Y 151, 152 (1977). Many inconsistent positions were taken in Congress during discussion of the compulsory license provisions. In describing the mood of Congress during the hearings and debates on these provisions, Brennan stated that, "[m]embers of Congress who usually proclaim the virtues of the market place were promoting government intervention, while well-known civil libertarians were insisting that an author must not be allowed to prevent the public performance of his work." Id.

39. Ringer, supra note 21, at 306. A case in point has been the recent discussion of whether new typeface designs should be copyrighted and whether compulsory licenses should be used to guarantee access to these new designs. Register of Copyrights, Second Supplementary Report of the Register of Copyrights on the General Revision of the U.S. Copyright Law: 1975 Revision Bill October-December 1975, at 15-21 (Draft 1978).

40. R. Posner, Economic Analysis of Law 10 (2d ed. 1977) (emphasis in original); see also Calabresi & Melamed, Property Rules, Liability Rules, and Inalienability: One View of the Cathedral, 85 HARV. L. REV. 1089, 1094 (1972). It should be noted that the goal of economic efficiency is just one way of analyzing and developing legislation. It should also be recognized that the "efficiency criterion" itself is partially inadequate in examining legislation because numerous other considerations may be involved. Nevertheless, it does help provide "one view of the cathedral." Id.

A second economic consideration is that of externalities. Often, the economic activities of one individual impinge on the welfare of another without the intervention of any market transaction between them. Economists characterize these situations as instances of externality: "[S]ituations in which markets fail to mediate interactions between individuals. . . ." For example, externalities result when a record purchaser plays his record at a party and his guests enjoy the music. Similarly, externalities occur when an individual reads a newly purchased book to her friends. In both situations, third parties enjoy the benefits of the artists' labors without paying for that enjoyment. If externalities result from a transaction within a market system, however, the market allocation may not be efficient. While a change in resource use may improve the situations of some individuals, it may have external effects that actually may damage the situations of individuals not involved in the market transaction. The goal of economic efficiency, sometimes called Pareto optimality, however, is to choose the set of legal rights that will "lead to that allocation of resources which could not be improved in the sense that a further change would not so improve the condition of those who gained by it that they could compensate those who lost from it and still be better off than before." Consequently, three major methods for the control of externalities have evolved to meet this efficiency criterion: Use of private contract; reliance on the property protecting provisions of the common law; and resort to direct government control. Therefore, the question for compulsory licensing, a form of

43. D. Orr, Property, Markets, and Government Intervention 288 (1976); see generally Coase, supra note 41.
44. Pareto optimality is an equilibrium position in static economic analysis. An equilibrium position is "pareto-optimal" if (and only if) there is no possible movement from it that could make everyone better off. P. Samuelson, Economics 462 n.12 (10th ed., 1976); E. Shows & R. Burton, Microeconomics 568 (1972). It should be noted that Pareto optimality and the general efficiency criterion are not technically synonymous in that Pareto optimality is used to describe a static situation while general efficiency criterion seeks to determine what an individual, who is effected by a resource shift, will consider to be the most desireable allocation of those resources.
45. Calabresi & Melamed, supra note 40, at 1094.

The use of private contract to control externalities may be demonstrated in the following classic example: An orchard owner lives next to a bee keeper. Because the bees pollinate the orchard owner's fruit, the orchard owner's fruit harvest is greater than it would be without the bees. The value conveyed to the fruit grower is not recognized by the bee keeper and, thus, does not influence his decision on how many hives he should keep. The fruit grower's pollinated orchard is an external economy from the bee keeper's production of honey. If, however, these activities are pursued at too small a scale so that
direct government control, is whether it is an efficient and effective controller of externalities.

A third economic issue in compulsory licensing is that of competition. The basic condition of competition requires that every participant in the market process behave as if price were unaffected by the participant's decisions regarding how much he should purchase or produce. 47 If this and other basic conditions are met, the long run equilibrium of an industry will have three important characteristics. First, the cost of producing the last unit of output, the marginal cost, will be equal to the price paid by consumers for that unit. 48 This condition is necessary for profit maximization because of the competitive firm's belief that its output decisions do not affect price. Second, because price will be equal to the average total cost for the representative firm, above normal profits are absent. 49 As a result, investors receive returns just sufficient to keep investments at the level required to produce the industry's equilibrium output efficiently. 50 Finally, if an industry is competitive, each firm will produce at its lowest possible cost or else be driven from the industry. 51 Thus, competition allows resources to be used at maximum produc-

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mutual benefits are ignored, the problem can be rectified through a merger or through other forms of private contract. The bee-keeping activity will then be carried out at a scale which reflects the gains resulting from pollination and the sale of honey. Id. at 286, 289.

Similarly, reliance on the property protecting provisions of the common law also controls externalities. The classic example hypothesizes two farmers, one raising cattle and the other growing corn. The cattle owner finds it impossible to keep his cattle out of the corn at all times. Nevertheless, the common law provides that the cattle owner must compensate the corn grower for any damage done by the cattle. This law encourages the cattle owner to reduce his herds and to build stronger fences to keep his cattle away from the corn. This, in turn, causes less damage to the corn grower's crops and, thus, will mean lower production costs for him. The cattle owner's decision to decrease his herd is a decision having external effects on the corn grower. The property protection provided by the common law, however, helps control the external effects of the cattle owners decision. As with the bee-keeper example, the externalities may be internalized if one farmer purchases the land of the other so that the new property owner's decisions concerning the amounts of cattle to keep and grain to grow will no longer affect the selling farmer-land owner. Coase, supra note 41, at 2-4.

Finally, use of direct government intervention as a controller of externalities may be exemplified by a government statute that prohibits certain activities (such as burning bituminous coal) or requires other activities (such as use of pollution control devices on automobiles) in order to reduce air pollution. D. Orr, supra note 42, at 292.

48. Id. at 13.
49. Id.
50. Id.
51. Id.
tion efficiency.52

The final economic issue in compulsory licensing is that of transaction costs. This term is central to the body of economics concerned with the formation, exchange, and enforcement of property rights.53 Broadly conceived, it includes the "costs of interacting parties identifying each other, informing each other of a willingness to deal, carrying out and memorializing negotiations, and enforcing the resulting agreement."54 This concept may be refined further by breaking it down into three components: Information costs, the costs of gaining and communicating the necessary information to achieve an efficient allocation of a given resource; contracting costs, the costs associated with contract negotiations to reach a final agreement; and policing costs, the costs of enforcing and administering the new and potentially beneficial resource allocations.55

It has been argued that, assuming perfect competition, perfect information, and no transaction costs, the allocation of resources in an economy will be efficient and unaffected by legal rules regarding the initial impact of costs resulting from externalities.56 Transactions, however, require money and because substitutes for transactions also are costly, the optimal result is not necessarily the same as if transactions had no costs.57 The goal in resource allocation, therefore, is to approximate, both closely and cheaply, the result the market would bring about if bargaining were costless.58 The problem then becomes making the choice between the methods that most ac-

52. Id.
54. Id.
55. Id.
56. See Coase, supra note 41. Coase's work quickly led to critical responses by Wellisz, On External Diseconomies and the Government Assisted Invisible Hand, 31 ECONOMICA (N.S.) 345 (1964), and Calabresi, The Decision for Accidents: An Approach to Nonfault Allocation of Costs, 78 HARV. L. REV. 713 (1965). Calabresi, however, later withdrew his criticism in Calabresi, Transaction Costs, Resource Allocation and Liability Rules—A Comment, 11 J.L. & ECON. 67 (1968) [hereinafter cited as Transaction Costs]. Coase's critics alleged that his theorem neglected long run considerations. For example, if farmers or ranchers are required to bear the risk of liability for their activities in the long run, they will leave farming. Hence, even if transaction costs are zero, the market may allocate resources differently in the long-run depending upon which liability rule is chosen. Critics also charged that Coase's theorem endorsed the use of resources for the undesirable purpose of extortion. See, e.g., Demsetz, When Does the Rule of Liability Matter?, 1 J. LEGAL STUD. 13 (1972); Regan, The Problem of Social Cost Revisited, 15 J.L. & ECON. 427 (1972).
57. Transaction Costs, supra note 56, at 69.
58. Id.
curately and inexpensively accomplish this goal.\textsuperscript{59} Whatever device is used, be it reliance on contract and property law or government intervention, it must be determined whether the system's costs are worth the benefits in the resource allocations that it causes.\textsuperscript{60}

IV. Compulsory Licensing: Government Intervention in the Exclusive Rights of Creators

Government intervention in resource allocation usually occurs because of market breakdowns.\textsuperscript{61} Such was the situation when the first compulsory licensing provision relating to the mechanical reproduction of musical compositions was introduced into federal copyright law.\textsuperscript{62} Although this set of circumstances may have justified passage of the compulsory licensing provision of section 1(e) in 1909,\textsuperscript{63} economic theory will support the compulsory licensing concept only if it adequately substitutes for competition and provides the least expensive control of externalities and transaction costs.\textsuperscript{64}

It has been contended that the government has powers that might enable it to accomplish this control at a lower cost than could a private organization.\textsuperscript{65} Indeed, it may be argued that through the use of compulsory licensing, the government is the lowest cost controller of externalities. For example, when a person plays a jukebox

\begin{itemize}
\item \textsuperscript{59} Id.
\item \textsuperscript{60} Id. at 68-69. Recognizing that one or more of the conditions necessary for Pareto optimality cannot be satisfied, some individuals have questioned whether encouraging conformity to the competitive model is the second best alternative. Lipsey & Lancaster, \textit{The General Theory of Second Best}, 24 REV. ECON. STUD. 11 (1956). Depending on the circumstances of a situation, it quite possibly is not the best alternative. Indeed, it has been suggested that

\begin{quote}
[O]ne may decide that the whole question of allocative efficiency is so confused and uncertain, once second-best considerations are introduced, that policy-makers should give up trying to achieve the best possible allocation of resources and base their choices on other criteria, such as equity of income distribution, compatibility with political beliefs, conduciveness to production efficiency, and speed of technological progress. This is a step unpalatable to most economists . . . .
\end{quote}

\item \textsuperscript{61} \textit{Transaction Costs, supra} note 56, at 69-70; Demsetz, \textit{Toward a Theory of Property Rights}, 57 AM. ECON. REV. 347, 354 (1967); Krier & Montgomery, \textit{supra} note 42, at 102.
\item \textsuperscript{62} See \textit{supra} notes 12-23 and accompanying text.
\item \textsuperscript{63} See Henn, \textit{supra} note 18, at 1-12, for a history of the passage of the compulsory licensing features of the 1909 Act.
\item \textsuperscript{64} See generally \textit{Transaction Costs, supra} note 56, at 70-1, where it is stated that monopoly laws are believed to be "cheaper than market correction would be, and more important, we believe they are cheap enough to be worth having." Id.
\item \textsuperscript{65} Coase, \textit{supra} note 41, at 17.
\end{itemize}
in a public place, he provides external benefits to the other patrons because they may listen to the music without paying. The external benefits provided to the other patrons are not reflected in the price paid for the music. If the enjoyment of the music by all the patrons could be measured, the value of hearing one selection might equal several dollars. To maximize efficiency in allocating this resource, the jukebox and copyright owners could decide to raise the price of playing one song to three dollars. Thus, the value of the music would be maximized because the amount received for the music could equal the benefits given. Unfortunately, the burden, or transaction cost, to one patron in soliciting quarters from all those who wished to hear the music might be so high that little if any music would be played. Thus, reliance on compulsory licensing may be justified as a way of accommodating the interests of copyright owners who wish to maximize the value of their works with the public's interest in obtaining music at reasonable prices. By establishing a maximum royalty rate, compulsory licensing may insure the copyright owner a fair return for his work and may provide the public with music at low cost.

The effectiveness of compulsory licensing as a controller of externalities, however, is uncertain. This is because compulsory licensing generally applies to copyrightable subjects that may be experienced by people in groups. In the jukebox hypothetical, for example, the jukebox may play all night long. Instead of one individual paying for the music, there may be reciprocity among the patrons. Each may contribute a proportionate share toward the cost of providing music in the establishment for the entire evening. Thus, rather than viewing each decision to play the jukebox in isolation, it may be more accurate to view all of the patrons as a single customer. As a result of each patron's paying for what the music is worth to him for the evening, there actually may be no externalities.

If externalities do exist in the jukebox example, however, it is not certain that compulsory licensing is a satisfactory alternative to private contract. The external benefits provided to the nonpaying listeners may not be reflected in the price paid for the music. Reliance on compulsory licensing still may not reflect these externalities because of primary administrative concern with the transaction between copyright owner and music purchaser, and government need for uniform regulations which cannot reflect the individual differences among compositions. As a result of these externalities, less music may be purchased than people may desire, and the amount returned to the jukebox and copyright owners may be artificially
low. Consequently, compulsory licensing may result in fewer resources being expended to make music available to the public. Thus, the public may be left with a more limited selection of musical works.

Although it is debatable whether government intervention best controls externalities, its intervention in the allocation of the use of creative resources may be justified as a method of controlling transaction costs.\footnote{66} The enactment of compulsory licensing for noncommercial broadcasting, for example, was justified as a means of avoiding "administratively cumbersome and costly 'clearance' problems that would impair the vitality of . . . [such broadcasters'] operations."\footnote{67} Further, in the jukebox hypothetical it was suggested that compulsory licensing may reduce the transaction costs of deciding whether to play a musical selection. Because compulsory licensing establishes the maximum royalty that may be paid, a patron may play a song without having to solicit contributions from others who also may enjoy the music.

Direct government control of compulsory licensing, however, has its drawbacks. Government intervention usually occurs because of market breakdowns.\footnote{68} The primary costs associated with government intervention through compulsory licensing are: Information costs, the costs of obtaining and communicating the knowledge necessary to achieve a more efficient allocation of a given resource; and policing costs, the costs of enforcing this new knowledge or of administering these potentially beneficial resource allocations.\footnote{69} While resources such as musical compositions and television programs may be sufficiently valuable to justify government intervention, their value may be so small that the gains resulting from an efficient allocation by the government are not worth the information costs associated with achieving them.

Uniform regulations have been used to reduce information costs.\footnote{70} Because of these uniform regulations, all jukebox operators are required to pay to the Register of Copyrights eight dollars each

\footnote{66} The Committee on the Judiciary justified using the compulsory license in secondary transmissions by cable systems as a way to reduce transaction costs by providing that, "The Committee recognizes . . . that it 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." 1976 HOUSE REPORT, supra note 24, at 89.

\footnote{67} Id. at 117.

\footnote{68} See supra notes 12-23 and accompanying text for a brief history of the economic conditions leading to the passage of the Copyright Act of 1909.

\footnote{69} Krier & Montgomery, supra note 42, at 96.

\footnote{70} Id. at 102.
year for every jukebox owned.\textsuperscript{71} This royalty is then paid to copyright owners and to performing rights societies.\textsuperscript{72} Similarly, composers or publishers are compelled to allow anyone to use their compositions who is willing to pay the statutory rate of either “two and three-fourths cents, or one-half of one cent per minute of playing time or fraction thereof, whichever amount is larger.”\textsuperscript{73}

Use of uniform regulations, however, is inherently inefficient. Individual consumers are better equipped to determine how much a product is worth to them. The allocative inefficiency caused by uniform standards could be controlled by obtaining information on individual variations in demand.\textsuperscript{74} The costs associated with a centralized response to create variable standards, however, would be enormous.\textsuperscript{75} Consequently, any gains in allocative efficiency would be lost through increased information costs. Thus, the inefficiency associated with uniform regulations may be counterbalanced by the savings resulting from the minimal need for information.\textsuperscript{76}

The allocative inefficiency resulting from the use of uniform regulations can be seen in the compulsory licensing provision of section 115 of the 1976 Act, which concerns the making and distribution of phonograph records.\textsuperscript{77} This provision sets the maximum rate that a composer or publisher may charge a record company for the use of a musical composition.\textsuperscript{78} Although a record manufacturer may contract with the composer or publisher to pay less than the statutory ceiling, the composer or publisher may not demand more than the ceiling rate.\textsuperscript{79} A musical composition may be worth more to the record manufacturer than the 1976 Act requires him to pay, resulting in an inefficient allocation of resources because the artificially low rate of return will attract fewer resources.\textsuperscript{80} Attempts by Congress or the Copyright Royalty Tribunal, the administrative agency charged with periodically reviewing and adjusting these statutory royalty rates,\textsuperscript{81} to consider these individual variables may be too costly.

\textsuperscript{72} Id. § 116(c)(4).
\textsuperscript{73} Id. § 115(c)(2).
\textsuperscript{74} Krier & Montgomery, supra note 42, at 97.
\textsuperscript{75} Id. at 98.
\textsuperscript{76} Id.
\textsuperscript{78} Id. § 115(c)(2).
\textsuperscript{79} Id. As a practical matter, some recording companies actually begin recording before clearing the rights. Negotiated licenses are usually attempted before resorting to a compulsory license. Henn, supra note 18, at 56.
\textsuperscript{80} See generally R. Posner, supra note 40, at 10.
\textsuperscript{81} 17 U.S.C. § 801 (1976).
The lowest cost controller of transaction costs in negotiations between a composer and a record company may be the contracting parties themselves. They already may have paid the expenses of locating each other to bargain and may have gone through other negotiations in an effort by the record manufacturer to get a royalty fee lower than the statutory ceiling. Use of a government agency to review and enforce the statutory rates may serve only to increase transaction costs.

Although it has been shown that the use of compulsory licensing may not guarantee lower transaction costs or more effectively controlled externalities, these provisions might be justified if they encouraged competition. The primary reason behind adoption of the first compulsory licensing provision in the 1909 Act was the fear of monopoly in the mechanical reproduction and recording industries. Proponents of compulsory licensing, therefore, attempt to defend it as a means of preventing any supplying firm from obtaining a dominant share of the market, keeping a large number of firms engaged in supplying the market so that suppliers cannot conspire to restrain trade, and preventing the establishment of legal or financial barriers to any new firm that wishes to enter the industry.

In the recording industry, compulsory licensing no longer appears necessary to spur competition. Fears that recording monopolies may restrict their outputs, obtain high returns for their products, and prevent others from reducing those profits by bringing close substitute goods to the market, no longer seem tenable. There are now hundreds of record companies competing for the record purchaser's dollar. Undaunted, supporters of compulsory licensing maintain that it enables smaller record companies to compete with larger companies by allowing them to record the same music. Granting all record companies access to the same musical compositions, however, may have the effect of limiting the number of songs that are recorded. As all record companies generally concentrate on the same compositions, the songs must either be complete successes or total

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82. See supra notes 61-69 and accompanying text.
83. See supra notes 12-23 and accompanying text.
85. 1961 Register's Report, supra note 25, at 33.
86. Id.
failures. There is little in between because, unless a song is recorded, there is no market for it. Compulsory licensing actually may tend to discourage competition, as a small record company cannot get the full benefit of a hit song it may create because a large record company may follow immediately with a recording of the same song by a more outstanding artist. If the compulsory licensing provision were not in effect, record manufacturers could get exclusive rights to a particular song, forcing other manufacturers to work on different compositions. There also would be little danger that the large companies would get all the hits because the popular music available for recording is practically inexhaustible, and any composition has some chance of becoming a hit.

Proponents of compulsory licensing also maintain that without such a provision, creators will be able to monopolize their works and deny public access to them. Removal of compulsory licensing, however, would not necessarily result in exclusive licenses being given. If it is true that authors and publishers benefit from multiple recordings of their music, presumably, they would seek to give nonexclusive licenses to several companies. Further, the granting of a copyright to a creator does not give a monopoly in his particular medium of expression. "[I]t is basic to copyright law that anyone else is free to create another original writing in the same subject matter, so long as he does his own creative work." Thus, without com-

88. *Id.*
89. *Id.*
90. Evidence of the large amount of rerecording and arranging of hit songs may be seen in a New York Times article which reported that approximately 40 artists had recorded their own versions of Gilbert O'Sullivan's hit, *Alone Again (Naturally).* Along with versions by Johnny Mathis, Andy Williams, Jerry Vale, Jim Nabors, Woody Herman, and Doc Severinson, there was a jazz version by Hank Crawford, a country-music rendition by Brush Arbor, and a religious treatment by Anita Bryant. *N.Y. Times*, Sept. 7, 1973, at 45, col. 1.
91. Letter from Herman Finkelstein, *supra* note 89.
92. 1961 *REGISTER'S REPORT*, *supra* note 25, at 34.
93. *But see id.* at 33, where it is stated that "the antimonopoly reason for the compulsory license is gone . . . ." *Id.*
94. *Id.* at 34.

Copyright has sometimes been said to be a monopoly. This is true in the sense that the copyright owner is given exclusive control over the market for his work. And if his control were unlimited, it could become an undue restraint on the dissemination of the work.

On the other hand, any one work will ordinarily be competing in the mar-
pulsory licensing, those who wished a particular kind of intellectual
property could attempt to purchase the good from the creator, or
create or purchase a substitute.

Government regulation in the form of compulsory licensing
may be justified if it improves efficiency by resolving difficulties of
negotiations so that all parties are enabled, and required, to take into
consideration all costs or missed opportunities for mutual benefit en-
tailed by their courses of action, before they decide to embark on
them.96 The problem with government controls, however, is that
they are inflexible. They are based on a false, implicit premise that
everyone should behave in the same way for the sake of the public
welfare.97 The inflexibility of direct legal control actually may cause
a reduction in the public welfare.98 This inefficiency may be com-
ounded because of increased government expenditures for the cre-
ation and support of administrative agencies to supervise these
regulations.99 The inefficiency, however, does not stop here. These
fallible administrative agencies are subject to political pressures and
operate without any economic check. Hence, the regulations issued
may not lead to increased efficiency in the economic system.100 Nev-
evertheless, while it may be true that compulsory licensing does not
promote efficiency by encouraging competition or minimizing trans-
action costs and externalities, it still must be demonstrated that reli-
ance on contract and property law principles as embodied in
traditional copyright law will provide a better economic alternative.

V. RELIANCE ON CONTRACT AND PROPERTY LAW AS AN
ALTERNATIVE TO COMPULSORY LICENSING

Legal protection of property rights has the important economic
function of creating incentives to use resources efficiently.101 Ac-

1961 REGISTER'S REPORT, supra note 25, at 5.
96. Michelman, supra note 4, at 1174-75.
97. D. Orr, supra note 43, at 256, 292-93; see supra notes 90-91 and accompanying
text.
98. See supra notes 90-91 and accompanying text.
99. See, e.g., 17 U.S.C. § 801 (1976) which created the Copyright Royalty Tribunal
to periodically review and adjust statutory royalty rates for the use of copyrighted materi-
als pursuant to compulsory licenses.
100. Coase, supra note 41, at 18.
101. See generally Calabresi & Melamed, supra note 40, for a discussion of why
capitalist property rights develop.
According to some economic theorists, the creation of exclusive and transferable rights is a necessary condition for this efficient resource use. The property right should be exclusive so that the owner may use his property as he wishes. The property right also should be transferable so that resources may be shifted from less valuable to more valuable uses through voluntary exchanges. Through a succession of such transfers, resources shift to their most valuable uses, thereby maximizing efficiency. Property rights, however, are never exclusive because exclusive property rights often could be incompatible. Consequently, this economic theory of property rights implies that rights will be redefined as the relative values of different resource uses change. The law may resolve this incompatibility either by recognizing a property right in the party whose use is more valuable or by imposing liability on the other party. Arguably, the 1976 Act, through reliance on compulsory licensing, has attempted to resolve the potential incompatibility of exclusive property rights in artistic creations with society's need for such works. Subjecting creators' exclusive rights in their works to compulsory licensing implies that society's access to these works is more valuable than the creators' rights to use their works as they wish. The use of compulsory licensing appears to depart from the constitutional language referring to the possible grant of exclusive rights in copyrightable works. This redefinition of property rights also may fail to promote economic efficiency. By requiring creators to let anyone use their works, rather than allowing creators to deal with those individuals they believe will not distort or damage their works or reputations, much duplication of effort may result and the public may get products of poor quality. Creativity may be discouraged by the thought that the public will face potential exposure only to shoddy or distorted versions of the original. Creativity also may

102. See supra notes 7-8.
103. R. Posner, supra note 40, at 12.
104. Id. at 13.
105. Id. at 27-31.
106. Id. at 34.
107. Id. at 38; Coase, supra note 41.
108. See Michelman, supra note 4, at 1182.
110. See Roeder, supra note 7, at 565-72 for a discussion of the right to prevent distortion of one's work.
111. The European concept of moral rights allows redress for the distortion of an artist's work. American copyright law, however, does not recognize moral rights or provide a cause of action for their violation. Courts have, therefore, had to rely on various theories outside the copyright law to provide creators with some remedy. See, e.g.,
be discouraged by the rate ceiling set by the compulsory licensing provisions. These provisions do not respond to the public’s willingness to pay more for the creators’ works. Thus, the value to the creator of his own work may not be maximized. Granting the creator an exclusive property right in his work not subject to compulsory licensing, however, may provide the artist or author with an incentive to use his work efficiently. In addition, if the creator will benefit from increased public exposure, it is probable that the public will have the same access to new works as it does under the compulsory licensing provisions of the 1976 Act.

Contract law, like property law, helps maintain incentives to use resources efficiently. While serving the important function of holding people to their promises, it also reduces the complexity and hence, the cost, of transactions by supplying a set of normal terms that in the absence of the contract law, the parties would have to negotiate expressly. Finally, contract law furnishes prospective transacting parties with information concerning the many contingencies that may defeat an exchange and, therefore, assists them in planning their exchange sensibly.

The principal economic function of contract law is to reduce transaction costs and, thereby, encourage efficient resource use. Reliance on contract law has the added advantage of giving the negotiating parties flexibility. The compulsory licensing provisions also retain these benefits to the extent that they encourage the copyright holder and the prospective user to negotiate for fees below the statutory ceiling. Further, if the statutory rate is adopted as a standard term in written agreements, transaction costs also may be


113. See supra notes 77-81 and accompanying text.
114. "Ordinarily the failure of one party to a contract to fulfill the performance required of him constitutes a breach of contract for which he is liable in damages to the other party." Posner & Rosenfield, Impossibility and Related Doctrines in Contract Law: An Economic Analysis, 6 J. LEGAL STUD. 83 (1971).
115. Id. at 88.
116. Id. at 87-8.
117. Id. at 88-9.
118. Id. at 89.
119. One writer has suggested that Congress intended to encourage parties subject to the compulsory license provisions to reach agreements through private negotiations rather than through reliance on the compulsory license provisions. Brennan, supra note 38, at 153.
reduced because one less term need be negotiated. The statutory fee, however, is merely a maximum. Copyright users can bargain to pay less for the creator's work, but the author cannot bargain for more.\textsuperscript{120} In addition, if the parties do not reach an agreement, transaction costs are increased further by the existence of administrative machinery that will enforce a legislatively created agreement on the negotiating parties.\textsuperscript{121} As a result, the value of the creator's work is not maximized because he must allow others to use his work at a statutorily established rate. Consequently, compulsory licensing as one form of fixed contract terms is not sufficiently valuable to outweigh its harm.

Contract and property law also are effective controllers of externalities. Nearly every transaction can be said to have a myriad of third-party effects, many of which stem from differences in taste and preference.\textsuperscript{122} For example, an individual who plays a recording for his guests at a party provides his guests with the external benefit of being able to enjoy the music without having to purchase the recording themselves. Because of these externalities, however, the royalty return to the copyright owner may be artificially low. As a result, the value of the music has not been maximized because individuals have been able to enjoy the music without paying for it. Absent the compulsory licensing provisions, the composer and record company could consider the externalities that would result from a popular recording to establish the price for the work.\textsuperscript{123} Under compulsory licensing, however, negotiation above the ceiling royalty rate is not permitted.\textsuperscript{124} Consequently, reliance on private contract should control externalities more effectively and may more closely achieve efficient resource use.

In addition to controlling externalities that result from nonmarket transactions, reliance on contract and property law also may control third-party effects through the pricing system in market transactions.\textsuperscript{125} Indeed, it is ridiculous to assume that parties bargaining for the use of a copyrighted work do not consider the effects that their agreement will have on others. The creator of the work

\textsuperscript{120} 1967 House Report, \textit{supra} note 24, at 72-73.
\textsuperscript{121} See, e.g., 17 U.S.C. § 801 (1976) which created the Copyright Royalty Tribunal.
\textsuperscript{122} D. Orr, \textit{supra} note 43, at 299. See also Demsetz, \textit{supra} note 61, at 348; Krier & Montgomery, \textit{supra} note 42, at 89.
\textsuperscript{123} See \textit{supra} notes 42-49 and accompanying text for a discussion of externalities.
\textsuperscript{124} See \textit{supra} notes 77-79 and accompanying text.
\textsuperscript{125} D. Orr, \textit{supra} note 43, at 287.
generally wants maximum public exposure so that more copies of the work may be sold. Therefore, the creator will not demand exorbitant prices which might limit exposure of the work to the public. With new works of unascertainable value, it is also questionable whether, in an effort to get public exposure, the creator would grant any party exclusive rights to use the work. Instead, the creator may grant exclusive licenses to use the work to one company for a limited period or may grant nonexclusive licenses to several companies for the use of his work. If a new artist grants the exclusive rights to use his work to an individual or firm, that does not prevent others from bargaining with the new copyright owner to obtain the right to use the work. Further, individuals wishing to use copyrighted materials may attempt to obtain the right to use the works at prices low enough so that the public can enjoy the presentation of the work, be it through records, cable television, jukeboxes, or public broadcasting. This need, coupled with the creator's desire to get public exposure for his work, should insure that the public has access to new, creative works at reasonable prices. Any increase in the price of the right to use copyrighted works reached during negotiations between a copyright owner and a potential user will be the result of market pressures which indicate that third parties would be willing to purchase the goods even at the increased price. 126

VI. Conclusion

Economists and policymakers have tended to overestimate the advantages that come from government regulation. 127 This principle is demonstrated clearly by the compulsory licensing provisions retained in the 1976 Act. While developed, in 1909, at a time when there was a threat of monopolization and antitrust laws were in their infancy, 128 this concept has not only been allowed to continue to exist well past the time that such fears were extinguished, but also has been allowed to expand into other areas of copyright law. Indeed, the trend has been to expand the concept. This trend has resulted from the political compromises that have been necessary to establish the new property rights required by technological advances. Rather than make a new property right exclusive, the right has been limited by compulsory licensing in order to guarantee public access to the

126. Id. at 299.
127. Coase, supra note 41, at 18.
128. See Blaisdell, supra note 25, at 110-11.
new works of creative persons.\textsuperscript{129}

Despite this trend, continued adherence to the compulsory licensing scheme should be reexamined. The existence of externalities and transaction costs in the negotiations for creative works does not mean, necessarily, that government intervention in these transactions is needed. Transaction costs and externalities may be equally well controlled during private negotiations by contract and property law. Besides the inherent inefficiency of the uniform regulations found in the compulsory licensing provisions, the expense of supporting administrative agencies to enforce these regulations only serves to increase transaction costs. Finally, compulsory licensing actually may discourage competition by preventing creators of newly copyrighted works from reaping the full benefit of their efforts. Any other threats to competition, such as monopolization, can be resolved by reliance on the antitrust laws, which have been successful in the regulation of other businesses.

Although compulsory licensing already may be a firmly established part of public broadcasting and the record, jukebox, and cable television industries, the concept should not be expanded to other areas. In its absence, the owner of a copyrighted work will be able to limit licensing for the use of his work to individuals with whom he wants to deal, limit the time period for the use of his work, and freely negotiate the price charged for such use. The ultimate result will be efficiency in granting the right to use copyrighted materials.

\textsuperscript{129} Ringer, \textit{supra} note 21, at 304.