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**Intellectual Property Rights and Compulsory Licensing:  
A First Principles Approach to Reform**

by

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## **Introduction and Summary**

In 1909, Congress for the first time subjected intellectual property protections to compulsory licensing and rate regulation. A compulsory or statutory license is a legal requirement that mandates that the owner of the intellectual property allow third parties to make reproductions of the protected property, provided the third party pays royalties to the owner. Government sets the prices or royalty amounts to be paid by the third party to the intellectual property owner.

With the Federal Communications Commission now, in effect, proposing to establish a new compulsory licensing regime in connection with new rules governing video navigation devices, it is useful to understand the origin of compulsory licensing regimes and the limited ways they typically have been justified and applied in the past. Absent the existence of any clear legal authority authorizing it to do so, the FCC is considering imposing a compulsory licensing system that would allow those accessing video programming on third-party video devices and video apps to view copyrighted programming. In essence, in a competitive, fast-changing video marketplace in which consumers already have many more choices than ever before, the FCC

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proposes to set license terms and enforce them – over and against the objections of copyright owners. The agency’s proposal also threatens to undermine existing private contracts regarding cable and satellite carriage rights.

The Copyright Act of 1909, the earliest statutory compulsory licensing regime, established a mechanical licensing provision. Under the 1909 Act, once the songwriter of a music composition used or permitted a mechanical reproduction of the copyrighted work, “any other person” could “make similar use of the copyrighted work upon payment to the copyright proprietor of a royalty of 2 cents” for each reproduction.

Additional facets of copyright protections in music later became subject to compulsory licensing and rate regulation. In 1971, Congress recognized public performance rights in copyrighted sound recordings but attached to those rights a compulsory licensing and royalty regulation scheme. And in 1995, Congress first established compulsory licensing and rate regulation concerning digital public performances of musical compositions. Aside from music, Congress has established compulsory licensing for cable and satellite operators to retransmit copyrighted radio and video programming that is broadcast over-the-air.

When it comes to intellectual property rights secured by the Constitution, only copyright protections have been subjected to pervasive compulsory licensing and rate regulation schemes. Congress has not broadly imposed compulsory licensing and royalty rate regulation on patent rights. This paper therefore focuses primarily on compulsory licensing and rate regulation of musical compositions and sound recordings.

As a matter of constitutional principle, imposing compulsory licenses and rate controls on copyrights or patent rights is highly problematic. Compulsory licensing and rate controls are at odds with the Constitution’s philosophic premises regarding the origin of property and the proper role of government. The Founding Fathers and early American constitutionalism regarded intellectual property as arising out of human nature and created through human creative and inventive labor, independently of government. It was the role of government to secure and protect property rights and, when appropriate, to clarify property boundaries.

American law writers in the 19th century echoed the view that intellectual property owes its primary existence to human labors and therefore exists independently of government. In describing his role in advocating passage of the Copyright Act of 1831, for instance, New York Congressman and author Gulian C. Verplanck declared:

I therefore denied that the right of the author or inventor was the mere creation of the positive law of the land. I maintained that the right of property in the productions of intellectual labour was as much founded in natural justice as the right of property in productions of corporeal labour—that he who toils with the mind is as honestly entitled to the fruits of that toil as he who works with the hands.

Identical reasoning was offered by Eaton S. Drone in *A Treatise on the Law of Property in Intellectual Productions* (1879):

Thus, rather than simply create intellectual property, it is a primary duty of government to secure intellectual property – that is, to clarify its scope and to protect it, as well as to provide opportunity for its acquisition and enlargement it through law and the administration of justice.

Compulsory licensing is in conflict with the idea that intellectual property precedes government. Compulsory licensing and rate regulation of IP fit more comfortably in a paradigm that regards property rights as mere creatures of government, bestowed at its own discretion and unconstrained by antecedent principles of justice.

Further, as with other property rights, exclusivity is a core component of both copyright and patent rights. On its face, restricting or conditioning intellectual property rights through compulsory licensing and rate regulation certainly is contrary to the idea of exclusivity in a property owner's use of his or her property. At the very least, such regulatory incursions on property rights require compelling justification.

Indeed, compulsory licensing and rate regulation appear contrary to the constitutional concept of exclusivity expressed in the Article I, Section 8, Clause 8 Intellectual Property Clause. The IP Clause confers on Congress power to “To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.” Over the years, some observers have remarked that the IP Clause's use of the term “securing” refers to pre-existing rights rather than something merely created by Congress. This rendering makes the IP Clause's use of “securing” IP rights consistent with the Declaration of Independence's use of “secure” to government's role in safeguarding the inalienable rights belonging to all men. Moreover, the Constitution expressly reflects the underlying concept of “exclusive Right” concerning copyrights and patents. The IP Clause's only constraint on the exclusive rights of authors and inventors is the delineation of “limited Times” for the period of such exclusivity. It is unlikely that the power to secure exclusive rights to authors and inventors entails a congressional power to make those rights subject to non-exclusive provisos regarding who can license the IP rights being secured.

Furthermore, it is unlikely that Congress's power to secure exclusive rights in IP entails the power to curtail the author's or inventor's discretion regarding what prices they can charge to licensees of their intellectual property. In Great Britain, the Statute of Anne (1710) included a complaint process for challenging the prices of copyrighted books and allowing government officials to set rates. But the First Congress rejected such rate controls for copyrighted works. The Copyright and Patent Acts of 1790 expressly recognized the rights of authors and inventors to freely assign their creative works and inventions. Over the next century, amendments to federal copyright and patent laws by Congress retained the concept of exclusivity in intellectual property rights. Supreme Court decisions in the 19th and early 20th centuries similarly recognized the general rule of liberty of contract when it came to outright exchanges or licensing agreements by copyright and patent right holders.

Liberty of contract is a necessary component of the exclusive rights that copyright and patent right owners hold in the use and exchange of their intellectual property. The individual who labors to produce a creative work or an invention – or who lawfully obtains all rights in the intellectual property – is entitled to decide whether and on under what terms it will be used or not used.

But under a compulsory licensing system the holder of a copyright or patent right no longer has control over whether or under what conditions their intellectual property can be used. The intellectual property owner no longer has discretion regarding who can license the creative work or invention. And the owner loses control over the price or value he or she can demand in exchange for licensing usage.

Although the Copyright Act of 1909's compulsory licensing and rate regulation provisions were never constitutionally challenged in court, constitutional objections were raised in the years surrounding its adoption. Infringement of the exclusive rights of copyright holders under the IP Clause were among the objections leveled against those provisions of the 1909 Act. Thus, it is worthwhile to consider extent to which those aspects of the 1909 Act deviated from exclusive property rights and liberty of contract principles.

Congress formally conferred on the Interstate Commerce Commission (ICC) the power to set “just and reasonable” maximum rates for interstate commercial services such as railroads, telephones, and telegraphs by passing the Hepburn Act of 1906. Yet the degree to which the Copyright Act of 1909 controlled prices and restricted returns to property rights owners – in this case, owners of intellectual property – was far more extensive. Rather than establish a body to review rates or prescribe a formula for ensuring reasonable rates offering a fair return based on factual circumstances – as Congress did for the ICC – the 1909 Act fixed royalty rates for music compositions at \$0.02 cents per mechanical reproduction, and provided no inflation index.

Late 19th and early 20th century American constitutional jurisprudence permitted but also limited regulation of private property used in connection with a “business affected with a public interest.” However, copyrighted creative works do not fit within the conceptual categories of property that are properly subject to rate regulation according to classic Supreme Court doctrine regarding businesses affected with a public interest. Put another way, copyrighted creative works are not the type of property used specifically for furtherance of businesses affected with a public interest – such as ports, highways, railroads, grist mills, or inns. No barriers to entry prohibit others from creating their own creative works and obtaining copyright protections. Calls for reform or repeal of compulsory licensing for copyrighted musical compositions and sound recordings cannot be dismissed lightly when they cannot even be justified by those principles that were historically defined regulations of businesses affected with a public interest.

The compulsory licensing and rate regulation scheme that federal copyright law currently imposes on musical compositions and sound recordings poses serious practical problems that require reforms by Congress. First, Congress's compulsory licensing and rate regulation system for sound recordings has been applied in a profoundly arbitrary manner. Federal law establishes different ratemaking standards for different types of music services. For public performances of non-interactive Internet-based digital music services – or “webcasting” – such as Pandora, the

Copyright Royalty Board applies the “willing buyer/willing seller” standard. Under that standard, the Board determines what royalty rates “most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller.” The Copyright Royalty Board applies the different Section 801(b)(1) rate standard for public performances of copyrighted sound recordings through cable and satellite services. Among other things, that standard requires that the selected rates “minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices.” Moreover, AM/FM broadcast radio stations are exempt from having to pay any performance royalties to owners when their copyrighted sound recordings are aired. And no federally protected public performance right exists for any copyrighted sound recording made prior to 1972.

There is no justification for subjecting performance royalties for copyrighted sound recordings to different standards. Nor is there any compelling reason for specially exempting any one service or older copyrighted sound recordings from royalty payment requirements.

Second, compulsory licensing and rate regulation likely have reduced compensation that music copyright holders otherwise would have received through voluntary exchanges. Ultimately, the free market offers the only non-arbitrary way to assign economic value to copyrighted musical compositions and sound recordings.

Third, technological and other marketplace changes have upended any justification for compulsory licensing and rate regulation. Long gone is the time of piano rolls and concerns about the Aeolian Company monopoly of published music that motivated the Copyright Act of 1909. For that matter, consumers have a multiplicity of means for accessing music, including CDs and vinyl, broadcast radio, cable and satellite music services, satellite radio, and Internet-based music services.

Fourth, advances in technology – including Internet communications capabilities – enable market participants to reduce transaction costs that otherwise may inhibit the functioning of a free market. Today, technological and other marketplace developments facilitate transactions between songwriters, recording artists, and their associates in the music industry. Performance Rights Organizations and other entities – including ASCAP and BMI, Harry Fox Agency, and SoundExchange – serve as intermediaries between music copyright holders and commercial music services. Those entities have developed complex arrangements for negotiating licenses and rates, collecting royalties, and distributing proceeds to copyright holders. Such entities enable mass scale transactions that overcome cost barriers. So there is little to no reason to believe that compulsory licensing and rate regulation offer any clear benefit to consumers.

Congress can place copyright protection in music on a more constitutionally sound and free market-oriented footing. Such reform should be guided by classic principles of property rights, secure an individual’s exclusive rights in his or her creative works and inventions, and preserve liberty of contract regarding intellectual property rights.

Above all, Congress should *not* expand compulsory licensing and rate regulation of copyrighted music, video programming, or other media. As new technologies, services, and products emerge in the market, Congress should respect the exclusive rights of copyright holders rather than pare

back those rights by subjecting them to new restrictions. Also, intertwining new or expanded copyright protections with regulation inevitably creates vested interests in the perpetuation of such regulation. Refraining from imposing new compulsory licensing and rate control requirements is a far easier task for Congress than repealing regulations that have outlived their ostensible reason for being yet remain firmly entrenched.

Likewise, the FCC's proposed *de facto* compulsory licensing system for viewing copyrighted video programming on third-party video devices and video apps should be dropped by the agency. The FCC should *not* undermine the exclusive rights of video programmers in their copyrighted content. Nor should it be able to effectively rewrite the terms of privately negotiated contracts by imposing its own licensing terms on the market. The FCC should act only within the confines of its lawful authority under the Communications Act, not engage in regulatory adventurism with copyright policy.

### **Intellectual Property Rights and Compulsory Licensing: A Brief History**

In 1909, Congress for the first time subjected intellectual property protections to compulsory licensing and rate regulation. A compulsory license is a legal requirement that the owner of the intellectual property allow third parties to make, vend, and otherwise use reproductions of the protected property, provided the third party pays royalties to the owner. In the compulsory licensing context, rate regulation is the means by which government sets the prices or royalty amounts to be paid by the third party to the intellectual property owner.

The Copyright Act of 1909 was passed by the 60th Congress and signed into law by President Theodore Roosevelt. The 1909 Act was the first major revision to American copyright law since the Copyright Act of 1870. In the years preceding the 60th Congress's passage of the new law, authors and other creative artists lobbied for longer copyright protection terms for their works. For their part, songwriters urged Congress to secure recording and mechanical reproduction rights in musical compositions. Also, the U.S. Supreme Court's decision in *White-Smith Music Publishing Co. v. Apollo Co.* (1908) – that the manufacture and sale of copyrighted sheet music without consent did not constitute infringement – added urgency to the calls for overdue reform.

During the course of congressional hearings that led up to the 1909 Act, many voiced concerns about the Aeolian Company establishing a possible music publishing monopoly. The Aeolian Company was the nation's largest manufacturer of piano rolls, and it had contracted with several major music publishers for exclusive rights to reproduce their musical compositions. Beginning in 1908, compulsory licensing provisions began appearing in copyright reform bills introduced in Congress. The House Committee on Patents, in a report that accompanied the bill that eventually would become law, declared that the bill's compulsory licensing provision was included to protect the public interest from monopolization of mechanical reproduction rights in copyrighted musical compositions.

Among its provisions, the Copyright Act of 1909 extended copyright protection renewal terms from fourteen years to twenty-eight years, thereby expanding maximum protection terms to fifty-six years. The 1909 Act also broadened the scope of copyrightable subject matter by including a longer list of works and by including a catch-all provision that covered "all the writings" of an

author. In addition, the 1909 Act reversed the Supreme Court's decision in *White-Smith Music Publishing Co.* Section 1(e) of the 1909 Act by expressly recognizing that the authors of musical compositions possessed copyright protections in mechanical reproductions (or "phonorecords") of their compositions.

But at the same time it recognized recording and mechanical reproduction rights in musical compositions, the Copyright Act of 1909 subjected those rights to novel restrictions. The 1909 Act established a mechanical licensing provision, whereby songwriters were entitled to royalty payments when mechanical reproductions of their musical compositions were made. Once the songwriter used or permitted a mechanical reproduction of the copyrighted work, "any other person" could "make similar use of the copyrighted work upon payment to the copyright proprietor of a royalty of 2 cents" for each reproduction. Thus, songwriters effectively retained exclusive rights in making the first publication or recording of their musical composition under the 1909 Act. Thereafter, their musical compositions were subject to compulsory licensing and government-set rates governing mechanical reproductions or other copying of the protected work.

Following the 1909 Act, additional facets of copyright protections in music became subject to compulsory licensing and rate regulation. In 1971, simultaneous with its recognition of public performance rights in copyrighted sound recordings, Congress attached to those rights a compulsory licensing and royalty regulation scheme. Additionally, Congress established compulsory licensing and rate regulation concerning digital public performances of musical compositions in the Digital Performance Right in Sound Recordings Act of 1995.

The BMI/ASCAP Consent Decree also imposes a compulsory licensing and royalty rate scheme for public performances of musical compositions. The Consent Decree was entered into between the two major Performance Rights Organizations and the Department of Justice in 1941. Under the supervision of the U.S. District Court for the Southern District of New York, the Consent Decree has been subsequently modified in only limited respects.

Aside from music, Congress has established compulsory licensing for copyrighted video programming. The 1976 Act established a cable compulsory license. Under this license, cable operators are permitted to intercept over-the-air television and radio broadcast signals that are copyrighted and retransmit those signals to their subscribers in distant markets. Similarly, the Satellite Home Viewer Act of 1988 first established the satellite carrier compulsory license. It permits a satellite carrier to intercept over-the-air TV signals – but not radio signals – and retransmit them to their subscribers.

In addition, now pending is a proposal by the FCC to impose a *de facto* compulsory licensing system for viewing copyrighted video programming on third-party video devices and video apps. In essence, the FCC proposes to set the license terms by which copyright owners of video programming would have to make their content and related information available to third parties. The FCC proposes to enforce its bureaucratically-designed license over and against the objections of copyright owners in video programming and despite existing private contracts regarding cable and satellite carriage rights. Of course, the Copyright Act nowhere authorizes the FCC to become a copyright enforcer. Its jurisdictional authority to impose *de facto* compulsory

licensing on video programming under Section 629 of the Communications Act – addressing competitive conditions in the retail market for cable set-top box and other physical equipment – is extremely dubious, to say the least.

When it comes to intellectual property rights secured by the Constitution, only copyright protections have been subjected to pervasive compulsory licensing and rate regulation schemes. Congress has not broadly imposed compulsory licensing and royalty rate regulation on patent rights, although various patent licensing bills have been introduced. Some foreign countries have compulsory patent licensing schemes. But the United States has resisted compulsory patent licensing systems.

In the Atomic Energy Act, Congress has included compulsory licensing for patents deemed by the Department of Energy to be “of primary importance in the production or utilization of special nuclear material or atomic energy.” Similarly, the Clear Air Act also includes a mandatory licensing provision when the Attorney General deems a patent is necessary for persons to comply with the Act, no reasonable alternative methods of compliance exist, and such unavailability might substantially lessen competition or tend to create a commercial monopoly. “In both instances,” law professors Ronald A. Cass and Keith N. Hylton have pointed out, “the critical nature of the technology is not enough. Both provisions require a showing that the patent has been withheld from the use at issue.” Neither of those provisions has ever been used.

### **Compulsory Licensing of Intellectual Property Rights is Problematic in Principle**

As a matter of constitutional principle, imposing compulsory licenses and rate controls on copyrights or patent rights is inherently problematic. Subjecting copyrights and patent rights to compulsory licensing and rate controls is at odds with the Constitution’s philosophic premises regarding the origin of property and the proper role of government. Moreover, compulsory licensing is seemingly contrary to the constitutional concept of exclusivity expressed in the IP Clause. And compulsory licensing and rate regulation is certainly at odds with the liberty of contract—a policy regarding IP rights that generally prevailed from the First Congress until the Copyright Act of 1909.

#### ***Intellectual Property Rights Are Ultimately Rooted in a Person’s Labors, Not Government Grants***

It is a bedrock premise of American constitutionalism that individual rights do not come from government, but from “the laws of Nature and of Nature’s God.” The Declaration of Independence offers the most monumental expression of this premise. The Declaration held it to be self-evident truths “that all men are created equal, that they are endowed by their Creator with certain unalienable Rights, that among these are Life, Liberty, and the pursuit of Happiness.” In the view of the Founding Fathers, the pursuit of happiness was closely connected with the acquisition and use of private property. The Declaration explained that government is instituted “to secure these rights.”



Indeed, classic liberal philosophy, common law tradition, and early American constitutional thinking regarded private property as something created by individuals, not government. In this view, individuals create property through their own labors. As 17th century British political philosopher John Locke wrote in his *Second Treatise of Government* (1690), every man's labor belongs to himself. "Whatsoever then he removes out of the state that nature hath provided, and left it in, he hath mixed his labour with, and joined to it something that is his own, and thereby makes it his property." An individual's just claim to the property that results from his or her mixture of labor and resources is based on the law of nature or first principles of practical reasoning – independent of government.

Locke and the American Founders recognized that an individual has, by nature, a right of property in one's self and in one's own labor. According to classic liberal political philosophy, while private property is created by an individual's labor, the institution of property is ultimately rooted in human nature. Or as Chancellor James Kent put it in his *Commentaries on American Law* (1826-1830), "The sense of property is inherent in the human breast."

From the origin of property in one's own labors, it follows that the individual who so labored was entitled to sole possession and use of his or her property. In his essay *On Property* (1792), James Madison defined the concept of property ownership as "that dominion which one man claims and exercises over the external things of the world, in exclusion of every other individual." (Madison's definition was a direct quotation of Sir William Blackstone.) Thus, exclusivity in possession and use is an essential ingredient of property rights.

Moreover, since human nature exists independently of government and property is rooted in human nature, property – including intellectual property – exists independently of government. Francis Lieber described further this order of priority in his *Essays on Property and Labour* (1841):

Property is not the creature of government; but if by government we understand that system of protection, authority, and administered justice which naturally grows up, the stronger and the better defined, the more settled the society becomes, then property precedes government, and the latter arises out of the former. It may be maintained, with far greater truth, that government is the creature of property.

Lieber's statement similarly reflects a central purpose of government in protecting private property rights. This responsibility of government to private property owners was a core principle of the Founding Fathers and was widely reflected in early American constitutionalism. According to this view, the proper role of government is to protect property and enlarge it as society advances. Madison explained in his essay *On Property*: "Government is instituted to protect property of every sort; as well that which lies in the various rights of individuals, as that which the term particularly expresses. This being the end of government, that alone is a *just* government, which *impartially* secures to every man, whatever is his *own*."

The Founding Fathers and early American constitutionalism applied this understanding of property rights – arising out of human nature and created through human labor independently of government established to protect and enlarge it – directly to copyrights and patents. This understanding was the focus of our book, *The Constitutional Foundations of Intellectual Property: A Natural Rights Perspective* (2015). In other words, intellectual property in creative works and inventions is rooted in the nature of humanity. Since humans by nature have self-ownership of their own labors, it is their own labors that bring intellectual property into being and give them title to that property and its proceeds.

Early American law writers echoed the view that intellectual property owes its primary existence to human labors and therefore exists independently of government. As Francis Lieber observed in his essay, *On International Copyright* (1840), “the more a producer unites with his manual labor intellectual exertion... the more readily does the universal voice of mankind acknowledge his individual title of property in the product effected by this combination of judgment, agents and material.” Therefore: “If there exists any species of property not made by government, but existing by its own spontaneous right, and which requires only to be acknowledged by way of protection on the part of government, it is literary property.”

Similarly, New York Congressman and author Gulian C. Verplanck described intellectual property as rooted in human labor. As Verplanck declared to an audience regarding his role in advocating for passage of the Copyright Act of 1831:

I therefore denied that the right of the author or inventor was the mere creation of the positive law of the land. I maintained that the right of property in the productions of intellectual labour was as much founded in natural justice as the right of property in productions of corporeal labour—that he who toils with the mind is as honestly entitled to the fruits of that toil as he who works with the hands.

Identical reasoning was offered by Eaton S. Drone in *A Treatise on the Law of Property in Intellectual Productions* (1879): “Literary property, like all property, has its origin in natural law, and not in legislation; it is, therefore, a natural and not an artificial right.”

Importantly, the same core of reasoning applies with respect to inventions as well as creative works. Wrote early American journalist and lawyer Thomas Green Fessenden in his *Essay on the Law of Patents* (1822):

In a moral, as well as a political point of view, the author of a new and useful invention, has the best of all possible titles to a monopoly of the first fruits of his ingenuity. The invention is the work of his hands, and the offspring of his intellect.

Consider also Willard Phillips’ explanation in *The Law of Patents for Inventions* (1837):

Though *property* in a discovery, therefore, like that in land, originates in and is created by legislation, the right to such property exists to an imperfect degree, independently of the positive laws.” Thus, rather than simply create intellectual

property, it is a primary duty of government to secure intellectual property – that is, to clarify its scope and to protect it, as well as to provide opportunity for its acquisition and enlargement it through law and the administration of justice.

Given early American constitutionalism’s concept of property rights – which regarded exclusivity in possession and use as essential ingredient of ownership – and its application of that concept to intellectual property, exclusivity is therefore a core component of both copyright and patent rights. At first blush, restricting or conditioning property rights – including intellectual property rights – through compulsory licensing and rate regulation certainly appears contrary to the idea of exclusivity in a property owner’s use of his or her property. At the very least, such regulatory incursions on property rights are departures from property rights principles and therefore require justification.

Compulsory licensing is also seemingly in conflict with the idea that property – including intellectual property – precedes government and is not merely contrived by government. Compulsory licensing and rate regulation of IP fits more comfortably in a paradigm that regards property rights as mere creatures of government, bestowed at its own discretion and unconstrained by antecedent principles of justice. If government creates IP rights then it should be of little or no moment if government places restrictions or conditions on the use of those government-bestowed rights. Likewise, compulsory licensing and rate regulation of IP makes more sense if it is regarded as a special privilege or monopoly charter bestowed by government.

But as previously indicated, property rights – including IP rights – are grounded in human nature and in human labor, in particular. According to those philosophical premises, property rights are not mere government creations but are to be secured and enlarged by government operating according to the rule of law. As we described in our *FSF Perspectives* paper “[The Public Contract Basis of Intellectual Property Rights](#),” the Constitution secures IP rights by virtue of a public contract. Even so, it is the labor of the author or inventor that brings the property into existence. Contract is the mechanism that binds both creative artist or inventor and the government on behalf of the people. Creative artists and inventors obtain copyright and patent right protections and thereby perfect their exclusive rights in consideration for disclosure of their creative works or inventions by complying with application and registration requirements. Moreover, as we explained in Chapter 4 our book, [The Constitutional Foundations of Intellectual Property: A Natural Rights Perspective](#) (2015), the Founding Fathers did *not* regard copyrights and patent rights like trade franchises or other monopolies bestowed by the British Crown. Rather, they regarded those rights as limited protections for creative artists and inventors, leaving other individuals free to seek exclusive protections for their own creative works and inventions.

Of course, American constitutionalism is hardly limited to immediate deductions from first principles. Experience, circumstances, and practical consequences also shape the application of those principles. Philosophical and historical reflection is primarily useful for understanding how to interpret the Constitution’s meaning and how to construe its provisions to apply to particular circumstances. And as will be seen, the text of the Constitution offers additional reason for being skeptical of the legitimacy of compulsory licensing and rate regulation of intellectual property.

### ***Compulsory Licensing of Intellectual Property Rights Appears Inconsistent with the Text of the IP Clause***

The Constitution's Article I, Section 8, Clause 8 IP Clause confers on Congress power to "To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries." Over the years, observers have occasionally remarked that the IP Clause's use of the term "securing" refers to pre-existing rights rather than something merely created by Congress. This rendering makes the IP Clause's use of "securing" IP rights consistent with the Declaration of Independence's use of "secure" to characterize government's role in safeguarding the inalienable rights belonging to all men. Moreover, the Constitution expressly reflects the underlying concept of "exclusive Right" concerning copyrights and patents. The IP Clause expressly restricts the exclusive rights of authors and inventors to "limited Times." But duration is the only restriction countenanced in the Constitution.

Thus, the Constitution's text weighs against the idea that Congress possesses the power to impose compulsory licensing and rate regulation on copyrights and patent rights. On its face, it is unlikely that the power to secure exclusive rights to authors and inventors entails a congressional power to make those rights subject to non-exclusive provisos regarding who can license the IP rights being secured.

### ***Compulsory Licensing and Rate Regulation of Intellectual Property Rights is Inconsistent with Liberty of Contract***

In addition, it is also unlikely that Congress's power to secure exclusive rights in IP entails the power to curtail the author's or inventor's discretion regarding what prices they can charge to licensees of their IP. This conclusion is bolstered by early congressional practices favoring liberty of contract regarding copyrighted works, including Congress's rejection of British rate control provisions regarding copyrighted books.

Great Britain's Statute of Anne (1710) included a complaint process for challenging the prices of copyrighted books and allowing government officials to set rates. It provided that if any booksellers or printers "shall... set a price upon, or sell, or expose to sale, any book or books at such a price or rate as shall be conceived by any person or persons to be too high and unreasonable; it shall and may be lawful for any person or persons, to make complaint thereof" to any one of several named government officials, including the archbishop of Canterbury, the lord keeper of the great seal of Great Britain, or the lord bishop of London. And "if upon such enquiry and examination it should be found, that the price of such book or books is inhaunced, or any wise too high or unreasonable," then such official held "full power and authority to reform and redress the same, and to limit and settle the price of every such printed book and books, from time to time, according to the best of their judgments, and as to them shall seem just and reasonable."

Members of the First Congress were undoubtedly aware of the Statute of Anne. Indeed, the Copyright Act of 1790 was in some respects patterned after the Statute of Anne. Both statutes, for instance, provided authors of creative works initial protection terms of fourteen years.

Significantly, however, the First Congress rejected the idea of rate controls for copyrighted works in adopting the 1790 Act. Absence of government regulation of prices for copyrighted works constitutes an important characteristic of early American constitutionalism's understanding of exclusive rights. In his *Commentaries on American Law*, Chancellor James Kent remarked on the difference between the Statute of Anne and the 1790 Act with respect to rate controls:

The act of Congress has no such provision; and it leaves authors to regulate, in their discretion, the number and price of the books, calculating (and probably very correctly) that the interest an author has in a rapid and extensive sale of his work, will be sufficient to keep the price reasonable, and the market well supplied.

The First Congress and later Congresses built on the constitutional concept of exclusivity in IP rights. The Copyright and Patent Acts of 1790 expressly recognized the rights of authors and inventors to freely assign their creative works and inventions. Over the century that followed, amendments to federal copyright and patent laws by Congress retained the concept of exclusivity in IP rights. U.S. Supreme Court decisions in the 19th and early 20th centuries similarly recognized the general rule of liberty of contract when it came to outright exchanges or licensing agreements by copyright and patent right holders. This constitutional policy favoring free exchange of copyright and patent rights was the subject of our *FSF Perspectives* paper "[Liberty of Contract and the Free Market Foundation of Intellectual Property](#)."

Indeed, liberty of contract is a necessary component of the exclusive rights that copyright and patent right owners hold in the use and exchange of their intellectual property. The individual who labored to produce a creative work or an invention – or who lawfully obtained all rights in the intellectual property – is entitled to decide whether or under what terms it will be used or not used.

But compulsory licensing removes critical incidents of property ownership. Under a compulsory licensing system the holder of a copyright or patent right no longer has control over whether or under what conditions their intellectual property can be used. The IP owner no longer has discretion regarding who can license the creative work or invention. And the IP owner loses control over the price or value they can demand in exchange for licensing usage. Thus, compulsory licensing and rate controls are at odds with the longstanding constitutional policy of liberty of contract because they curtail the exclusive rights of copyright and patent holders to assign or exchange their intellectual property.

### **Compulsory Licensing and Rate Regulation of Intellectual Property Rights is Contrary to Classic Principles of Rate Regulation**

Although the Copyright Act of 1909's compulsory licensing and rate regulation provisions were never subject to constitutional challenge in court, constitutional objections were sporadically voiced in the years surrounding its adoption. Infringements of the exclusive rights of copyright holders under the IP Clause were among the objections leveled against those provisions of the 1909 Act. Nonetheless, it is worth considering the significant extent to which the 1909 Act deviated from exclusive property rights and liberty of contract principles that reigned for more

than a century in American copyright law. In particular, such deviation is revealed by the extent to which compulsory licensing and rate regulation provisions of the 1909 Act departed from classic principles of rate regulation – then a recognized part of American constitutional jurisprudence.

The Interstate Commerce Act (1887), which established the Interstate Commerce Commission (ICC), was the first major federal rate-control statute. It declared that interstate railroad shipment rates “shall be reasonable and just; and every unjust and unreasonable charge for such service is prohibited and declared to be unlawful.” However, the Supreme Court decided in *Interstate Commerce Commission v. Cincinnati, New Orleans & Texas Pacific Railway Company* (1897) that the ICC lacked the power to fix rates, having only the power to assess the reasonableness of rates established by railroads. For that matter, even the ICC’s power to review rates were circumscribed out of regard for private property rights protected by the Due Process Clauses of the Fifth and Fourteenth Amendments. Supreme Court decisions such as *Minnesota Rate* (1890) and *Smyth v. Ames* (1898) recognized that rates must be based on the “fair value” of a railroad’s property and thereby ensure a “fair return” in order to be “reasonable” rates. The Elkins Act of 1903 added the ICC’s power over prices only insofar as it banned rebates to preferred large companies in interstate railroad shipments. Congress formally conferred on the ICC powers to set “just and reasonable” maximum rates for interstate commercial services such as railroads, telephones, and telegraphs by passing the Hepburn Act of 1906. Even then, ICC powers to fix maximum rates were subject to due process requirements regarding fair return and reasonableness previously recognized in Supreme Court jurisprudence. According to historian Morton Keller, “[t]he ICC could lay fair claim to being the strongest and most interventionist of American regulatory agencies in the early twentieth century.”

Compared to other ratemaking powers that Congress conferred upon the ICC in the late 19th and early 20th centuries, the controls Congress established in the Copyright Act of 1909 are particularly onerous. The degree to which it controlled prices and restricted returns to property rights owners – in this case, owners of intellectual property – was far more extensive. Rather than establish a body to review rates or prescribe a formula for ensuring reasonable rates offering a fair return, the 1909 Act fixed royalty rates for music compositions at \$0.02 cents per mechanical reproduction, and provided no inflation index.

The 1909 Act also departed from classic principles of rate regulation regarding the categories of business that may properly be subject to rate regulation. Late 19th and early 20th century American constitutional jurisprudence permitted but also limited regulation of private property used in connection with a “business affected with a public interest.” That jurisprudence reflected a deep respect for private property rights, backed by longstanding common law precedents.

In *Munn v. Illinois* (1877), a landmark Supreme Court decision regarding rate regulation, Chief Justice Morrison Waite briefly traced “the principles upon which this power of regulation rests.” “Looking, then, to the common law, from whence came the right which the Constitution protects,” Waite wrote, “we find that when property is ‘affected with a public interest, it ceases to be *juris privati* only.’” A Latin term, *juris privati* means “of private right.” Waite quoted from passages by Sir Matthew Hale, Lord Chief Justice of England, including *De Portibus Maris*

(1670). The title translates as “The Gates of the Sea.” According to Hale, when a subject of the Crown has a public wharf on license from the King, or dedicates his own private wharf to the public, he must allow all to use it, and only subject it to reasonable charges.

Waite wrote in *Munn* that “De Portibus Maris... has been accepted without objection as an essential element in the law of property ever since” its publication over 200 years prior. Thus, “[p]roperty does become clothed with a public interest when used in a manner to make it of public consequence, and affect the community at large.” Further, Waite concluded that “In countries where the common law prevails, it has been customary from time immemorial for the legislature to declare what shall be a reasonable compensation under such circumstances, or, perhaps more properly speaking, to fix a maximum beyond which any charge made would be unreasonable.” *Munn* thereby established non-discrimination and reasonable rates as among the regulatory requirements that could be imposed upon businesses affected with a public interest.

Waite also described the duty of courts in considering legal challenges to rate regulations in *Munn*. The judicial duty, according to Waite, is to ascertain whether the private property at issue and the business enterprise carried in connection with that property come within the operation of the principle that private property devoted to a public use is subject to public regulation. In other words, the question for courts to decide is whether the type of business being operated met the legal definition of a business affected with a public interest. “The controlling fact is the power to regulate at all,” explained Waite. “If that exists, the right to establish the maximum of charge, as one of the means of regulation, is implied.”

Over the half-century that followed *Munn*, the Supreme Court elaborated on its jurisprudence concerning rate regulation of businesses affected with a public interest. In *Wolff Packing Co. v. Court of Industrial Relations* (1923), Chief Justice William Howard Taft summarized three categories of businesses that were properly considered to be affected with the public interest and therefore properly subject to rate regulation:

- (1) Those [businesses] which are carried on under the authority of a public grant of privileges which either expressly or impliedly imposes the affirmative duty of rendering a public service demanded by any member of the public. Such are the railroads, other common carriers and public utilities.
- (2) Certain occupations, regarded as exceptional, the public interest attaching to which, recognized from earliest times, has survived the period of arbitrary laws by Parliament or Colonial legislatures for regulating all trades and callings. Such are those of the keepers of inns, cabs and grist mills.
- (3) Businesses which though not public at their inception may be fairly said to have risen to be such and have become subject in consequence to some government regulation. They have come to hold such a peculiar relation to the public that this is superimposed upon them. In the language of the cases, the owner by devoting his business to the public use, in effect grants the public an interest in that use and subjects himself to public regulation to the extent of

that interest although the property continues to belong to its private owner and to be entitled to protection accordingly.

Copyrighted creative works do not fit within the conceptual categories of property that are properly subject to rate regulation, according to classic Supreme Court doctrine regarding businesses affected with a public interest. Put another way, copyrighted creative works are not the type of property used specifically for furtherance of businesses affected with a public interest.

It is obvious enough that copyrighted works are not the type of property that is central to the functions of “railroads, other common carriers and public utilities.” And it is equally obvious that copyrighted works are not the type of property that is central to the functions of “inns, cabs and grist mills.” Undoubtedly, common carriers, public utilities, or other “exceptional occupations” can become copyright holders. Yet, copyright ownership is merely incidental to such enterprises. While the primary business operations of common carriers and the like may be subject to non-discrimination and rate requirements, those incidental activities may not under classic Supreme Court jurisprudence.

Moreover, copyright protections cannot be subject to any “affirmative duty of rendering a public service demanded by any member of the public.” Nor can a copyright holder grant the public an interest in a creative work that subjects the protected work to rate regulation. Simply put, copyright protections don’t conform to those categories of property used by business activities affected with the public interest that may be subject to regulations concerning licensing or royalty rates. Certainly, there is nothing in songwriting or sound recording that gives rise to affirmative duties of public service.

Congress’s establishment of compulsory licensing and rate regulation in the 1909 Act, thus appears to constitute an unfortunate realization of the concerns expressed by Justice Stephen Field in his dissent in *Munn v. Illinois*. In his dissent, Field worried that the *Munn* majority opinion was not sufficiently protective of private property from incursions by legislative majorities:

The public is interested in the manufacture of cotton, woolen, and silken fabrics, in the construction of machinery, in the printing and publication of books and periodicals, and in the making of utensils of every variety, useful and ornamental; indeed, there is hardly an enterprise or business engaging the attention and labor of any consideration portion of the community, in which the public has not an interest in the sense in which that term is used by the court in its opinion.

To be sure, every type of business – including industries especially dependent upon copyrighted works and patented inventions – may be subject to police power regulations intended to protect public safety and health. Yet it is exceedingly difficult to justify the 1909 Act’s compulsory licensing of musical composition according to classic principles of rate regulation. And the 1909 Act constitutes an unfortunate instance of over-regulating enterprise in the name of the public interest, just as Field feared.



Had copyright law ever permitted individuals to obtain copyright protections in facts, ideas, public documents, or information that is in the public interest, then one could perhaps generate hypotheticals in which a copyright holder would have an affirmative duty to serve all members of the public by licensing its copyrighted work or otherwise making it available at a regulated rate. But that is surely not the history or the reality. Indeed, the federal government cannot obtain copyright protections in public documents and records. Nor may it confer copyright protections in public documents or records on public officials, employees, or private contractors. In *Wheaton v. Peters* (1834), Justice John McLean wrote “the Court is unanimously of opinion that no reporter has or can have any copyright in the written opinions delivered by this Court, and that the judges thereof cannot confer on any reporter any such right.” Courts the 19th century uniformly held, on public policy grounds, that individuals could not obtain copyright protections for public documents and records. In the Printing Act of 1895, Congress expressly provided that “no Government publications shall be copyrighted.” The Copyright Act of 1909 contained similar prohibitions.

To be sure, the third category identified by Chief Justice Taft in *Wolff Packing* – involving businesses that become quasi-public in consequence of the owner devoting the business to the public use – is the least clearly defined. However, Taft added some certainty by his observation that: “In nearly all the businesses included under the third head above, the thing which gave the public interest was the indispensable nature of the service and the exorbitant charges and arbitrary control to which the public might be subjected without regulation.” Similarly, Taft described the category as applying to scenarios “when the public becomes so peculiarly dependent upon a particular business that one engaging therein subjects himself to a more intimate public regulation.”

Here again, the limited scope of copyright protection – confined to particular tangible expressions of ideas – avoids scenarios by which the public becomes peculiarly dependent upon certain protected creative works. No barriers to entry prohibit others from creating their own creative works and obtaining copyright protections. More specifically, however popular or well liked they may be, neither individual songwriters nor sound recording artists become indispensably necessary to the public interest so as to turn their activities into businesses affected with a public interest.

In the New Deal era the Supreme Court swept away the concept of a “business affected with the public interest.” In its place, the Supreme Court substituted a broader “arbitrariness” standard for rate regulation of any business concern. While current Supreme Court jurisprudence marks the outer boundaries of what is deemed constitutionally permissible, the IP Clause ultimately charges Congress with securing copyright protections. For members of Congress interested in constructing copyright policy on a property rights foundation, consideration of classic rate regulation principles regarding businesses affected with a public interest offers a useful perspective.

Brief examination of those principles supplies a means for gauging the extent to which compulsory licensing and rate regulation is antithetical to exclusive nature of rights in creative works that the Constitution contemplated. Indeed, calls for reform or repeal of compulsory licensing for copyrighted musical compositions and sound recordings cannot be dismissed lightly

when they cannot even be justified by those principles that were historically used to define regulations of businesses affected with a public interest. Reform or repeal of copyright compulsory licensing and rate regulation by no means calls the idea of regulation itself into question. Such repeal or reform is hardly a *laissez faire* notion. Targeted regulation may be justifiable in many economic and business contexts, but justification for compulsory licensing and rate regulation of copyrighted works is considerably lacking.

### **Compulsory Licensing of Intellectual Property Rights Presents Practical Problems**

The compulsory licensing and rate regulation scheme that federal copyright law currently imposes on musical compositions and sound recordings poses serious practical problems.

#### *Arbitrariness*

First, Congress's compulsory licensing and rate regulation system for sound recordings has been applied in a profoundly arbitrary manner. Indeed, the current regulatory scheme regarding performance royalties for owners of copyrighted sound recordings epitomizes arbitrariness. As a general matter, current federal copyright law recognizes that public "performances" of sound recordings by commercial music service providers entitle owners of sound recordings to performance royalty payments. For instance, in order for SiriusXM, Pandora, or Comcast to lawfully transmit copyrighted sound recordings via their respective music services, they must pay royalties to SoundExchange. Royalty payments collected by SoundExchange are then distributed to the sound recording's copyright holder. If copyright holders, either individually or through their music service providers, cannot agree on royalties, compulsory licensing and government-set royalty rates supply a backstop.

For most music services that publicly perform copyrighted sound recordings subject to compulsory licensing, the Copyright Royalty Board conducts ratemaking proceedings to establish royalty rates. Copyright judges set rates for traditional media like CDs and vinyl and for non-interactive Internet-based digital music services. They also set rates for cable and satellite music services and for satellite radio services.

But federal law establishes different ratemaking standards for different types of music services. For public performances of non-interactive Internet-based digital music services – or "webcasting" – such as Pandora, the Copyright Royalty Board applies the "willing buyer/willing seller" standard. Under that standard, the Board determines what royalty rates "most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller."

Other music services, however, are not subject to this "willing buyer/willing seller" standard. The Copyright Royalty Board applies the different Section 801(b)(1) rate standard for public performances of copyrighted sound recordings through cable and satellite services. Under the so-called 801(b) standard, "reasonable terms and rates" are those calculated to: (A) maximize availability of creative works to the public; (B) afford copyright holders a fair return and copyright users a fair income under existing economic conditions; (C) reflect the roles of the copyright holders and users with respect to creative contribution, technological contribution,

capital investment, cost, risk, and contribution to the opening of new markets; and (D) “minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices.” In practice, Section 801(b)(1) results in lower royalties than the willing buyer/willing seller standard.

Moreover, AM/FM broadcast radio stations are exempt from having to pay any performance royalties to owners when their copyrighted sound recordings are aired. In most cases, broadcast radio stations do pay mechanical royalties to copyright holders in music compositions when copyrighted sound recordings are played over the air. But when it comes to public performances of sound recordings, broadcast radio stations enjoy a special privilege over music services platforms such as webcasting or cable services.

For that matter, no federally protected public performance right exists for any copyrighted sound recording made prior to 1972. Federal copyright law permits any music service to publicly perform pre-1972 sound recordings without paying royalties to the owner of copyrighted sound recordings. (In the past few years, Copyright infringement claims concerning pre-1972 recordings have been raised under state laws. The litigation – some of which still continues – has primarily favored copyright holders.)

There is no justification for subjecting performance royalties for copyrighted sound recordings to different standards. Nor is there any compelling reason for specially exempting any one service or older copyrighted sound recordings from royalty payment requirements. Federal copyright law’s disparate treatment of performance royalties for different music services is thoroughly arbitrary. Indeed, the arbitrariness of current federal copyright policy toward music appears even more sharply when one considers how it singles out for regulation copyright holders in music compositions and sound recordings – while allowing copyright holders in photographs, paintings, sculptures, plays, and books to retain exclusive rights in their creative works.

### ***Reduced Compensation for Copyright Holders***

Second, compulsory licensing and rate regulation has likely reduced compensation that music copyright holders would have otherwise received through voluntary exchanges. From a historical standpoint, songwriters were clearly shortchanged by the Copyright Act of 1909. It established a royalty rate for music compositions of just \$0.02 cents per mechanical reproduction – with no index for inflation. For nearly seven decades the rate remained unaltered. By the time Congress finally updated mechanical license in the Copyright Act of 1976, this \$0.02 cent rate was undoubtedly worth far less than it was near the beginning of the century. Moreover, the mechanical license rates overstate the royalties received by songwriters. Mechanical royalty rates function as a ceiling on negotiations, leaving songwriters and music publishers effectively precluded from bargaining for rates higher than those set by Congress. Reviewing the history of compulsory licensing and negotiating for songwriters’ royalties, Professor Robert Merges observed, “the actual ‘going rate’ was lower; it remained at between 1 ¼ and 1 ¾ cents during this period” between 1909 and 1978.”

The question of whether royalty rates are too low today remains a topic of intense debate. Songwriters, recording artists, the music publishing and recording industries, as well as Performance Rights Organizations insist that rates are too low. Meanwhile, music service providers reliably insist that rates are too high and eat up too much of their service revenues. Yet what is clear is that compulsory licensing and rate regulation tips the scales against songwriters, leaving little to no leverage for obtaining higher rates. The same is true for sound recording artists.

As just described, the effect of royalty rates is the ceiling on returns to copyright holders. Reduced mechanical licensing or public performance royalty rates are typically negotiated with music service providers, giving them a discount from government-set rates. There is good reason to expect that the dynamics of such negotiations and agreed-upon rates would be different without compulsory licensing and rate standards providing a backstop. In fact, the absence of such regulation would likely mean higher returns for copyright holders. Ultimately, the outcome should be decided in a free market-oriented setting that – from a regulatory standpoint – provides a level playing field for copyright holders, intermediaries, and music service providers to agree to terms.

### *Old Justifications Rendered Obsolete by Market Change*

Third, technological and other marketplace changes have upended any justification for compulsory licensing and rate regulation. Long gone is the time of piano rolls and concerns about the Aeolian Company monopoly of published music that motivated Congress to pass the Copyright Act of 1909. For that matter, the music market has moved far beyond the days when radio and cassette tapes were the only ways to access music. CDs and vinyl are still widely available for music aficionados. AM and FM broadcast radio remains another platform for music services. But consumers now have ample choice among cable and satellite music services, as well as satellite radio. Moreover, consumers also have ample choice among competing Internet-based music services. Those services include online on-demand music services such as iTunes, Amazon, and Google Play. Many recording artists make their music available for digital download through their own websites or on other specialized websites. In addition, consumers have choices among subscription-based webcasting services. Those include interactive webcasting services such as Spotify, as well as non-interactive webcasting services like Pandora. Today's choices also include free ad-based models, as well as full subscription models.

Given this rivalry in available services relying on different technologies and business models, decades-old assumptions and rationalizations for compulsory licensing and rate regulation have been swept away. Technological breakthroughs and competitive developments increase the complexity of markets, as in the case of music in the digital age. Increasing market complexities reduce the ability of government regulators to intervene in a manner that brings clear benefit to consumers over and above voluntary exchanges. Competition and dynamic market change render regulation not only unnecessary but potentially harmful to future growth and innovation in music services. The free market – and not bureaucratic boards – should be the mechanism for setting prices.

Advances in technology – including Internet communications capabilities – enable market participants to reduce transaction costs that may otherwise inhibit the functioning of a free market. Today, technological and other marketplace developments facilitate transactions between songwriters, recording artists, and their associates in the music industry. Performance Rights Organizations and other entities – including ASCAP and BMI, Harry Fox Agency, and SoundExchange – serve as intermediaries between music copyright holders and commercial music services. Those entities have developed complex arrangements for – among other things – negotiating licenses and rates, collecting royalties, and distributing them. Given the ability of such entities to engage in transactions involving copyrighted music on a mass scale, there is little to no reason to believe that compulsory licensing and rate regulation is needed to overcome transaction costs. It is also doubtful that compulsory licensing and rate regulation confers any discernable benefit to consumers.

### ***Artificial Imposed Uniformity Has Reduced Innovation***

Fourth, compulsory licensing and rate regulation has imposed artificial uniformity in the market for music and likely reduced diversity and innovation in music services. Compulsory licensing and rate regulation for musical compositions and sound recordings hamper the ability of copyright holders to pursue novel entrepreneurial opportunities. Federal statutory rate formulas and rates set by the Copyright Royalty Board make no distinction between the economic values of particular musical compositions or sound recordings. Thus, a widely regarded masterpiece by an accomplished songwriter is subject to the same rate as an ignored musical composition by a semi-skilled amateur. Nor do rates allow for differential values according to time dimensions. So a popular recorded song released one month prior and enjoying the height of its stardom will be subject to the same rate as when it is five years old and its star has waned.

Absent compulsory licensing and rate regulation, one should expect copyright holders in musical compositions or sound recordings to continue making use of so-called “blanket licensing” in order to reduce transaction costs. Under blanket licensing arrangements, copyright holders issue non-exclusive licenses to industry entities or other organizations acting on their behalf. Licensees that obtain blanket licenses are thereby permitted to record, reproduce, or perform any copyrighted composition or sound recording in the entity’s catalog. But in a truly free market setting, one should also expect variations in how musical compositions and sound recordings are offered and priced. When left free to experiment, sought-after songwriters might opt for higher rates for select musical compositions. Or big-selling recording artists might prefer to charge a premium rate for public performances their sound recording for the first year following their release. Economics aside, a songwriter or a recording artist might have deeply-felt artistic reasons for retaining exclusive rights in a published and publicly performed creative work. For example, a songwriter may prefer that his or her own sound recording of the musical composition be the exclusive publicly available recording for a period of time.

In a sense, the overall compulsory licensing and rate regulation scheme is a reflection of Section 801(b)’s wrong-headed charge to “minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices.” New ideas and novel applications of knowledge drive free markets by supplying new products and services,

overthrowing old industry patterns. Consumers are much more likely to benefit from ongoing supplies of new types of products and services than from static markets lacking innovative impact.

To be sure, treating all music compositions and sound recordings alike for ratemaking has the merit of simplicity. And doubtless many or most songwriters and recording artists might prefer to forego customized and exclusive licensing and royalty arrangements. It is also extremely difficult – if not impossible – to assess the degree to which regulation results in foregone innovation and consumer benefits. But what is certain is that the existing compulsory licensing and rate regulation scheme for music artificially stifles experimentation and diverse commercial arrangements involving copyrighted music.

### **Putting Copyright on a More Constitutional Footing: Proposals for Reform**

Congress can place copyright protection in music on a more constitutionally sound and free market-oriented footing. Reform should be guided by classic principles of property rights. In particular, like other forms of property, intellectual property is created by an individual's labors, and Congress has the responsibility to secure an individual's exclusive rights in their creative works and inventions. Further, the right to exchange property is a critical ingredient of ownership, and liberty of contract is the longstanding constitutional policy regarding IP rights. Informed by those principles, some important copyright policy recommendations follow.

#### ***No New Compulsory Licensing Schemes***

First, Congress must *not* expand compulsory licensing and rate regulation of copyrighted music. As new technologies, services, and products emerge in the market, Congress must respect the exclusive rights of copyright holders in music rather than pare back those rights by subjecting them to new restrictions.

There may be future occasions when it is fitting for Congress to secure copyright protections in new technologies, services, and products. Or Congress may have reason to provide additional types of protections for songwriters, recording artists, or music performers. But new copyright protections should not be tied to compulsory licensing and rate regulation. Congress has previously made the mistake of coupling new protections with restrictions on what should be exclusive rights in copyrighted music. Intertwining new or expanded copyright protections with regulation inevitably creates vested interests in the perpetuation of such regulation. Refraining from imposing new compulsory licensing and rate control requirements is a far easier task for Congress than repealing regulations that have outlived their ostensible reason for being yet are firmly entrenched.

It is also imperative that the FCC's proposed *de facto* compulsory licensing system for viewing copyrighted video programming on third-party video devices and video apps be dropped by the agency, repealed by Congress, or vacated by the courts. The FCC should *not* undermine the exclusive rights of video programmers in their copyrighted content by bureaucratically imposing licensing terms of its own making on private market participants. Nor should it be able to effectively rewrite the terms of privately negotiated contracts by imposing its own licensing

terms on the market. The Copyright Act does not authorize the FCC to become a copyright licensing authority. The FCC should act only within the confines of its lawful authority under Section 629 of the Communications Act rather than engage in regulatory adventurism with copyright policy.

### ***Eliminate Compulsory Licensing***

Second, Congress should eliminate compulsory licensing and rate regulation of copyrighted music. Aside from being constitutionally problematic, outside the scope of classic principles of rate regulation, and arbitrary in application, policy rationalizations for compulsory licensing have been upended by technological and other marketplace changes. Immediate outright repeal remains the simplest and starkest option. Congress could also explore options for gradual elimination of compulsory licensing and rate regulation in favor of a truly free market policy toward copyrighted music.

### ***Reform Rate Formulas to Better Approximate Market Outcomes***

Third, short of eliminating compulsory licensing and rate regulation of copyrighted music, Congress at least can seek to better approximate free market pricing through a uniform rate formula. If copyrighted music is to remain under rate regulation, the “willing buyer/willing seller” standard should always be preferred over alternatives. That standard attempts to emulate market outcomes instead of achieving protectionist outcomes or otherwise furthering interest group preferences. It defines “reasonable” rates as payments that “most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller.” Congress should therefore jettison the anti-disruptive Section 801(b) rate standard that in practice leads to artificially reduced and below-market royalty rates.

### ***Eliminate Arbitrariness***

Fourth, establishing the “willing buyer/willing seller” standard as the uniform rate formula also furthers the critical reform goal of reducing arbitrariness in the existing compulsory licensing and rate regulation scheme for copyrighted music. The current federal policy of applying varying rate standards dependent on the underlying service technology is nonsensical and should be discarded. So far as practicable, Congress should seek to treat all copyright holders and music service providers equally, regardless of the underlying technology involved.

Accordingly, recording artists should be entitled to receive performance royalties when AM and FM radio stations broadcast their copyrighted sound recordings. Broadcast radio stations should no longer enjoy a special exemption not shared by other music service platforms. As to the disputed question of whether publicity from radio broadcasting confers more benefit on recording artists than performance royalty payments, the market participants should be left free to consider and bargain among themselves. Neither Congress nor any delegated board should tip the scales by placing ceilings on royalty rates.

Congress can also reduce arbitrariness in federal copyright law concerning music by finally providing public performance protections to owners of sound recordings made before 1972. No good reason exists for excluding federal copyrights in pre-1972 sound recordings while including pre-1972 books or movies as well as post-1972 sound recordings. Full federalization of public performance copyright protections for pre-1972 recordings – that is, federal field preemption of state law – offers one approach. Alternatively, instead of entirely preempting state copyright protections, Congress could take a more nuanced approach. It could provide that payment of royalties for pre-1972 sound recordings in the same manner as post-1972 sound recordings creates a safe harbor for music service providers from state copyright infringement claims.

## **Conclusion**

As a matter of constitutional principle, imposing compulsory licenses and rate controls on copyrights or patent rights is inherently problematic. Compulsory licensing and rate controls are at odds with the Constitution's philosophic premises regarding the origin of property – grounded in human nature and in human labor – and the proper role of government – to secure and protect property rights. On its face, restricting or conditioning intellectual property rights through compulsory licensing and rate regulation certainly appears contrary to the idea of exclusivity in a property owner's use of his or her property.

Compulsory licensing and rate regulation is contrary to the constitutional concept of exclusivity expressed in the IP Clause. It is unlikely that the power to secure exclusive rights to authors and inventors entails a congressional power to make those rights subject to non-exclusive provisos regarding who can license the IP rights being secured. Furthermore, it is unlikely that Congress's power to secure exclusive rights in intellectual property entails the power to curtail the author's or inventor's discretion regarding what prices they can charge to licensees of their intellectual property.

Liberty of contract is a necessary component of the exclusive rights that copyright and patent right owners hold in the use and exchange of their intellectual property. But under a compulsory licensing system the holder of a copyright or patent right no longer has control over whether or under what conditions their intellectual property can be used. The IP owner no longer has discretion regarding who can license the creative work or invention. And the IP owner loses control over the price or value they can demand in exchange for licensing usage.

The compulsory licensing and rate regulation scheme that federal copyright law currently imposes on musical compositions and sound recordings also poses serious practical problems that require reforms by Congress. Those problems include arbitrary application, reduced compensation for copyright holders, and lack of viable justification for regulation in light of marketplace changes that have upended any justification for compulsory licensing and rate regulation.

Congress should place copyright protection in music on a more constitutionally sound and free market-oriented footing. Such reform should be guided by first principles of property rights, secure an individual's exclusive IP rights in their creative works and inventions, and preserve liberty of contract regarding IP rights. First and foremost, Congress must *not* expand compulsory



licensing and rate regulation of copyrighted music, video programming, or other media. Congress should eliminate compulsory licensing and rate regulation of copyrighted music – either immediately or gradually. Alternatively, short of eliminating compulsory licensing and rate regulation of copyrighted music, Congress can at least seek to more closely approximate free market pricing through a more uniformly applied rate formula. Such a reform would also reduce arbitrariness in the existing compulsory licensing and rate regulation scheme for copyrighted music.

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